

# Innovative thinking for European business

By Edmund Phelps

Published: December 16 2007 18:36 | Last updated: December 16 2007 18:36

The great ideas about enterprise and society were all European. Ancient Greece began humanist conceptions of the good life. Italy evolved a culture of practical knowledge and artistic creativity for business ends.

Britain's property rights and rule of law enabled the rise of a commercial society. French thinkers celebrated entrepreneurs for inventing the new, and contrasted their usefulness with that of businesses that merely vied for political patronage. Germany pioneered finance capitalism with its big banks and giant companies.

The thinking bore fruit. By the last decades of the 19th century, Europe's business was humming and productivity was growing at record speed – both powered by unprecedented innovation. For this intellectual heritage, Europe has earned the gratitude of the world.

Yet European ideas hostile to capitalism also arose.

In the 20th century, they shaped on the continent a system that was a giant step backward – a set of values and institutions that has been badly lacking in internal dynamism and stultifying, save when external opportunities lit the way.

At the core of this reaction were the tenets of corporatism: a tradition of “solidarism”, originating with the *corporazioni* of ancient Rome and the medieval guilds, inspired the formation of industrial unions and employer confederations. These combines operate against entry of the outsider with an innovative idea for starting a new company and instil uncertainty even for incumbent enterprises.

A desire for order led to virtual unanimity being required among “stakeholders” and the “social partners” for a change to be allowed. The number of permissions needed by a start-up – reaching 21 or so in Italy – has become a measure of the veto powers arrayed against innovation. In Germany's co-determination, a labour representative guards against innovations that would cause job cuts. There is no one to vote for innovations that create jobs in the economy as a whole.

An ethic of egalitarianism deterred the individual from deviating from his or her group or the society lest he or she end up standing out from the rest. This could only have damped the entrepreneurial spirit.

A distaste for “money-grubbing” led many young people to prepare for the public sector or to manage the family business rather than start a new one.

An attitude called “scientism” deriving from the rationalism of the French Enlightenment saw the speculations of entrepreneurs and traders as worthless and held that rational economic policy demanded a co-ordinating role by the state – indicative planning and some key state enterprises.

The corporatist tenet that companies are arms of the state for the good of society was also inimical to dynamism. It caused owners and managers of a company to fear that oversized profits would make it a target of politicians. It led to a system of patronage in which companies strove more for the “rents” from winning non-competitive government contracts than for profits from successful innovations. It also led to state protection of threatened companies through tax relief, tariffs and bars to competition. Whole industries were subsidised as “national treasures”.

Making companies into a protected preserve led them to become social clubs in which only those with connections were let in. In such circumstances, employees disliked taking orders and felt uncomfortable giving them. Flexibility and rapid response suffered.

Companies remained private, with concentrated ownership of shares, rather than listing on the stock exchange. Relational banking was the norm. Can the continent, with this legacy, regain high dynamism so as to lift its employment, productivity and spirits?

A state-led transformation of the economy would have the daunting task of identifying dozens of reforms that give hope of large gains. The political task would be to persuade the public that, in the last century, it went wrong: it can expect that the front-loaded costs incurred in restructuring would be repaid many times over – for those with their careers ahead of them, at any rate. The state cannot do it all – even if it wanted to.

Now it is said that the corporate sector has the power to transform itself, which it is about to show. However, if the interests of owners and managers did not lift economic performance before, why should those interests raise performance now?

The general argument is that globalisation, in widening foreign trade and foreign investment flows, heightens pay-offs from better-performing economic structures. Moreover, the contact of continental companies with Anglo-American capitalism can make vivid to them some ways by which they can pull up performance.

For me, the key point is that globalisation has opened markets for the launch of continental European innovations – and these new markets have fast growth rates. This will create jobs and speed growth.

Time will tell how innovative the continental companies will become. Many companies may have to struggle in unreceptive domestic markets. Some managers may shun the risks and shareholders may fail to organise carrots and sticks to motivate managers.

Finally, one wonders how large the gains can be without the revolution in workplace attitudes that high dynamism requires.

*The author is director of the Centre on Capitalism and Society, Earth Institute, Columbia University, New York. He won the Nobel Prize for economics in 2006*

[Copyright](#) The Financial Times Limited 2007