

CAPITALISM AND THE FORCES OF GLOBALISATION

In the eyes of many, the preservation of Europe's hard-won affluence looks increasingly shaky: the pressures exerted by globalisation, the ageing of its population and climate change, to name but a few of the current challenges, will put Europe's institutions to the test over the coming decades.

This calls for a careful examination of how fit these institutions are for seeing Europe through the rough patch. Can a look at Europe's economic past provide some light for the road ahead? Two leading economic thinkers, one on each side of the Atlantic, think so. **Barry Eichengreen** (University of California, Berkeley) and **Hans-Werner Sinn** (University of Munich and Ifo Institute) put their

thoughts on paper and produced two formidable books* which, interestingly enough, reach different conclusions. What could be better than to sit the two authors in front of an audience and have them discuss their views face to face?

This is exactly what the Munich Seminars did this month. Besides both authors, two further experts on the European economy – **Georges de Ménil** (PSE Paris) and **Torben Andersen** (Aarhus University) – were also invited to take place in the panel discussion, which was chaired by **John Peet**, Europe Editor at *The Economist*.

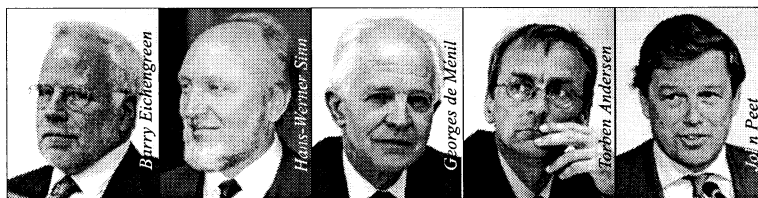
Barry Eichengreen opened with a review of Europe's achievements over the past half century. After WWII, Europe was in ruins, far behind the economic leader, the US. "Now, nobody can dispute that the dramatic differences in quality of living that existed between Europe and the US are effectively gone." This, he said, was achieved thanks to institutions that had been formed previously and had been inherited by the respective countries.

These institutions, which he calls "the institutions of neocorporatism or the social market economy" and are sometimes labelled as "the European Model", included employment security, an extensive social safety net, strong unions, patient finance provided by banks with long-term relationships to their industrial clients, and cohesive employers' associations that encouraged firms to invest in training. "These are the bad guys in Hans-Werner Sinn's book, and they are the good guys in mine," he said.

The parts of Europe's social model fit together in mutually supportive ways and for

half a century or more they enhanced the economy's capacity to deliver high-quality products, stable employment, incremental innovation and an equitable distribution of income.

While acknowledging that these institutions were well tailored to catching up with the US but not so suitable for coping with globalisation, Mr Eichengreen argues that no more than their updating would be needed to bring them up to par to master the new chal-



lenges. In other words, interest groups and the governments are part of the solution.

This is where Hans-Werner Sinn begs to differ. While he sees the benefits of the European institutions and discards the US capitalist model because it does not redistribute enough income, he finds the European institutions overdrawn and badly adjusted to the forces of globalisation. Germany, the case in point in his book, suffers now from low birth-rates, high unemployment among the unskilled, low investment levels, and low accumulation of human capital. "I accuse the welfare state of being responsible for some of the problems", he says.

Take the pay-as-you-go pension system, for instance. Instituted by Bismarck, it ensured that everyone would have a decent income after retirement. But it also had the unforeseen effect of decoupling child-rearing from one's prospects of well-being in old age. The result was that now too few babies are being born, both as a result of low fertility rates and low numbers of people in child-bearing age. Needless to say, the scant number of working people who pay into the pension system will have dire consequences to its sustainability.

On top of this, the lack of state support for child-rearing families means in effect that the state taxes the few babies that are born—to the tune of 140,000 euros in terms of each baby's contribution into the pension system throughout its working life.

Or take the employment security norms, which combine in pernicious ways with the power of the unions. The former make it dif-

ficult to fire people, while the setting of industry-wide wages by the latter makes German workers among the most expensive in the world, above what their productivity levels would justify. This leads to job losses to cheaper competitors.

This problem is compounded by the "wage competition" posed by the state in the form of generous unemployment benefits awarded under the condition that the recipient stays away from the labour market. This com-

presses the wage distribution from below and destroys the jobs of people with low skills. Because of its extremely generous system of social replacement incomes, Germany has the highest rate of unemployment amongst the low-skilled of any OECD country.

The solutions are spelled out in his book: an activating kind of social assistance, child-encouraging family policies, less power to the unions, child-based pensions and investment wages, among others.

Georges de Ménil provided the French perspective. As regards adapting the welfare state to the forces of globalisation, he said solutions cannot be expected from Brussels: "The core job is to be met at the national level." He sees many parallels to the German case, both in the problems and in the solutions proposed. But he is optimistic: after all, he said, a couple of years ago public opinion in France was dead against liberalising the labour market, and now has just elected a reforming president. So, there is hope for Germany as well.

Torben Andersen, representative of Denmark, a country that, as John Peet put it, has already solved all the problems, showed how a fairly generous welfare state can be maintained while raising employment and safeguarding equality. However, he argued that Denmark's incentive structure would have to be adjusted so as to make it compatible with the forces of globalisation, a fine-tuning task that the country has successfully managed in recent years.

* B. Eichengreen: *The European Economy since 1945: Coordinated Capitalism and Beyond* (Princeton University Press, 2007).

H.-W. Sinn: *Can Germany be Saved? The Malaise of the World's First Welfare State* (MIT Press, 2007).