Europe: The Current Situation and the Way Forward

Delivered by Dr. Wolfgang Schäuble
Federal Minister of Finance, Germany

Discussion by Edmund S. Phelps
2006 Nobel Laureate in Economics and Director, Center on Capitalism and Society, Columbia University

Wednesday, April 15, 2015
Columbia University in the City of New York
I am most honored to be invited to discuss the presentation by Minister Schäuble.

So much of what he said I heartily agree with. I too have suggested that the fiscal deficits and financial leveraging in the private sector in recent years are responses to worsened economic performance. And the deterioration of balance sheets adds fuel to the next crisis.

I too believe that the “declines in productivity growth” are at the core of the declines of economic performance in the West.

But I disagree with him about the deeper causes. A thesis of my book Mass Flourishing is that the productivity slowdown that came to the West – first the U.S. in the mid-‘60s, then France and Italy in the late ‘90s and finally Britain and Germany in the early ‘00s – resulted from slower innovation by the last innovator standing, which was the U.S. economy. In my view, the U.S. economy stopped being massively innovative in the late 1960s – my impression is that Germany and Britain stopped much sooner. (Italy’s innovative period only began around 1973 and was over in about two decades.)

American innovation slowed sharply in the established industries in the late 1960s – new entrants were blocked and incumbents lost interest in attempting defensive innovation. Innovation has survived mainly by entering or creating a small range of industries, mostly in Silicon Valley. Ultimately the shrinkage of aggregate innovation in the U.S. has been costly for economic performance in both western Europe and America.

Minister Schäuble comments that Europe’s economies are well-designed for equality of opportunity and social equity, though he wants “moderate and sustained growth through structural reforms.” It may be that Europe comes fairly close to having a just economy – perhaps closer than the U.S. does. However, Europe is now far from having a good economy – perhaps farther than the U.S. is.
By a good economy I mean one that offers large numbers of its participants a good life – a fulfilling life as Aristotle and Confucius sometimes put it. The economist Kenneth Boulding spoke of how gratifying it is to gain more and more mastery and thus earn better and better terms for oneself in one’s field. Vitalist writers like Montaigne, Cervantes and Nietzsche have in mind meeting challenges and surmounting obstacles. Philosophers such as Hume, Hegel and Kierkegaard wrote of using one’s imagination, exercising one’s creativity, journeying into the unknown and acting on the world. Material gains handed on a platter by the stock market or the labor market are not enough.

Europe’s economies are not offering lives of that sort. They do little more than let global market forces – including advances in science at home and abroad – pull up the going level of wage rates and prop up the market rates of return on wealth. This is a poor sort of economy next to the highly dynamic economies that sprouted up in the 19th century.

Why did Europe not act to regain the very considerable dynamism that Britain, Germany and France had even to the end of the 1930s. The answer in part, I think, is the influence of standard economics. In that theory, no one is attempting to improve, to venture and perchance to succeed. There is no human agency, only responses to wages, interest rates and wealth. The economy is mechanical, robotic. The standard theory, despite its sophistication in some respects, has left no room for economies in which people are imagining new products and using their creativity to build them. What is most fundamentally wrong with Europe is that it takes such an economy to be the norm – to be “as good as it gets.” So when a once-imaginative, once-creative economy slips into the classical mode, economics has no book to cure.

Once Europe decides to act, what will it have to do? To obtain an economy enabling widespread prosperity and flourishing, the European nations will require not only the right set of institutions. It will require the development of an economy with the right culture. The question is whether the Europeans want that.