

# European Myths, European Realities

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Following centuries of bold explorations in science, navigation and engineering, Continental Europe in the 20<sup>th</sup> century launched major social innovations. New economic policies and institutions were invented in the belief that a more rationally and humanely organized economy would deliver higher productivity and wages, greater job satisfaction, lower unemployment, wider participation, and milder slumps. This has resulted in a market economy that retains private ownership, but that looks very different from other market economies, such as America's.

The characteristic Continental economy is loosely organized along the corporatist lines that emerged during Europe's inter-war years (1919-1939). A tripartite system of big, closely held corporations, big industrial unions and government mediate conflicts and block changes through barriers to entry, control over licenses and standards, sway over big banks, golden shares and, in some countries, state ownership of key enterprises.

Inter-war corporatism undermined labor unions, even outlawing strikes. Nowadays it empowers unions through *concertazione*, co-determination, and an unqualified right to strike. But while this safeguards against business abuse and "externalities" that cause environmental damage, it also yields a more politicized and regimented economy than America's atomistic, decentralized capitalist structures do.

Economic and social policies are another distinctive feature, especially in Western Europe, where massive social insurance and assistance programs are seen as fostering sturdier, more resilient human capital. Or consider this cultural difference: American children typically leave home at 18, some earlier; Continental offspring expect support for as long as desired. Europeans see this as healthy. Americans, with their ethos of self-help, initiative, ambition, and competition, think it breeds risk-averse Peter Pans unwilling to strike out on their own.

Most Continental Europeans, however, believe that their economic model is better in terms of productivity, quality of jobs, and stability than America's system. But is it? The

habitues of Paris's avenue Montaigne are visibly prosperous, zestful, and engaged. But what do the statistics show?

A study by the OECD last year seemed to confirm the Continent's superior productivity. Gross domestic product per hour worked appeared higher in western Germany, France, and Italy than in the US. However, that evidence is problematic because the GDP includes government "output," which is not sold in the market and so cannot be directly measured.

In contrast, a study using data on firms by McKinsey & Co. found that business output per hour worked is markedly lower in Europe than in America. Measurements of output per unit of capital on the Continent relative to the US are even lower.

These differences suggest that Europe's technical know-how and commercial sophistication lag six years behind the US. Yet even this more accurate calculation overestimates Europe's efficiency.

Why? Labor regulations, minimum wage laws, and trade unions all bar many less qualified people from obtaining jobs in Europe's formal economy. If these persons were employed to the extent such workers are employed in America--through liberalization of labor markets or through wage subsidies (as France and Holland have done on a modest scale)--European labor productivity would be pulled down markedly.

Moreover, the US productivity edge arises not because Americans are more nimble, but because the US passes up safe productivity gains (through investing more capital in existing product lines) in favor of higher expected productivity gains through research and development--and new technologies that may fail. If another country supplied America with technical and commercial advances free of investment costs, as the US supplies Europe, the US would have more capital left to equip its workforce more lavishly. Europe is getting a free ride.

If Europe shared 50% of the cost with the US for the latest technical and commercial discoveries, it would have less capital left for equipping labor in established production lines; America would have more. On the other hand, Europe would get a head start with the new things it developed; the US would be behind in those developments. Productivity in both Europe and America might gain, and America's edge might be narrowed.

Is the Continent superior in job satisfaction? Circumstantial evidence suggests that it is not. Far fewer working-age persons--not only women; men too--belong to the labor force in most Continental nations than in the US.. Middle-aged retirees and idle youth speak volumes.

What redeems their system in Continental eyes is its stability and job security. But recent history suggests vulnerability, not stability. Europe's slump in the 1980s was longer and deeper than America's. If the severe decline in Europe's stock markets is a guide, the current downturn will be as deep on the Continent as in the US.

Europe is learning that when economic shocks hit, policies that rigidify wage rates and protect existing jobs can only slow--not lessen--the fall of total employment. The impact is merely deflected onto unemployed workers who would have been hired and workers in small businesses who would not have been laid off. By delaying restructuring, such policies may aggravate the fall in profitability, share prices, and the currency, worsening unemployment.

A Europe constrained and dispirited by lagging economies might turn inward, endangering itself and others. So identifying the main causes of Europe's malaise and remedying them is crucial. American economists would gladly join Europeans in searching for ways to save the Continent from continued under-performance.