

Refitting The West's Winning Economic Model

by [Edmund S. Phelps](#)



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NEW YORK: The advantages of the West's economic system defeated communism in Eastern Europe and set back economic nationalism and populism in much of the Third World. Yet, in the West itself, a flaw in the system has become glaring -- and damaging - - to all.

The system no longer offers a fifth or more of its active-age members enough economic opportunity to integrate them into society. In the U.K. and U.S., pay has fallen too low for the self-support and job stability of low-end workers. In Western Europe and Canada, to varying degrees, such low pay is ruled out by law or wage-setting bodies, but these block low-end workers from jobs. The resulting idleness, deprivation, drugs and crime pose costs and hazards to everyone.

With damage so widespread, a broad-based political bargain to correct the flaw is now feasible. To conceive the needed package of reforms, though, we must first understand the West's economic model: how its parts were designed to work and how it can be refitted to regain its capabilities.

The core of that model was invented (mostly by Scots) in the 18th century Enlightenment. It was a system to release people's enterprising spirit and clear the way for broad prosperity.

The central element was free enterprise. Anyone was to be free to start a business, investing out of his own or other's private capital -- without buying a license or winning a charter from the state. And free to close or downsize a business just as fast -- without paying an indemnity. This freedom of enterprise would stimulate innovation and create employment far better than the heavy hand of the state.

The other element was a mechanism for inclusion -- open markets. Running the economy on the principle of free enterprise would lack legitimacy if the system left many people

out. The Scots saw the moral imperative of extending free enterprise to the largest number possible, stamping out privilege and democratizing opportunity. No bars against new entrants to shield vested interests. No bail-outs or subsidies to prop-up the unprofitable activities of the politically powerful. With a level playing field, competition would dislodge the entrenched and help enfranchise the disadvantaged.

This system -- call it competitive capitalism -- is not the "free market" sought by some present-day economists. They want markets not just open, but which give no break at all to vested interests. They want markets free of all subsidies and nearly all taxes. The Scots, however, saw the utility of circumscribed state interventions to broaden opportunity and help enterprise to grow. Adam Smith endorsed myriad government functions, including subsidizing education. Recent research confirms that private enterprise is ultimately essential for productivity growth, and helpful competition. Growth does not appear very sensitive to tax rates and subsidies.

Once we view the core of the West's model to be this system -- free enterprise to achieve growth plus markets aimed at inclusion -- we can see that economic policy, particularly on the European Continent, has been a double blunder: First, there was a gamble to disempower and bypass private capital -- to make layoffs difficult, to prop up inefficient firms, to interfere with decisions that should be made by private business and to expand public-sector jobs -- in the mistaken hope that demoting enterprise would shore up jobs and inclusion. Second, there was a fear of intevening with subsidies and taxes as incentive devices to channel the power of the market toward rebuilding inclusion. These policies cost Europe a loss of productivity growth, with no clear lift -- maybe a setback -- to pay and jobs in return.

The right policy mix is the reverse. First, the Continent must liberate its enterprises before it turns into an industrial museum. This means broadening privatization. It also means dropping disruptive restrictions on private capital. Then productivity growth will pick up. And employment will not suffer -- just as the restrictions on enterprise did nothing to create employment. Indeed, there is evidence that where the penalty for firing workers is low, private business takes the risk of hiring more of them.

But let's not pretend that free enterprise alone will shrink unemployment on the Continent to the levels of the '60s, when it was 2% in France and not much higher elsewhere. Nor will it deliver the prompt lift to low-end jobs in Europe and to low-end pay in the "Anglo-Saxon" nations that are needed so badly. Its help there will be gradual and moderate.

Hence another bold reform is needed to fix the system's flaw. This step is a market-friendly intervention to redirect market forces toward helping to integrate low-end workers. The best tools for a comprehensive raise of low-end employment and pay are low-wage employment subsidies -- ongoing across-the-board tax credits to enterprises for their continued employment of low-wage workers. Its cost may exceed a little the budgetary savings. Its towering merit is that it will work.

The logic of this two-pronged strategy is that subsidies are hopeless at creating productivity growth, but good at boosting low-end jobs and pay. Free enterprise, on the other hand, creates growth and jobs, but, by itself, few low-end jobs. This is why mandating private firms to preserve jobs and using subsidies to try to buy some growth is a recipe for disaster.

The West must debate the choice: Accept the narrowing of the opportunities originally promised by competitive capitalism and provide permanent social assistance to those left out. Or refit competitive capitalism for renewed pursuit of growth and the broadest opportunity, thus renewing the Enlightenment vision of what the West might be.