Cultural Matters

By Edmund S. Phelps

The nations of Continental Western Europe, in the reforms they make to try to raise their economic performance, may prove to be a testing ground for the view that culture matters for a society's economic results.

As is increasingly admitted, the economic performance in nearly every Continental country is generally poor compared to the U.S. and a few other countries that share the U.S.'s characteristics. Productivity in the continental Big Three—Germany, France and Italy—stopped gaining ground on the U.S. in the early 1990s, then lost ground as a result of recent slowdowns and the U.S. speed-up. Unemployment rates are generally far higher than those in the U.S., U.K., Canada and Ireland. And labor force participation rates have been lower for decades. Relatedly, the employee engagement and job satisfaction reported in surveys are mostly lower, too.

What's really behind Europe's economic malaise? Here's a hint: It's not the 'social model.'

It is reasonable to infer that the economic systems on the Continent are not well structured for high performance. In my view, the Continental economies began to be underperformers in the interwar period, and have remained so—with corrective steps here and further missteps there—from the postwar decades onward. There was no sense of a structural deficiency during the "glorious years" from the mid-'50s through the '70s when the low-hanging fruit of unexploited technologies overseas and Europeans' drive to regain the wealth they had lost in the war powered rapid growth and high employment. Today, there is the sense that a problem exists.

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What could be the origins of such underperformance? It may be that the relatively poor job satisfaction and employee engagement on the Continent are a proximate cause—though not the underlying cause —of the poorer participation and unemployment rates. And high unemployment could lead to a mismatch of worker to job, causing job dissatisfaction and employee disengagement. The task is to find the underlying cause, or causes, of the entire syndrome of poorer employment, productivity, employee engagement and job satisfaction.

Many economists attribute the Continent's higher unemployment and lower participation, if not also its lower productivity, to the Continent's social model—in particular, the plethora of social insurance entitlements and the taxes to pay for them. The standard argument is fallacious, though. The consequent reduction of after-tax wage rates is unlikely to be an enduring disincentive to work, for reduced earnings will bring reduced saving; and once private wealth has fallen to its former ratio to after-tax wages, people will be as motivated to work as before.

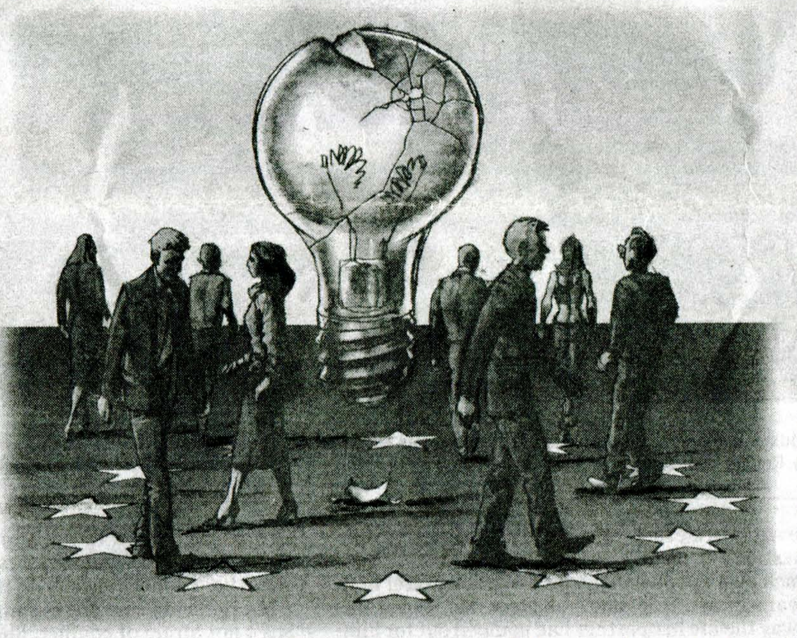
An indictment of entitlements has to focus on the huge "social wealth" that the welfare state creates at the stroke of the pen. Yet statistical tests of the effects of welfare spending on employment yield erratic results. In any case, it is hard to see that scaling down entitlements would be transformative for economic performance. (Indeed, some economists see increased wealth, social plus private, as raising the population's willingness to weather market shocks and helping entrepreneurs to finance innovation. I am skeptical.)

It's Innovation, Silly

In my thesis, the Continental economies' root problem is a dearth of economic dynamism—loosely, the rate of commercially successful innovation. A country's dynamism, being slow to change, is not measured by the growth rate over any short or medium-length span. The level of dynamism is a matter of how fertile the country is in coming up with innovative ideas having prospects of profitability, how adept it is at identifying and nourishing the ideas with the best prospects, and how prepared it is in evaluating and trying out the new products and methods that are launched onto the market.

There is evidence of such a dearth. Germany, Italy and France appear to possess less dynamism than do the U.S. and the others. Far fewer firms break into the top ranks in the former, and fewer employees are reported to have jobs with extensive freedom in decision-making—which is essential at companies engaged in novel, and thus creative, activity.

Further, I argue that the cause of that dearth of dynamism lies in the sort of "economic model" found in most, if not all, of the Continental countries. A country's economic model determines its economic dynamism. The dynamism that the economic model possesses is in turn a crucial determinant of the country's economic performance: Where there is more entrepreneurial activity—and thus more innovation, as well as all the financial and managerial activity it leads to— there are more jobs to fill, and those added jobs are relatively engaging and fulfilling. Participation rises accordingly and productivity climbs to a higher path. Thus I see the sort of economic model operating in the Continental countries to be a major cause— perhaps the largest cause—of their lackluster performance characteristics.



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There are two dimensions to a country's economic model. One part consists of its economic institutions. These institutions on the Continent do not look to be good for dynamism. They typically exhibit a Balkanized/segmented financial sector favoring insiders, myriad impediments and penalties placed before outsider entrepreneurs, a consumer sector not venturesome about new products or short of the needed education, union voting (not just advice) in management decisions, and state interventionism. Some studies of mine on what attributes determine which of the advanced economies are the least vibrant—or the least responsive to the stimulus of a technological revolution—pointed to the strength in the less vibrant economies of inhibiting institutions such as employment protection legislation and red tape, and to the weakness of enabling institutions, such as a well-functioning stock market and ample liberal-arts education.

The other part of the economic model consists of various elements of the country's economic culture. Some cultural attributes in a country may have direct effects on performance—on top of their indirect effects through the institutions they foster. Values and attitudes are analogous to institutions—some impede, others enable. They are as much a part of the "economy," and possibly as important for how well it functions, as the institutions are. Clearly, any study of the sources of poor performance on the Continent that omits that part of the system can yield results only of unknown reliability.

Of course, people may at bottom all want the same things. Yet not all people may have the instinct to demand and seek the things that best serve their ultimate goals. There is evidence from University of Michigan "values surveys" that working-age people in the Continent's Big Three differ somewhat from those in the U.S. and the other comparator countries in the number of them expressing various "values" in the workplace.

The values that might impact dynamism are of special interest here. Relatively few in the Big Three report that they want jobs offering opportunities for achievement (42% in France and 54% in Italy, versus an average of 73% in Canada and U.S.); chances for initiative in the job (38% in France and 47% in Italy, as against an average of 53% in Canada and the U.S.), and even interesting work (59% in France and Italy, versus an average of 71.5% in Canada and the U.K). Relatively few are keen on taking responsibility, or freedom (57% in Germany and 58% in France as against 61% in the U.S. and 65% in Canada), and relatively few are happy about taking orders (Italy 1.03 , of a possible 3.0, and Germany 1.13, as against 1.34 in Canada and 1.47 in the U.S.).

The 'Solidarity' Tax

Perhaps many would be willing to take it for granted that the spirit of stimulation, problem-solving, mastery and discovery has impacts on a country's dynamism and thus on its economic performance. In countries where that spirit is weak, an entrepreneurial type contemplating a start-up might be scared off by the prospect of having employees with little zest for any of those experiences. And there might be few entrepreneurial types to begin with. As luck would have it, a study of 18 advanced countries I conducted last summer found that inter-country differences in each of the performance indicators are significantly explained by the inter-country differences in the above cultural values. (Nearly all those values have significant influence on most of the indicators.)

The weakness of these values on the Continent is not the only impediment to a revival of dynamism there. There is the solidarist aim of protecting the "social partners"—communities and regions, business owners, organized labor, and the professions—from disruptive market forces. There is also the consensualist aim of blocking business initiatives that lack the consent of the "stakeholders"—those, such as employees, customers and rival companies, thought to have a stake besides the owners. There is an intellectual current elevating community and society over individual engagement and personal growth, which springs from antimaterialist and egalitarian strains in Western culture. There is also the "scientism" that holds that state-directed research is the key to higher productivity. Equally, there is the tradition of hierarchical organization in Continental countries. Lastly, there a strain of anti-commercialism. "A German would rather say he had inherited his fortune than say he made it himself," the economist Hans-Werner Sinn once remarked to me.

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In my earlier work, I had organized my thinking around some intellectual currents—solidarism, consensualism, anti-commercialism and conformism—that emerged as a reaction on the Continent to the Enlightenment and to capitalism in the 19th century. It would be understandable if such a climate had a dispiriting effect on potential entrepreneurs. But to be candid, I had not imagined that Continental Man might be less entrepreneurial. It did not occur to me that he had less need for mental challenge, problem-solving, initiative and responsibility.

It may be that the Continentals, finding over the 19th and early 20th century, that there was little opportunity or reward to exercise freedom and responsibility, learned not to care much about those values. Similarly, it may be that Americans, having assimilated large doses of freedom and initiative for generations, take those things for granted. That appears to be what Toqueville thought: "The greater involvement of Americans in governing themselves, their relatively broad education and their wider equality of opportunity all encourage the emergence of the 'man of action' with the 'skill' to 'grasp the chance of the moment'."

The most basic point to carry away is that the empirical results related here lend support to the Enlightenment theme that a nation's culture ultimately makes a difference for the nation's economic performance in all its aspects—productivity, prosperity and personal growth.

It was a mistake of the continental Europeans to think that they expressed the right values—right for them. These values led them to evolve economic models bringing in train a level of economic performance with which most working-age people are now discontented. Perhaps the way out—to go from unsatisfactory performance to high performance—will require not only reform of institutions but also a cultural shift that returns Europe to the philosophical roots that put it on the map to begin with.

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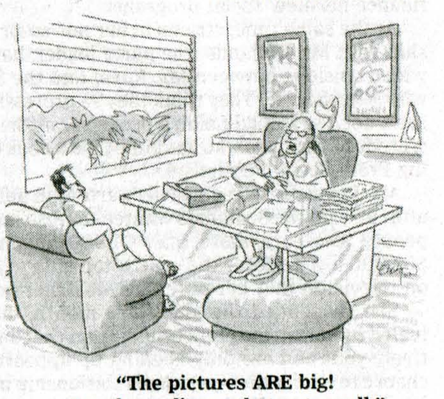

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