

Session 1: Globalization and National Politics: The European Experience in Building Governance

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I thank Prof. Touraine for his sobering thoughts which are obviously very important and introduce a dimension on this particular set of problems. Just a minor comment on the fact that, apart from the apparent French reluctance to accept a new European model, well, there are encouraging signs in that direction. During the recent summit at Hampton Court the statements of Prime Minister Blair on the social problems were more focused than on other occasions and again, though this is a bit of self-promotion, but just to give an idea of the ways in which a civil society institution such as a foundation can contribute to this modus, re-starting integration processes at a European level, among the six papers that were attached to Blair's main speech at Hampton Court the main one on social policies was in fact produced at one of our research institutes which did research on unitive government. This was presented [?] at the opening meeting on co-ordination and it was a tool for defining European policy, so there are several ways in which the social and cognitive dimension can also be cultivated by non state actors and that is what we are trying to do. There were several references in Prof. Touraine's speech to the American hegemony, but there is also another kind of hegemony that has always been the hegemony of economists in the field of reasoning on public affairs, and so I'm glad to leave the floor to Riccardo Faini, an economist, but one whose heuristic tools are quite broad and definitely not so orthodox. So I'm glad to have a chance to listen to his ideas.

PROF. FAINI

Thank you very much Piero. Alain Touraine started his speech by apologizing for not being an economist, let me start by apologizing for being one. I've been given the very tall order of walking with you through the very difficult task of looking at the European economy and its relationship with globalization. Fortunately enough, we can start from a simple consideration, namely the general of *malaise* about Europe's economic performance and its role in determining voters' attitudes throughout Europe. What I am going to say may sound peculiar to most of you. Yet, I'm convinced that Europe's economic performance is not as bad as it is typically depicted by a number of economists and international institutions. The simple fact is that if we look at the last 30 years, or the last 20, or the last 10, we see that income per-capita growth has been virtually the same in Europe and in the US. This may sound odd. We all recall the headline numbers, which show the US growing at 4% and Europe, when things are good, growing at 2%. Let's remember however that there is a major gap in population growth: much of aggregate income growth in the US is boosted by population growth while in Europe population growth is very, very limited. The fact is that between 1970 and 2003/2004 the relative income gap between Europe and the US has

not changed. I mean that Europe's GDP per capita is stuck at 70% of that in the US; what *has* changed however are the determinants behind this gap. Let's go back 30 years ago: at that time, most of the income gap was accounted for by lower per-hour productivity in Europe. One hour of work in the US was much more productive than in Europe. The other two components of income per capita - the amount of hours per worker and the ratio between the number of workers and the total population - did not differ much between Europe and the US. Hence, the main determinant of the income per capita gap was *productivity*. If we now jump to the mid 90's we find that the picture has radically changed. Indeed, productivity per hour is now higher in Europe. The income gap however is unchanged. To offset the improvement in Europe's productivity performance is the twin fact that now each worker there works a much more limited number of hours, and the number of workers over the population has fallen in Europe with respect to the United States. Let's move on a few more years from the mid nineties to 2002. Now the productivity gap has opened up again: the US productivity performance in the last 7/8 years has been truly extra-ordinary. So now per-hour productivity in the US is higher than in Europe. What about hours worked and the employment to population ratio? The former has fallen even more; the latter has improved substantially, thanks to a buoyant employment performance in Europe and the fall in the employment rate in the US. To sum up, we see that the gap has stayed the same but its determinants have changed. The key explanation today of the lower income in Europe is simply the fact each worker spends less time on the job and enjoys leisure. We would want to know why this is so. Economists as usually disagree. Olivier Blanchard argue that Europeans have a stronger preference for leisure. More broadly, we should recall that a shorter working week has been a basic component of trade unions struggles over the centuries and the 35 hours in France was indeed part of this process. Some other economists claim that Europeans work less because of high taxation. Personally, I am not convinced. For instance, if we look at Scandinavian countries, we find high taxes, high employment rates and long working weeks. The same is true for Ireland. The fact that differences in preferences matter most is reassuring. What is less reassuring is the opening up of the productivity gap between Europe and the US. Again, the jury is not out on this issue. If higher productivity growth in the US is permanent, then Europe is in (relative) trouble given that that productivity growth is the key to economic well-being. However, high productivity growth in the US may well be a temporary phenomenon, reflecting say the fact that Europe has been lagging behind in absorbing the new technologies and that its newly hired workers are temporarily less productive but will soon catch up.

Still, this rather optimistic assessment does not imply that there is no need to reform Europe's economy. The US may have been more apt to catch the opportunities offered by globalized markets. However, the need for reform does

not arise solely or mainly from the challenges of globalization. For instance, ageing is unrelated to globalization; yet pension reform is essential because of population ageing. In the last 30 years, governments throughout Europe have allowed increasingly cohorts to take early retirement at the very same time that life expectancy was increasing. Clearly, this trend is not sustainable from fiscal point of view. However, it has nothing to do with the challenge of globalization.

So what are the future prospects? Here, as economists typically do, let me emphasize the *risks*. A key risk in Europe is that the fear of globalization may prevail, with an increasing emphasis on its costs rather than on its opportunities. Having worked in international institutions, it is quite depressing to see that most of the debate focuses on the impact of globalization on Europe and the role that Europe could play in reorienting the globalization process and influencing the role of international institution is somewhat neglected. I'm not going to touch these issues: they will be discussed this afternoon when we talk about global public goods. Still, I am convinced that European governments should agree that international institutions should play a bigger role, that some of the gaps in the international economic architecture should be filled, and that we should all support a stronger role for the International Labour Office in the field of labor and social conditions. The second risk I see comes from the attempt by many heads of state to blame Europe's alleged poor economic performance on its excessively conservative fiscal and monetary policies. This issue goes a bit beyond my assigned topic. Suffice to say the stability pact has worked relatively well, that its recent reform is well designed and if we keep insisting with the central bank for a more accomodative monetary policy we are most likely to get the opposite reaction.

Having talked about the risks, let me say that why I am relatively optimistic about the prospect of the European economy. Let's start with Germany: Germany, together with Italy, is often described as the sick economy of Europe but, I believe this is not accurate. First, the German government has implemented many important reforms, for instance in the labor market or in the pension system. Secondly, German firms have undergone a deep restructuring process and the results are now visible: a growing market share for exports, a strong productivity performance, and high profitability: the weakness of domestic demand still hampers the aggregate performance. However, this simply reflects the weak labor market (because of corporate restructuring) and the weakening of the protection net (because of government reforms). In the transition, households are likely to save more because of the uncertainty connected with restructuring and reform. Sooner or later, though, domestic demand should pick up in Germany, as well, and after poor growth first, jobless growth afterward we

should have a faster and employment intensive growth boosted by a buoyant productivity performance. Remember the US in the nineties? In other parts of Europe, things are already working relatively well. Most of Scandinavia features rapid growth, a fast employment expansion, a strong position in the high technology sector, and an efficient public sector - in André Sapir's words, "we are in the case of high equity and high efficiency". If we now move slightly to the West, we end in the UK, with a good performance in the labor market, rapid output growth, but legitimate concerns about income distribution. This is a world, quoting again Sapir, of high efficiency and low equity, although the labor government is working hard in addressing the equity issue.

There is, unfortunately, a dark spot in the picture, a country with an abysmal growth performance, negative productivity growth, shrinking export market shares and continuing high inequality. This is Italy, a case of low equity and low efficiency. The key question here is why Italy is lagging behind so much. Many reforms have been enacted: the pension reform was certainly more extensive in Italy than in most EU countries, the labor market is much less sclerotic than it used to be, and product markets reforms have also progressed, at least until 2001. Clearly, other factors must be at work and most Italian economists are bragging for an explanation. My own analysis suggests that the key distinguishing feature of Italy's economy that sets it apart from most industrialized country is its poor endowment in human capital. Lack of human capital plays a key role in determining Italy's pattern of trade in traditional goods sector, which are more vulnerable to emerging market competition and less amenable to exploit the opportunities of the ITC revolution. Similarly, lack of human capital is also associated with the small size of Italy's firms. Italy's model worked well in the past, but times have changed during the 90s because of two major shocks, the information technology revolution and the greater role played by emerging countries, including China and India. By and large, both are favorable shocks but may have a negative impact on a country like Italy. Why this is so is simple. First, an economy will need a well trained labor force to absorb the new technologies. In the past, new technologies were incorporated in machineries. Today, to exploit new technological opportunities firms need to completely rethink their organization and this requires skills and human capital. Secondly, lack of human capital means that the country has a comparative advantage in unskilled intensive goods and will suffer more from competition coming from the emerging market. Unsurprisingly, the heated controversy about textiles and clothing imports saw northern countries willing to open up to developing countries and Italy and other southern European countries taking a fiercely protectionist stance.

To sum up, the policy prescriptions are well known and need to be implemented.

The emphasis should be on investing in human capital, boosting spending on in research and development and reforming the product market even more than the labour market. At the broader level, we should emphasize more the role that Europe can play in re-orienting the debate about globalization. All of this will require a good deal of political courage by leaders around Europe, so far a fairly scarce resource.