

Center on Capitalism and Society
Columbia University
Working Paper No. 110

Speeches on Europe:
Berlin, Barcelona and Rome

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July 11, 2018

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Global Solutions: Summit Berlin
 Parallel Plenary: Tuesday May 29, 2018
 ESMT Berlin, Schlossplatz 1, 10178 Berlin

Turning Around the Downward Spiral Of Economic, Social and Political Cohesion

by Edmund Phelps*

I will first pour out my thinking over the years on the social issues by way of background, then address *cohesion* and “turning around the downward spiral.”

I began running into social questions fairly early in my career.

A book I wrote over academic year ‘69-‘70 on unemployment observes that one’s job brings – beside the wage – “feelings of self-respect, esteem in the community, the sense of economic independence... and job satisfactions.”¹ The book also refers to a “gain in the dignity of workers who catch...opportunities for the ‘better jobs’.”

In that same academic year, it was my great fortune to be writing my book next door to John Rawls, who was writing his book on economic justice.² I became a Rawlsian economist: A *just* economy is one in which the reward to the least advantaged participants is pulled up to the highest level feasible through taxes and subsidies. I contributed a 1973 paper deriving the optimum schedule of marginal tax rates on wage income in

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¹ Phelps, *Inflation Policy and Unemployment Theory* (New York: Norton, 1972), p. xvii and p.114.

² John Rawls, *A Theory of Justice* (Cambridge: Harvard, 1971).

a mathematical model to see what Rawlsian justice might entail.³

My 1997 book *Rewarding Work* makes a broad case – safe streets, less drug addiction, children having examples at home as well as Rawlsian justice – for a graduated subsidy to firms for every full-time low-wage worker in their employ.⁴ Also, the cost to the government is calculated. The subsidy has to taper off (for technical reasons) and that adds a lot to the cost.

This employment subsidy was attacked by advocates of other programs in the late '90s. At an OECD Workshop in 1999, the wage subsidy plan was opposed by the American delegation as inferior to the earned income tax credit (EITC).⁵ At a Cambridge conference in 1999-2000, Philippe van Parijs disparaged work-based subsidies and tax credits in favor of the Universal Basic Income – the UBI.⁶ The preference for the EITC can be defended but the preference for UBI cannot be defended! It is anti-work and terribly far from being cost-effective.⁷

In America, at any rate, this is *not* what people appear to have wanted: We Americans appear to want serious employment that will occupy us the better part of the day. Evidence: Since the '60s the workweek in manufacturing has showed

³ Phelps, "Taxation of Wage Income for Economic Justice," *Quarterly Journal of Economics*, August 1973). See also the textbook: Phelps, *Political Economy: An Introductory Text*, (New York: Norton, 1985), Chapter 6, "Ideas of Fairness."

⁴ Phelps, *Rewarding Work: How to Restore Participation and Self-Support to Free Enterprise* (New York: Norton, 1997, 2007). \$4 per hour employees would bring a subsidy of \$6 per hour, \$5 per hour employees would bring in a subsidy of approximately \$4.5 per hour and so forth. The calculated total cost was \$97.7 million for about 10 million workers earning around \$4 to \$5 and 40 million workers receiving something.
(p. 175)

⁵ OECD Workshop, Making Work Pay, 10-11 September 1999. See: OECD *Economic Studies*, No. 31, 2000/II.

⁶ "A Basic Income for All," *Boston Review*, October 2000. Milton Friedman's idea of a Negative Income Tax is rather similar.

⁷ In the same vein, Keynes wrote an essay in which he foresees rising wealth levels leading to huge leisure and little work. I believe that too was a ghastly mistake. J. M. Keynes, "Economic Possibilities for our Grandchildren," in *Essays in Persuasion* (London: Macmillan, 1930).

no downward trend.⁸ The total labor force participation rate has increased significantly since 1948.⁹ I also feel that Americans have a rapport with the underdog and a concern about economic justice in the rewards from work.

What *ought* people to want in their economy? My book *Mass Flourishing* has an answer. While people need a *just economy* for their self-respect and national pride, they also want a *good economy* – an economy holding out expectations of a *good life* (or a life of “richness” as some humanists call it). That means, for one thing, the sense of *succeeding* – as when your “ship comes in” (called “prospering”) or when you gain recognition.¹⁰ As humanists conceive it, the good life *also* means a kind of *flourishing* – using one’s imagination, exercising creativity, taking journeys into the unknown and acting on the world.

In an op-ed last August, I asked what Americans *do* want. What is this thing called the American Dream?¹¹ I contended that the Dream is *not* to own your own house. Nor win the lottery. Nor have higher income than your parents had.¹² Nor do I believe the Dream is largely to achieve things – building things, learning things, improving things. I contended that the core Dream is *succeeding*

⁸ The workweek in manufacturing showed no trend from its 1966 level of 41.4 hours and its pre-crisis 2007 level of 41.2. Table B-47, Hours and earnings in private non-agricultural industries, 1960-2007. Economic Report of the President, February 2008, p. 282. The OECD does not appear to collect data on the hourly workweek in its member countries.

⁹ The participation rate went from 59.0 per cent in April 1948 to 62.8 in April 2018, as female participation rose more than male participation fell.

¹⁰ See also David Ellwood and Nisha Patel, “Restoring the American Dream,” Report to the Malcolm Wiener Center for Social Policy. Jan. 2018. Malcolm Wiener comments, “Economic success is, of course, fundamental. But power and autonomy, having a sense of agency and a say over the trajectory of your life, and being valued in community – belonging – are as important.”

¹¹ Phelps, “This Thing Called the American Dream,” *Project Syndicate*, August 28, 2017. The title evokes Cole Porter’s “What is This Thing Called Love?” and the question of whether it has died evokes Hunter Thompson’s title for an unwritten book, *Death of the American Dream*.

¹² The defect is that the higher income may be due simply to the nation’s productivity growth. (Raj Chetty has studied what happened over the decades to the extent to which people have higher incomes than their parents had. Chetty, “The Fading American Dream: Trends in Absolute Income Mobility,” NBER Working Paper 22910. Dec. 2016.)

at what is important to one. This dream of success may be related to the *restlessness* that some find in American literature.¹³ Americans are perhaps “restless” to find a place where they might succeed at something. (And another such place after that.)

Now, how does this bear on “social and economic cohesion” and its “downward spiral”? Regarding this “cohesion,” the Panel Description helpfully refers to “growing inequalities” and “diversity” as well as “economic gaps” not addressed. I admire this portrait, but I would like to raise some questions and point to issues.

The middle class has done relatively badly in recent decades while those among the top 1% (of earnings) have done alright. But many of these earners are new to the group, not among the old rich. And the middle class shouldn’t want society to close off opportunities for them to climb up the ladder. It may be that it is the slowdown of economic growth, most clearly that of labor incomes in the middle class – upper as well as lower – that has made the middle class discontent.

It is true, I think, that the gap between the “working class” and people in the middle looks to be farther from a resolution than it was in, say, the ‘80s. The working class, or “lower middle class,” has grown more resentful as *their* wages have *fallen* almost to the wages of the poor.

The displacement of many workers by *new sorts* of innovation in some industries – coal and manufacturing, perhaps also some other labor intensive industries – has left these workers with no alternative but to accept far worse-

¹³ In “American Dream” I cite Mark Twain, *Huckleberry Finn* (1885), which ends with Huck wanting to move on – to “light out for the Territory, ahead of the rest.” See also David Goldman, “Americans, the Almost Chosen People,” *Tablet*, April 18, 2018.

paying jobs than they had occupied before or to leave the labor force and subsist on social insurance and social assistance.

Relatedly, the slowdown of *old sorts* of innovation in much of the traditional parts of the economy – America (in the ‘70s), later France and then Britain – has impeded the absorption of those displaced workers by other industries in the traditional sector. I regard the slowdown story as no less important for understanding than the displacement story.

The continuing slowdown plus the new threat of mounting displacement of workers has led some to ask whether capitalism should be retained if its *raison d’etre* – the thrills of its *grassroots dynamism* as well as ever-rising living standards for all – continues to be largely lost. Of course, one hopes the West is a long way from drawing such a radical conclusion.

What, then, is to be done? To gain or regain a Good Economy – an economy where participants can pursue a life of *succeeding* and *flourishing* as well as enjoying rising living standards – it will be NECESSARY to end the *corporatism* that grips Europe: the “social protection” from the ugly bosses (and rentiers) and the *clientelism* that favors giant firms and big banks through access to the state; it will also be NECESSARY to reform the Continent’s labor unions with their restraint of trade, change and innovation.

But those reforms are not SUFFICIENT. There will have to be a profound change in *society*. Society must return to the modern values that once excited the West. To this end, it must restore the humanities to high school and university curricula. More broadly, it must do everything possible to instill all young people with the modern values of individualism (independence), vitalism and expressionism that once, in the West’s brilliant past, were the wellspring of economic dynamism and life itself.

Ceremony for the Induction of Juan Vicente Sola
RAED, Barcelona: June 1, 2018

Sola's Lessons on Contemporary Corporatism:
What Implications for the Great Slowdown and the Needed Reforms?

by Edmund Phelps*

It's wonderful to be here at RAED again – and so soon!

I will first say a word or two about Professor Juan Sola and his work on the meaning and the history of corporatism. And then, at his insistence, I will talk about corporatism in the context of the malaise of recent decades that has descended over the West and to discuss the possibility that corporatism has a lot to do with that malaise.

Everything I know about the history of corporatism I have learned from Professor Sola, and much about corporatist theory as well. It was very illuminating to hear Professor Sola explain some years ago at a presentation at Columbia that corporatism can be thought of as the opposite of individualism.¹⁴ Today, I would like to offer my own understanding of the evolution of corporatism, though I think that Sola's early point is fundamental.

My early reading of corporatism

Fairly early in my education, I ran into the famous encyclical of 1891 by Pope Leo XIII in which he regards companies as obligated to take care of their workers in various respects – in addition to paying the wages that are due.¹⁵

I think this encyclical stimulated the establishment in companies of a *union* of the workers that would communicate with the manager of the company.

¹⁴ Juan Vicente Sola, "Corporatism, Tradition and Survival," presented at the 10th annual conference of the Center on Capitalism and Society, Columbia University, New York, December 12, 2012.

¹⁵ Pope Leo XIII, *Rerum Novarum*, Libreria Editrice Vaticana, May, 1891.

Later, I came across the 1887 volume by Ferdinand Tönnies entitled *Gemeinschaft und Gessellschaft*, now known in English as *Community and Civil Society*.¹⁶ This Prussian sociologist was horrified by the damage caused to a community when new firms invade it. The widely read reprint in the early 1920s was one of the influences leading Germans to disempower German corporations and to try out an alternative to capitalism.¹⁷

I believe it is correct to say that the corporatists such as Tönnies and George Valois disapproved of disorder, such as the topsy-turvy disorder that came with the modern economy. They disapproved of the ambitions of those without wealth, calling them “money-grubbers,” and hated the new money that displaced established wealth. They also disapproved of competition, preferring instead what is called “solidarity,” which led to the doctrine of social protection.

Most fundamentally, corporatists deplored individualism, calling for a state that would bring harmony and nationalism in place of the individual’s autonomy to take initiative and to innovate. Everyone is to go on working, accumulating wealth and running a company – that is all seen to be for the good of society. (Corporatism sanctions and even encourages materialism.) But no one is to be permitted to hire the nation’s labor and borrow its wealth in order to embark on a venture aimed at testing a new commercial idea – though, deep down, undertaken in the hope of succeeding at something and for the sheer thrill of voyaging into the unknown. Thus, corporatism was aimed at dismantling the modernism that was the root-source of the spirit of the dynamic economies emerging in the 50 years between 1815 and 1870 and almost dying in the 50 years between 1968 or so and the present. (I like Steven Brill’s “50-year Fall.”)

¹⁶ Ferdinand Tönnies, *Gemeinschaft und Gesellschaft* (Leipzig: Fues Verlag, 1887); *Community and Civil Society* (Cambridge: Cambridge Univ. Press, 2001).

¹⁷ Tönnies did not join the Nazis though.

Corporatism came into practice when Benito Mussolini became the Prime Minister of Italy in 1922. Under his *corporativismo*, companies were under the considerable supervision and control of the state. A company did not have the freedom to risk its capital on a private venture that might cause damage here or there in rest of the economy.

As for the Anglo Saxon countries, they exhibited incremental corporatism. It would be an exaggeration to say that they installed a corporatist system like those introduced by Germany and Italy. But in the 1930s, the American President Franklin D. Roosevelt organized each industry into a cartel that raised barriers against new enterprises and against competing through price reductions. In Britain, new entry into industries needed approval by the Federations of British Industry.

After the Second World War, most economies in the West put the depression behind them. From the mid-40s to the mid-70s or even somewhat later, some of the institutions of corporatism were abolished or disempowered in America and Britain. Corporations could act without expecting any intervention from the government. Up to the mid-70s, it was widely thought to be a golden age.¹⁸⁻¹⁹

Nevertheless, the unbridled capitalism from 1840 or so to 1930 or so has certainly come to an end by now: Since the mid-70s, there has been a groundswell of governmental administration for the purpose of implementing and regulating a somewhat corporatist economy. Donald Trump represents a more striking corporatism in which threats and actions are taken against particular companies or industry leader; and actions are taken to boost some

¹⁸ See Antara Haldar, “Is there a future for capitalism? It doesn’t have to become an uncontrollable monster,” *The Independent*, May 21, 2018.

¹⁹ When, in the early 1960s, President John F. Kennedy threatened the steel industries with punishments for raising their prices for the good of the country, the people were surprised and some thought it was a radical step.

industries, such as the steel and auto industries. He is conducting the economy somewhat as Mussolini did.

During this same time, there has been a steady reversion to traditional values: family values and community values and also some dogma from Medieval times – a company ought not to take actions that would harm others and a company that is failing ought to be rescued by the State. The property rights of corporation owners have been diluted, as employees and communities have been taught that they have a stake in what the company does and therefore a say. The rise of a premodern culture of entitlement, self-importance, conformism, and dependence surely have led to a decline in vitalism – in wanting to “do things,” as Margaret Thatcher or Amartya Sen might call it.

What I have found particularly interesting is the idea that came to be articulated in America by the 1980s that “if you work hard and play by the rules, you can earn your share of America’s blessings.”²⁰ This strikes me as feudalist thinking: In this view, a person may think about his rewards the way a serf in a medieval manor might have felt. There is no recognition of the reward earned for individual initiative, creativity, intuitions and judgement – or even extraordinary effort.

This is the way that people thought about their relationship to the economy when it was under a corporatist regime. And I think it is fair to say that the Western nations started to slide back to a kind of corporatist thinking sometime in the 1960s or 70s. The individual is not encouraged to break away from prevailing thinking. Children are not even expected to break away from home.²¹

²⁰ Geraldine Ferraro, vice-presidential candidate 1984. Quoted in Edmund Phelps, *Mass Flourishing* (Princeton, 2013): 317.

²¹ I find it interesting that the original screenplay for the movie *Breaking Away* was written by a young person who had grown up in Yugoslavia. The book and film *Being There*, starring Peter

Economic consequences of corporatism and medievalism

This revival of elements from corporatism and medievalism has had costly consequences for the dynamism of economies. Behind indigenous grassroots innovation is a *spirit* that indulges and encourages imagining, creating, venturing and exploring. I point to three elements that are critical to high dynamism in a nation:

To have a broad flow of innovation, society has to allow businesses wide *latitude* to innovate: There is little leeway for innovations if society is unwilling to put up with the disruption or inconvenience that often accompanies innovation. In a *corporatist* society there is a web of “social protection” hindering innovation. In this society, it is considered a *right* to say ‘no’ to outsiders with new ideas. A community is entitled to bar an airport or a shopping mall. The government may put up regulations that have the “latent function” of protecting established companies from the threat of innovative outsiders. Government contracts may have the same function. Companies may be free to operate a cartel that removes incentives to innovate in order to gain market share.²² (In the U.S., patent trolls and a climate of litigation pose daunting hazards for innovative start-ups.)

How *capable* a nation is at innovating depends on its attitudes. Innovators tend to be people who *question* prevailing beliefs and think “outside the box.” There have to be financiers with enough experience to feel *confident* they can

Sellers, was written by Jerzy Kosinski who left Poland as a young man. And the film *Birdman* was conceived and directed by the great Mexican film-maker Alejandro G. Iñárritu.

²² I have in mind Saifedean Ammous and Edmund Phelps, ‘Tunisians Set Off on the Road from Serfdom,’ *Financial Times*, 24 January, 2011. See also Mancur Olson, *The Rise and Decline of Nations*, Yale, 1982; James C. Scott, *Seeing Like a State*, Yale, 1998; and Daron Acemoglu and James A. Robinson, *Why Nations Fail*, Crown, 2012.

judge well the innovative projects submitted to them. Aspiring innovators have to feel they have sufficient *insight* to warrant making a start. In a corporatist society, a start-up entrepreneur would have to fear condemnation by society in the event the enterprise failed.

At the heart of this dynamism is the *desire* to innovate – despite the obstacles or maybe in some part because of the obstacles. Some innovators have a deep need to *act on the world*. Others want to demonstrate to society that they can *go their own way*. Some others are driven by a need to *prove to themselves* that they can succeed. Obviously these motives and aspirations are not the work-and-save mentality of mercantile capitalism.

These aspirations and motives were stirred by the *modern values* that began to emerge as early as the Renaissance: the *individualism* of Pico della Mirandola and Luther – “taking charge of one’s life,” which entails “thinking for oneself” and willingness to break from convention; the *vitalism* portrayed by Cellini, Cervantes and Shakespeare – relishing challenges, surmounting obstacles and making a mark; and the *expressionism* or *experientialism* of Kierkegaard and Nietzsche – the fascination of venturing into unknown. These modern values steered people to pursue careers offering personal growth – the “becoming” of Montaigne and Bergson: As people created the new, they created themselves. These values were in sharp contrast to the *traditional* values of medieval or ancient times: *materialist* values that undermine exploration for its own sake; *communitarian* values that oppose new businesses and new money; and *family* values that impede breaking away and taking big chances.

In all the discussion of reform, however, it is supposed that it is the “economy” that needs fixing – that the *spirit* of our country and thus the values that inspire it are still dominant. America is believed to remain at heart a nation

of pioneers and innovators, Europe the home of mythic explorers and profound discoverers. The corruption of government and of corporations is blamed on self-interest, which can be outlawed. But these days, the self-interests and materialism that people have derive from their values. The transmutation of the state and business into something uninspiring and even unattractive is a result of a *resurgence* of the traditional values that we call *corporatist* values, which counter the influence of modern ones.

XXX Villa Mondragone International Economic Seminar
Rome: June 25-27, 2018

Diagnosing the Problem in Italy and Much of Western Europe

Edmund Phelps*

What are the deep, structural problems in Italy – the problems that stand in the way of a “good economy” – even if everything else goes right? The most critical problems, I would say, have to do with innovation, “indigenous” as well as “imported.” An innovative economy is generally necessary if people are to have ample opportunities to change jobs, a gratifying working life and rising living standards – though one kind of innovation worsens those problem for some on the way to solving the problem for most of the others. How has Italy fared in this dimension?

Innovation in Italy. Long ago, several nations enjoyed an *explosion* of *indigenous* innovation (innovation originating within the nation and not imported from abroad), most of it replacing existing machines more than existing employees: America and Britain around 1820, France and Germany around 1870 – and Italy around 1950. By my calculation, Italy in that year ranked in 4th place in the big country rankings – as Italy pulled up and Germany fell back. (That surprised me because I understood the magnificent history compiled by Gianni Toniolo as concluding that the Italian economy had never attained what might qualify as sustained innovation at good rate.²³)

With that hugely fruitful innovation going on, these nations enjoyed a

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²³ Gianni Toniolo, ed., *The Italian Economy since Unification* (Oxford Press, 2013).

“golden age” from 1950 to 1970: Real wages streaked ahead of wealth, leading to increased labor force participation; and the passion for new methods and products brought high job satisfaction and consumer satisfaction.²⁴ (As the song goes, “I remember it well.” I remember the model-building we were all doing at the RAND Corporation, the Lamborghinis in the Wilshire showroom, the Beatles, the Boeing 707s – and much more.)

But these good times were losing some of their shine. Estimates by Raicho Bojilov and I at the Center on Capitalism and Society show that indigenous innovation was *gradually slowing* in Italy as well as France over the postwar period; and it was much *slower* throughout the period in Germany than it had been in its heyday under Bismarck.

Since 1970, there has been tumultuous structural change in the West:

- *First*, indigenous innovating has been markedly *slower* over the period from 1970 or so to the present in the U.S.– aside from the years of the internet boom – somewhat sooner in Italy and France; the U.K. too, though later on it had a good stretch. Declines of “imported” innovation in Italy and Spain can be laid in large part to the contraction in the *supply* of importable innovations that has been available to them in this post-1970 period – not by internal developments. These slowdowns have brought a major slowdown of total factor productivity and labor compensation, which has caused social discontent: They have thrown events into reverse: Wages lag more and more behind wealth, leading to decreased labor force participation, decreased job satisfaction and boredom borne of stagnation.

²⁴ I came across this characterization in an op-ed suggesting that “[t]he period after the two world wars was in many ways a Golden Age.” See Antar Haldar, ‘Is there a future for capitalism? It doesn’t have to become an uncontrollable monster,’ The Independent, May 18, 2018.

I suspect you are wondering whether there is any factual basis for these conclusions. My book *Mass Flourishing* – coming out in Italian from Rubbettino – points to *evidence* drawn from the *World Values Surveys*.²⁵ It shows that in 1990-91 the mean level of reported *job satisfaction* was very low in the countries suffering low levels of indigenous innovation – Italy and France, for example– and relatively high in countries with relatively high indigenous innovation – notably Switzerland, Denmark and America. Now the same research team has found evidence from 2008 data in the *European Values Surveys* that further supports this theory.²⁶ It shows that among 13 economically advanced Western European countries, those ranking *lowest* in reporting “high” or “somewhat high” job satisfaction– Spain, France and Italy – ranked very low in indigenous innovation as well (9th, 11th and 13th respectively) and those ranking *highest* in job satisfaction –Switzerland and Denmark – ranked very high in indigenous innovation (in 2nd place and 4th place, respectively).

▪ *Second*, and perhaps more serious over the near term, the *losses* of this innovation, made so fruitful because it was predominantly capital-saving, are now accompanied by *gains* of innovation coming from the “digital economy” – in the U.S. and many other countries too. And this new innovation is much more labor-saving. (Amazon and Microsoft are good examples, I think; perhaps Google is an example of capital-saving.) It has caused major job losses in the affected factories. In regions with many such job losses, there has been a wholesale withdrawal from the labor force: America’s Rust Belt

²⁵ The data are from the *World Values Survey*. See *Mass Flourishing* (Princeton, Princeton University Press, 2013), pages 196 and 197.

²⁶ Data in the *European Values Surveys* are usually found in *World Values Surveys* but not in cases where American data to accompany them are not available.

in Appalachia and adjacent regions, Britain's West Midlands and France's Lorraine region.

It is interesting that the countries which have always been regarded – historically, at any rate – as “innovation nations” – are the ones that have these distressed regions, while the countries that have always been regarded as “trading nations” – Germany and Holland, for example – have not been afflicted with such regions. I have to leave it up to you to decide whether Italy fits in the first group or the second.

If Italy is suffering from the same rust belt phenomenon, then the country is in a double bind: There is less of the unambiguously good innovation and more of the problematic.

You may be interested in knowing what I believe Italy and other countries must do to reverse the decline of the good innovation. I have written some pages suggesting measures that state and society could take. The most thorough presentation is in the 8 ½ pages at the close of my book *Mass Flourishing* – pages 316 to 324. Society must cultivate in students and young people an eagerness and capability to innovate. Further, society must stop vested interests and corrupt officials from blocking or discouraging new product or methods – at least those not judged against the public interest.

It is clear now that such a revitalization of the economy might have the “side effect” of giving a boost to the problematic innovation – the innovation that drives down wages to a lower growth path. As a Chinese proverb says: “Beware that you get your wishes!” Is there a way out of this conundrum? It appears so, once we understand the dynamics of labor-saving innovation.

In a couple of theoretical models that Hian Teck Hoon and I built over the past year or more, a single, purely labor-saving innovation – more precisely, a single innovation that adds a bunch of robots to workforces in the way a wave of immigration adds workers to workforces – would drive down the wage rate. But the resulting increase in the capital stock would pull the wage rate back up to where it had been before the robots came. And the bulge of profits on private capital and the rise of tax revenues appear to be enough to pull wage rates back up. Perhaps the lesson to draw is that the nation's safest strategy is to take measures to slow the procession of robots that arrive to do the kind of work done by the humans.

My conclusion from all this is that Italy as well as America, Britain and France must take all reasonable measures to boost the dynamism of their economies while they also take steps to ensure that the influx of technologies proceeds sufficiently slowly so that wage rates and employment of the affected workers can be cushioned through government compensation paid for out of the rising tax revenues.

The euro, growth and employment I do think from time to time about other issues in the West. We have all been hearing for a very long time the contention that Italy has a serious problem with the euro – whether or not there is also a problem of deficient innovation that is independent of any currency problem.

I think we should be skeptical about these claims. (My friend Stefano Micossi once commented to friends over dinner that I am skeptical about everything.) But it is impossible for the proponents – all of them highly reputable economists – to prove their claims *beyond any doubt*. So we should take seriously their arguments.

There is the *slow recovery* claim and the *slow growth* claim. The former claim is that Italy could depreciate its currency in pre-euro times and now it can't. Of course, one of the arguments *for* the institution of a common currency was that it would put an end to devaluations and resulting inflations. (I heard other arguments from Robert Mundell and Tommaso Padoa Schiopa and later I had conversations with Dominick Salvatore.) One might wonder why the Italians are not grateful that the euro has averted the need for a catastrophic depreciation.

The complaint against the euro that we hear is that the *lack* of a devaluation has been a drag on the speed of recovery in Italy after it hit bottom following the global financial crisis. The recent book by Mario Baldassarri, *The European Roots of the Eurozone Crisis*, is perhaps a definitive source.²⁷ The data in FRED, a standard source of G7 data, show that Italy's so-called employment rate, seasonally adjusted, climbed from its low in July 2010 of 56.6 % to 58.2 % in October 2017. That is a slow speed of recovery, to be sure. But if the euro is at fault, we should expect to see a poor result also in France and Spain. In France, the same employment rate climbed from its low of 63.9% in October 2010 to 65.2 % in October 2017. The speed of recovery there is also poor. But in Spain, the employment rate climbed from its low of 56.0 % in April 2012 to 61.6% in October 2017. This is a much faster speed of recovery. Some other countries in the Eurozone also show a relatively speedy recovery: Holland climbed fast from its low of 64.5 % to 67.2 % and Portugal – bless its heart – has exploded from its bottom of 59.3 % to 68.9 %. Denmark also sprinted back to normal. Tentatively, I would lay all or most of Italy's poor performance to structural causes. We do not know how Italy would have performed had it chosen to

²⁷ Mario Baladassarri, *The European Roots of the Eurozone Crisis*, (Palgrave, 2017).

operate with a flexible exchange rate.

There is also a point of economic theory: Although Keynesian theory has a well-deserved place in understanding the initial employment effects of a contractionary shock, it is implausible to attribute a weakness of employment to a decrease of aggregate demand more than a dozen years ago. Nominal wages and prices ultimately adjust. Start-ups find openings.

The slow growth claim is that the overvaluation of Italy's currency has brought *slower growth* in Italy since the advent of the euro in 1999. I wonder: Is the euro the cause of that deceleration? My great colleague and dear friend, Joseph Stiglitz, points out that from 2000 to 2016 the eurozone GDP has shrunk noticeably relative to the US GDP – if my arithmetic is right, from 88.5% to 80.0%. But until 2005 or so, the US was enjoying the extraordinary rapid growth brought by the buildout of the internet. Furthermore, this relative shrinkage of the eurozone countries ought to be compared with what happened to the relative size from, say, 1985 to 2000. We need to recall that in the 1980s there was the deep “slump in Europe,” which Jean-Paul Fitoussi wrote about in our book *The Slump in Europe*:²⁸ The European slump was deeper and longer than the slump in the U.S., so Europe was losing ground in the ‘80s – long before the euro. And it lost still more ground in the 1990s when, as I noted, the US began to develop the internet. We called in the 2nd Great Depression!

However, the heart of the matter is whether the euro is the cause of still slower *productivity growth* in Italy – and, by the same logic, France and Spain too. I would note that the estimates by Bojilov and me show gradual *slowing of indigenous innovation* in Italy in the ‘50s, again in the ‘70s and

²⁸ Jean-Paul Fitoussi and Edmund Phelps, *The Slump in Europe: Reconstructing Open Economy Theory*, (Basil Blackwell, 1988).

again in the mid-‘90s – with no further slowing whatsoever after 1999 till the last year, 2011.

I would interpret these preliminary findings as suggesting that real, not monetary, forces are at work in the West. I feel that future data will show even slower indigenous innovation in the U.S., the U.K. and France leading to a *further* slowdown of productivity and investment throughout the West. The increased weakness of investment and real wages is already apparent.

In this crisis, it is disheartening to see the latest policy proposal: The government would pay something to young people not already employed provided they make themselves available to carry out tasks in the public sector. But that initiative would offer little of the rewards that people generally need and aspire to when possible. At the most basic level, adults need to feel that they are earning their way in the world – self-support, not public support. More important, carrying out tasks in the public sector, as children do chores, would not be a substitute for immersion in the heart of an enterprising economy. Most people, on growing up, need to be engaged in a central project of society: its economy. Most important, a meaningful career is essential for a gratifying life: to face challenges, to solve problems and to conceive better things. In *On the Waterfront*, Brando’s character says plaintively to his brother, “I could have been somebody...”²⁹ We want badly to strive at succeeding at something. That, I say, was the American Dream.³⁰

If that is so, the West must address the need not for a new monetary system but for a revival of the spirit of innovation. That is crucial if the West is to regain the prospering and flourishing of its Golden Age.

²⁹ The writer of the screenplay was Budd Schulberg, the director Elia Kazan, score by Leonard Bernstein. The young Marlon Brando was already a sensation. They knew something about success!

³⁰ I took up the subject in *Inflation Policy and Unemployment* (Norton, 1972), then *Rewarding Work* (Harvard, 1997) and “This Thing Called the American Dream,” Project Syndicate, August 2017.