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Contrasting Economic Systems: Economic Institutions and Economic Culture

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The nations of western continental Europe, in the reforms they choose to make in an attempt to improve their economic results, may prove to be a testing ground for the view that a country's *economic system* – its economic culture and its economic institutions – matters for a society's economic results. In the view of some, only the Continent's social system matters, particularly the size of social insurance entitlements. In the more sophisticated view of some others, the economic system matters in general but, fortunately, that system has been optimized in Europe, so changing it would gain nothing.

As is increasingly admitted, the performance characteristics of the national economy in nearly every Continental country are generally poor compared to comparator countries in the G7, including the U.S. Productivity in the Big 3 – Germany, France and Italy – stopped gaining ground on the U.S. level in the early 1990s, then steadily lost ground with the slowdowns at the end of the last decade and the U.S. speed-up. Unemployment rates n France and Germany are generally far higher than those in the U.S., U.K., Denmark, Canada and Ireland. Labor force participation in France and, most strikingly Italy, has been lower for decades. Relatedly, the breadth of employee engagement and of job satisfaction reported in surveys are appreciably lower in the Big 3 than in the U.S., Canada and the U.K.

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 under-performers 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 under-performance? 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 lay the Continent's higher unemployment and lower participation, if not also the 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 reducing saving; 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 find that hard to believe.)

If my skepticism needs a substantial qualification, the qualification may be that today in France and Italy there has been substantial outward mobility of young people to countries where tax rates and social benefits are lower. When France was adding benefits upon benefits to its welfare state, it was supposed that the labor force in France had nowhere else to go. That appears to be no longer so. Still, most working-age people have ties to their country that are difficult to break.

A DEARTH OF ECONOMIC DYNAMISM

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, 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, thus more innovation, and all the financial and managerial activity it leads to, there are more jobs to fill and those added jobs are relatively engaging, satisfying and fulfilling. Participation rises accordingly and productivity climbs to a higher path. Thus I see the sort of economic model operating in the Continent countries to be a major cause – perhaps the largest cause -- of their lackluster performance characteristics.

THE ROLE OF ECONOMIC INSTITUTIONS

There are two dimensions to a country's economic model. One part consists of its economic *institutions*. The economic institutions on the Continent do not look to be good for dynamism. These institutions 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 least vibrant – least responsive to the stimulus of a technological revolution – pointed to the strength in the less vibrant of inhibiting institutions, such as employment protection legislation and bureaucratic "red tape," and to the weakness of enabling institutions, such as a well-functioning stock market and ample liberal-arts education.

I know that in France there is, in some quarters, an insistence that the economic institutions are pretty good – not perfect, perhaps, but not bad in relation to real-life comparators. But I insist that company law and labor law in France cannot be healthy for economic dynamism. Besides the well-known regulations on work week, there is a richly textured fabric of restrictions on entrepreneurs embodied in labor law and company law. Here is a summary of two provisions of employment law prepared in English by French lawyers:

Works Council

A Works Council has to be implemented as soon as the threshold of 50 employees had been reached during the 12 months (whether or not consecutive) during the 3 preceding years. The Works Council benefits from wide powers and should be consulted on almost all major company decisions. Under article L.432-1 of the French Labor Code, it has to be informed and consulted mainly on the following issues:

(i) Matters relating to the reorganisation, management, general running of the company and, in particular, on measures likely to affect:
- the volume or structure of the workforce;

- working hours;
- employment and working conditions; and
- employee training.

(ii) Restructuring and collective redundancies;

(iii) A change in the economic or legal structure of the company, in particular due to a merger, sale, substantial change in the manufacturing structure, acquisition or sale of subsidiaries.

Failure to elect staff delegates constitutes an obstruction to the performance of the duties of a company's staff representatives, which is a criminal offence punishable by one year's imprisonment and/or a fine of €3,750 (for the company's CEO) and/or a fine of €18,750 (for the company itself as a legal entity).

Collective bargaining agreement
The terms thereof reflect local or national negotiation between bodies representing the employers and the employees within an industry. Collective bargaining agreements are generally binding upon employers who took no part in the collective bargaining nor were members of any employers' representative grouping party to the negotiations.

The agreement governs:
- Individual and collective labour relations,
- Working conditions, and,
- Employee benefits.

The question of which collective bargaining agreement applies depends on the company's main business.

The presence of such restrictions may operate not only to diminish the resale value of business assets and organizations already created by past actions of entrepreneurs. The prospect of these restrictions may operate to discourage an entrepreneurs from embarking on the organization of new businesses, since the reduction of the resale value of the organization caused by the restrictions will be consequential in the event that the entrepreneur later would find it desirable to sell the new company or the new division created.

ECONOMIC CULTURE
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 are impeding, others enabling. 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 on the Continent’s Big 3 differ somewhat from those in the U.S. and the other comparators in the number of them expressing various “values” in the workplace. The values that might impact on dynamism are of special interest here. Relatively few persons in the big 3 report they want jobs offering opportunities for achievement (42% in France and 54% in Italy, an average of 73% in Canada and U.S.), chances for initiative in the job (38% in France and 47% in Italy, an average of 53% in Canada and the U.S.), and even interesting work (59% in France and Italy, an average of 71.5% in Canada and 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.).

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; also, the consensualist aim of blocking business initiatives that lack the consent of the “stakeholders” – those with a stake besides the owners, such as employees, customer and rival companies. There is an intellectual current of elevating community and society over individual engagement and personal growth, which springs from anti-materialist and egalitarian strains in Western culture. There is the “scientism” that holds that state-directed research is the key to higher productivity. There is the tradition of hierarchical organization in Continental countries. Lastly, there is a strain of anti-commercialism. “A German would rather say he had inherited his fortune than say he made it himself,” Hans-Werner Sinn once remarked to me. This attitude may originate in the airs of the kings. Louis XIV told his son “we don’t make the money, we marry into it.”

In earlier work I had organized my thinking around some of these intellectual currents of reaction on the Continent to the Enlightenment and to capitalism in the 19th century: the solidarism, consensualism, anti-commercialism and conformism. To be candid, I had not imagined that Continental Man might have a less *entrepreneurial* spirit. It did not occur to me that he or she had less need for mental challenge, problem solving, initiative and responsibility.

It may be that the Continentals, finding over the 19th century and early 20th that there was little opportunity or reward for exercising 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 de 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'."

SUMMING UP

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 economic performance in all its aspects – productivity, prosperity and personal growth.

It was a mistake of the Continentals to think they expressed the right values – right for them. These values led them to adopt economic models bringing an economic performance with which most working age people are now discontent. Perhaps the way out – 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 Europe on the map to begin with: to the vitalism of Aristotle, Cellini, Cervantes, Voltaire and Henri Bergson.