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The Future of Continental Socio-economic Models

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(This paper was translated from the French by Susanne Harrison.)

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0 Are There Several Continental Models?

0.1

A philosopher once said that making predictions is a dangerous business, especially making predictions about the future! But that's exactly what I've been asked to do, and in a particularly dangerous area, as it is one that is not governed by any form of determinism. The only economic model based on a deterministic view of economic history is the communist model, and we all saw how it collapsed in a way that was least expected.
To take an example on a completely different scale, but nevertheless a significant one, who would have thought 15 or so years ago that a country such as Ireland, which seemed to be afflicted by a secular curse, would take off in such an astonishing manner that its output per capita would overtake that of Great Britain?[1]
Thus I shall temper my rashness in approaching this subject and would ask you in advance to excuse any shortcomings.

0.2

The second comment I would like to make as a preliminary to this talk is to ask whether, as far as continental Europe is concerned, we really are justified in talking about economic models in the plural? One might be tempted to answer in the negative considering what current events keep emphasising, namely that all the members of the European Union on the continent share at least two major features: a slow rate of growth and mass unemployment without precedent in the present day and age and unique worldwide. However, these two common difficulties are not enough to define a common socio-economic model.

0.3

Thus my first step was to consult a book that, to my knowledge, is the best on the subject, *Les capitalismes en Europe.*[2] However, I have to admit that, in my opinion, the book does not provide a decisive answer to this question.
The first chapter is devoted to "the particular circumstances in Japan" and goes on to study four countries, of which, in my opinion, only one fully deserves to be considered as the centre of an economic model.
The first case to be examined is entitled "The Swedish model in transition to neoliberalism or to the German model?" This single question sums up the entire topic, and I have nothing to add to it except perhaps to pay tribute to the remarkable efforts undertaken by the Swedes to retain the essential features of their much-celebrated traditional social model, while at the same time adapting to the new constraints imposed by economic competitiveness. After Sweden, the book takes a look at Italy, and here, too, the chapter title is particularly revealing: "The different forms of capitalism in Italy". The following question is posed, but is not answered either: "Should Italy be considered as a national entity or merely as a juxtaposition of regional models, each characterised by a specific form of interaction between the economy and institutions?"
The next chapter deals with France, and it can be assumed a priori that France is a country that is both significant enough and distinctive enough to be worth considering as a model in both senses of the word. First of all, a model is an example to contemplate, if not to imitate. In this respect, economic and social development in France was considered exemplary in the 1950s and 1960s, but it seems to me that it lost this virtue with the oil crisis and the socialist experiment of 1981. More importantly, France cannot be considered as a model in the second sense, i.e. as a simplified prototype representing a more complex system. Indeed, I regret to have to say that, in my opinion, France's socio-economic system is too complex to be able to be accurately reduced to such a simplified model (although I might not be in an ideal position to form such an opinion). This is true to such an extent that, in 1991, when I presented my editor with the draft of my book entitled *Capitalism Against Capitalism*, he criticised the fact that I had not written a chapter on France. I went away and wrote one to satisfy him, basing the chapter on a long quotation by someone who was undoubtedly better placed to comment on France than myself, namely an Italian professor by the name of Romano Prodi, who, as you know, has since gone on to assume positions of great responsibility. This quotation was taken from an article with a particularly revealing title: "Between the two models."[3]

Allow me to read you an extract to save my coming back to the subject, however much my own country interests me:

> "As far as France is concerned, the country has never wholly opted for one or the other of these models. The stock exchange and the financial markets have traditionally only had a modest role to play. The size of the stock exchange in Paris in comparison with the London stock exchange is simple and unequivocal proof of this. Moreover, the phenomenon of banking groups being set up or structures of ownership being established similar to those seen in Germany has not occurred, whereas public enterprises - both industrial enterprises and companies in the banking or insurance sector - have always played a decisive role. Particular attention should be paid to the developments that took place in the 1980s, even if their significance is ambiguous. In 1986, prompted by the then Prime Minister Jacques Chirac, the Minister of Finance Balladur did in fact draft a plan for the extensive privatisation of public enterprises. (...) The initial motivation for this new policy in France may suggest that the objective was to move closer to the Anglo-Saxon model in that the size of the stock exchange was to be increased (...).

However, the way in which this privatisation was carried out constituted an 'objective' premise in moving closer to the structures of ownership found in the Germanic model. In all the privatised companies, the power of command lies with the 'hard core', although it only accounts for 25% of the shares. By means of skilful intertwinement of shareholders, who have become increasingly rationalised, several large financial and industrial groups are in the process of being set up in France. From the point of view of ownership and the stability of their contacts, these groups tend more towards the Germanic model than the Anglo-Saxon one, even though the system is infinitely less dense and impervious than in Germany.

Moreover, there are still a large number of publicly owned enterprises in France that do not correspond to either the Anglo-Saxon system or to the Germanic one, although during the past few years the strategy pursued by public enterprises in France, especially as far as the acquisition of foreign companies is concerned, draws its inspiration more from a Germanic than from an Anglo-Saxon form of logic."

Allow me to add a brief personal comment concerning the last point. At the time (in the early 1990s), I was the president of a French insurance company, AGF, which had bought 25% of the German insurance company AMB on the stock exchange. This was completely legal; however, the Commercial Court in Aachen refused us voting rights as shareholders. I found this judicial decision very enlightening about what I have since referred to as the "Rhenish model."

0.4

The significance of this term is based on two points:

- Firstly, the group of countries around the Rhine Valley have several economic and social characteristics that are very similar and that constitute the central model of continental Europe, a model that is both the most original and the most advanced. For this reason, I suggest that we consider in the singular the question that was put to me in the plural and that we concentrate on the problems facing the Rhenish model in the future.
- This Rhenish model of capitalism is profoundly different from the Anglo-Saxon model and above all from the neo-American model that emerged out of the revolution under the Reagan administration.

Portraying these models as opposites is no doubt something of a caricature; nevertheless, it appears to me to be to some extent an illuminating one, as my book has been translated into 19 languages. Above all, since it was written in 1991, there has been a radical change of perspective: today, the prevailing opinion is that the neo-American model is the only way open to those countries who wish to succeed in the 21st century, while on the other hand we are constantly having to listen to a chorus of laments on the failure and the doomy prospects of the Rhenish model.

The only music we hear is a kind of Rhenish requiem. Is it really justified?

0.5

Before discussing this point, allow me to remind you briefly of the distinctive features of the Rhenish model. I do not of course intend to enlarge on the subject and would merely like to emphasise four types of distinctive features:

a) The first two features are of a macroeconomic nature:

- The Rhenish model is characterised by the "social market economy." This social objective results in the extensive development of social protection, leading to an increase

in compulsory levies, which are much higher all over Western Europe than in the United States or in Japan.
- The Rhenish model of capitalism is institutional, collective and based on consensus. It is built up on the development of the role of agreements between the "social partners,"[4] i.e. employers and trade unions, especially as far as working conditions and remuneration are concerned. Codetermination - the involvement of works councils in the management of the major German companies - is probably the most characteristic institution.

b) The other two features are of a microeconomic nature.

- The task of enterprises in the Rhenish model contrasts with Anglo-Saxon ideas about the "shareholders' value". This task corresponds to the "stakeholders' value," i.e. it consists in reconciling the interests of clients, employees, shareholders and the social environment in general.
- The realisation of this task is favoured by the stable financing of enterprises; the role of the banks is much more important than that of the stock exchange, resulting in a stability of capital which encourages stable relations between the social partners, but which may constitute an obstacle to the changes that are necessary in the face of the technological revolution and economic globalisation.

0.6

These introductory remarks put me in rather an awkward position, because they mean that I have to concentrate on a subject that I know a great deal less about than you do, as it forms the topic of your daily discussions.
Thus I would ask you to be indulgent with me, and I can assure you that I will pay close attention to what you tell me after my brief talk, a talk which I may add will leave you with many more questions at the end than answers.

1 Is Current Opinion Biased by Contrasts between Business Cycles?

1.1

The case of Japan is striking in this respect. At the beginning of the 1990s, American companies found the superiority of the Japanese methods of management so terrifying that General Motors imported the methods of "toyota-ism." Some years later, in 1995, Japan's competitiveness had come to an end, as had its growth, which was nearly zero, despite a huge budget deficit and a monetary policy that was so accommodating that the curve of interest rates flattened out between 0.5% and 2.5%. The dollar was worth 85 yen. In the spring of 1997, it was worth 125 yen, and suddenly opinion changed once more. Japanese competitiveness was denounced in Congress as a danger to the American economy, particularly as far as the car industry was concerned.

Such is the way of the world: even more cyclical in its opinions than in its macroeconomic developments.

1.2

A similar phenomenon occurred in the competition between the Rhenish model and the neo-American model. In 1990, West Germany showed a performance that was unrivalled at an international level, as demonstrated by Professor Wolfgang Streeck,[5] and it was easy for me, in *Capitalism Against Capitalism*,[6] to show at that time that the Rhenish model embodied the most remarkable reconciliation ever obtained in the course of history between economic efficiency and social solidarity. This analysis was scarcely disputed. At the time, the USA was in the middle of a recession, and all that people talked about was the American decline. *Fortune* magazine published a long article entitled "'Made in the USA' on the Road to Extinction," and, in an extensive report called *Made in America*, the MIT undertook a gloomy examination of the reasons for the large-scale industrial decline in the United States.

1.3

Since then, economic conditions have radically reversed between the United States and continental Europe. Since 1992, the United States has been experiencing a period of growth, something that is all the more remarkable because this growth has been *continuous* and non-inflationary, leading to a twofold increase in the quoted values on Wall Street.
In contrast, continental Europe, which was hit by recession in 1993, has never recovered. This recession has been particularly severe in Germany, where growth, which had been greatly accelerated by reunification over a period of 2 years, subsequently slumped in the *Länder* of the former East Germany from 1995 onwards.
The pessimism that is currently rife in Germany is on the same scale as the euphoria that broke out after reunification and centres on the phenomenon of unemployment: in 1990, the levels of unemployment in the United States and in Germany were identical (7% in both cases). At the beginning of 1997, while the United States is enjoying full employment (5.3%), the unemployment rate in March in reunified Germany was 11.3% (9.8% in the West and 17.3% in the East). Moreover, according to the IMF, the percentage of unemployment of a structural nature is approximately 9%. These realities have been overamplified by an emotional reaction in which the media have at times gone so far as to evoke the precedent of the Weimar Republic! The cyclical nature of opinions in the current day and age thus reaches new heights ...

1.4

This romantic interpretation of developments in the economic climate detracts attention from what is actually a central phenomenon, namely the inadequacies of European structures faced with the new macroeconomic problem since the beginning of the 1990s. The first weakness consists in the fact that the costs of reunification were not considered as a Community problem, but as a national one. As a consequence, Germany has undergone budgetary and inflationary pressure, which naturally led to monetary policy being tightened, with a rise in real interest rates that has had repercussions to a greater or lesser extent in all of the countries belonging to the European Monetary System. On the one hand, this has resulted in diverging developments which, due to a lack of co-ordination at the European level, led to the major foreign exchange crises in September 1992 and July 1993; these crises in turn led to the devaluation of the pound, the lira and the peseta, in particular. The disorder that ensued suggests that it would have been in the common interest for the European Community to contribute to the budgetary assumption of the huge costs of reunification.
Instead, a policy of "each man for himself" was pursued, despite the undertakings signed at Maastricht, with unacceptable increases in the budget deficits in the majority of the member states of the European Union. Action has only been taken from 1995 onwards. However, all the countries launched a frantic effort to reduce these deficits, and the obvious effect of this simultaneous action was to make growth slacken even more throughout the Community and to make it even more difficult for each country to fulfil the famous 3% criterion.

1.5

Thus Europe's image has suffered dangerously at the same time as that of the Rhenish model; instead of bringing economic prosperity and social justice, both are now having to face the charge of having fallen into low growth and unemployment following a turnabout in economic

conditions that has been considerably magnified by the media at a psychological level.
It thus becomes clear why prevailing opinion has a simple answer to the question asked, and that answer is that the future of the Rhenish model lies in Americanisation. Even though, in June 1996, 300,000 demonstrators protested in Bonn against this prospect, and even though Chancellor Kohl keeps repeating that he will not accept an American-style society.

2 Do the Structural Problems of the Rhenish Model Make the American Solution Necessary?

2.1

Can the main structural difficulties of the Rhenish model be summed up in the excessive cost of labour? In this respect, in its latest report (June 1996), the Bank for International Settlements in Basle published the table shown below, which I find particularly interesting.

Total Costs of Labour in the Manufacturing Industry in Various Countries

Country	Total hourly costs of labour in 1995			Percentage of social security contributions and income tax contained in compulsory deductions (1993)
	Indices based on data in common currency; Germany = 100	Made up of [a]		
		Remuneration	Non-wage labour costs	
Germany	100	55	45	39
Japan	75	59	41	34
France	61	54	46	47
USA	55	71	29	29
Italy	52	50	50	37
UK	45	73	27	18

a Percentage of total costs of labour
Sources: Institut der Deutschen Wirtschaft, IW-Trends; IMF, Government Finance Statistics; OECD, Statistics concerning public revenue in the members states of the OECD; Confederation of Swedish Employers; national data.

This table is particularly interesting because it shows that the overall hourly costs of labour in German industry are 82% higher than in the United States. Admittedly, this very high figure is partly due to the fact that the value of the dollar was particularly low in 1995.
From a short-term point of view, these extra costs obviously constitute an enormous handicap for German companies. From a more structural point of view, however, the fact that - in contrast to the situation in the United States - the balance of trade in Germany has always been in surplus despite such extra costs can be attributed to a greater level of efficiency in German industry. It is justified to add that this superior efficiency is the result of the very application of the Rhenish model, with its consensus between the social partners, the role of vocational training and the loyalty, dedication and pride in their work that employees show... Are these values outdated, irrevocably banished by the new conditions created by modern technology and international competition? There is no reason to claim this is true, even if in certain areas

computerisation enables standards to be reached that could previously only be obtained by very high levels of professional qualification.
However, the rapid increase in direct investment by German companies abroad at a time when direct foreign investments in Germany have shrunk dramatically is a warning sign: if labour costs in Germany were to stay rigid, the competitiveness of German industry on the international stage would suffer further, as would the level of employment. The future of the Rhenish model depends more than anything on its ability to adapt in this respect.

2.2

Given the resistance to lowering nominal wages, it is clear that it is the social costs that are going to have to be influenced. John Major was not entirely wrong in saying "jobs for us, social security for you (continental Europeans)." It is difficult to imagine a better illustration of this than the one shown in the table above: in 1995, the non-wage labour costs alone paid by German industry amounted to the same as the total labour costs in England (45 in each case). In other words, it is hard to imagine how the Rhenish countries (which are all in a similar situation in this respect) will be able to withstand international competition without a dramatic reduction in the costs of social security. Throughout continental Europe, people are deeply attached to the principle of the universality of social welfare for all. If people are not willing to give up this principle in order to concentrate on the most disadvantaged groups, it is difficult to see how they will be able to avoid sooner or later being forced to follow the example of the new conservative revolution in America, i.e. to exclude the most needy from the right to enjoy a basic standard of living and to support them only through more or less random assistance.

2.3 Making working conditions more flexible

Up to now, the countries of the Rhenish model have on the whole benefited both from an increase in the purchasing power of wages and a reduction in working hours. This combination of two forms of "social progress" should probably now be considered as being called into question by the new conditions of international competition and in particular by the need to give new priority to the profitability of enterprises. Moreover, it seems that the German trade unions are now well aware of this, with the IG-Metall suggesting a 32-hour week in 1999 but accepting a wage cut.
If we look at what is actually taking place in companies, it seems that a great deal of progress has indeed been made over the past few years in most sectors. If the extent of this progress appears to be limited, this is due to the necessary latency period.
Anyway, at least two points in this debate remain to be settled:

- On the one hand, some suggest that the collective, liberal and consensual form of management seen in the "social market economy" was suited to relatively stable situations, but that it is no longer suitable in the new age of technological acceleration and uncertainties of competition, in which job security becomes a nuisance.
- After a period of several years during which Anglo-Saxon managerial thinking advocated methods of management and organisation that were increasingly restrictive (something that is indicated by expressions such as "reengineering" and "downsizing"), a new current of thought can now be observed according to which good management of a company in the long term should rely on the classical methods of the Rhenish model and in particular on relationships of trust based as much as possible on job security. Thus Professor Dieter Läpple[7] went as far as to wonder whether "the following question might arise after a time: can the Americans avoid taking on the European model?"

2.4

Until the Rhenish model crosses the English channel, too, its future will no doubt be largely determined by the development of financial structures and particularly by shareholding. Although I cannot address this huge question here, I would nevertheless like to comment, as Prof. Streeck has done, that it is an inherent problem of the social market economy. Indeed, the financial sector functions "as an economic infrastructure in order to establish a model of production that is compatible with social objectives such as the reduction of inequalities (...). However, just like the labour market, the German capital market is becoming diluted in its international environment." This phenomenon took on a symbolic character in 1993, when the Daimler-Benz group decided to radically alter its global strategy and to be quoted on the stock exchange in New York. Since then, German finance has rapidly moved closer to the Anglo-Saxon model and is propagating a new "equity culture" in companies that is all the more appealing, especially for the new generations of management executives, because it is accompanied by the distribution of stock options. In the Rhenish model, the bank prevails over the stock exchange, and in the Anglo-Saxon model, the opposite is true; at present, in Frankfurt, Zurich and Amsterdam alike, the stock exchange is relentlessly gaining ground on the bank.
The significance of this development is ambiguous:

- Since the financial markets are technically more efficient than intervention by the bank, this development favours the competitiveness of those companies that are able to benefit from it.
- On the other hand, the strategy that companies follow is increasingly being determined by their shareholders. To what extent is the internationalisation of capital in Rhenish enterprises compatible with the practice of "stakeholders' value"? This is still an open question.

Nevertheless, there is an area in which the development of the most modern financial techniques links up with social progress by creating new jobs, and that is the development of risk capital, following the example of the American NASDACQ. In this context, it is interesting to note that the French Society of the New Market has taken the initiative and created a European group with an economic interest called EURONM, in which as of now the "New Market" departments of the stock exchanges in Frankfurt, Amsterdam and Brussels are participating.

3 The Future Path of the Rhenish Model Will Go Via the Euro and European Political Union

3.1

All the problems of the Rhenish model, both those of a cyclical and those of a structural nature, are directly or indirectly associated with the difficulty of reconciling the competitiveness and creativity of an enterprise with the costs of social security, costs that are becoming increasingly high due both to demographic factors and to medical progress. Throughout continental Europe, the vitality of the economy and its ability to create jobs increasingly depend on the reduction of labour costs and on firms' profitability.
Whatever the significance of the European Social Charter and the possible impact of its future developments, the fact remains that social questions will essentially continue to be governed by decisions that are taken at the national level. This is dictated by the principle of subsidiarity, but above all by the following two facts: Firstly, the practices of working out and negotiating labour relations are the result of cultural phenomena of an essentially national character; secondly, all the systems of social security were set up based on the principle of national

solidarity. However, this national solidarity is now being put to the test. Up to now, it has allowed social insurance to be generalised to cover the entire population; if it is to remain financially feasible, changes of focus are now going to have to be made in order to give priority to the most needy. A certain degree of segmentation will necessarily have to be introduced instead of the principle of universality that has been applicable up to now. Such a reform will be all the more difficult to implement because, in the majority of the countries in continental Europe, and particularly in those of the Rhenish model, social security lies less in the competence of the state than in the responsibility of the social partners, who are particularly attached to the principle of equality.

3.2

These reforms, which are of an essentially national nature, will be all the more readily accepted as the prospects for growth and employment improve at the European level. However, in this respect, much depends on what happens at the deadline set for the Euro and on subsequent developments from the point of view of European Political Union.
Let us take a brief look at the two main contrasting scenarios:

a) The "Postponement-Failure" Scenario
If the deadline set by the Maastricht Treaty of 1 January 1999 had to be postponed, for whatever reason, this would mean more or less failure of the project of the single currency and all that it entails.
In order to assess the immediate consequences of this failure, we should remember first of all that, since the beginning of 1996, the markets have placed their bets to a very large extent on the Euro being introduced on schedule. Huge commitments have been made, for instance, on the basis of the opinion that, as of 1999, the German mark and the French franc will be one and the same currency. It is this in particular that explains why long rates have become almost identical in Germany and France.
If this bet were to be lost, the following divergence would result:

- In the majority of the Rhenish countries, beginning with Germany, the currency would rise in value, which would choke growth, further increase unemployment and lend credence to particularly gloomy prospects.
- In contrast, in the majority of the Latin countries, the currency would depreciate and interest rates would rise dramatically, making it extremely difficult to control public debt.
- For both groups, this would mean the end of any European model conceivable with reference to the "social market economy."

Inevitably, this would lead us into a perverse logic involving an increase in national unrest. The European Union would give way to disunity, and it would not be long before Germany's neighbours began to suspect that Germany could yield to what one might call "the Berlin temptation."

b) The "Euro-Europe" Scenario
This scenario perhaps deserves to be examined using a concrete example. At the beginning of 1997, Ford announced that it was going to stop production of its Escort models in Great Britain (Merseyside) in favour of production sites in Germany and Spain. Thus, "although wages in Germany are twice as high as in Great Britain, Ford is going to transfer part of its production to Germany. This step was justified by the fact that the level of productivity in Ford's factories in Great Britain is considerably lower, as well as by the geographical location of the German factory in Saarlouis, in the heart of Europe. In this context, the possibility cannot be excluded that, in choosing its site, Ford was already anticipating that Great Britain

probably would not join European Monetary Union."[8] The directors of companies such as Toyota, Mitsubishi and even Unilever have let it be understood that, on the basis of the same hypothesis, they too could envisage directing their investment more towards continental Europe.[9]

The single currency will be a phenomenon of huge importance for Europe's dynamism. From the point at which price comparisons between all the countries that have joined the single currency become completely transparent, companies will be motivated to invest, innovate and be creative and will have a solid base on which to face the great challenge of globalisation. Thus one of the major French companies is preparing to group together its factories, which are currently spread throughout the most important countries in Western Europe, so as to specialise each of them at the level of the single currency area. In approximately 5 years, this will result in a decrease in costs of 15-20%. From then onwards, this company will no longer have to fear any other on a world scale.

This entire scenario is of course based on the Euro being introduced in accordance with the Treaty. In this context, I have to smile when I hear people claim that Germany might well not pass the test to join the single currency in Spring 1998. We only have to remember that the objective of the Maastricht criteria is to create a European currency that is as stable as the German mark in order to see how strange such claims are - they amount to saying that Germany is not fit to have the German mark as its currency!

Endnotes

1

	Ireland	United Kingdom
Mean 1961-1970	60.5	112.5
1996	97.5	96.0
Source: OSCE		

2 Colin Crouch and Wolfgang Streeck (eds.) *Les capitalismes en Europe*. Edition française La Découverte 1996.
3 *Il Molino*, issue no. 1, 1991.
4 This concept is often unknown in Anglo-Saxon countries.
5 See footnote no. 2.
6 *Capitalism against Capitalism*, Whurr Publishers.
7 Speech at the Institute of Political Studies, Paris, February 1997.
8 Prof. Dieter Läpple, speech given at the Institute of Political Studies, Paris, February 1997.
9 Meanwhile, direct foreign investments are turning away from Germany and direct investments abroad by German companies are increasing. Any upset in the timetable for the single currency would inevitably strengthen these two developments.
