Reforming Europe: Is the Third Way the Only Way?

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Summary

The subject of reform is at the heart of current economic debate in Europe. The "Sapir Report" is the latest example. It denounces the institutions of the European model for keeping the European Union from growing at a sufficient pace. These institutions, it claims, are creating roadblocks to structural changes, changes that have been made vital by the important role of innovation in today's world. The Report claims that the answer lies in implementing reforms to increase "microeconomic" efficiency.

This text examines critically this argument. If Europe were to adopt these reforms, European countries would have to switch to a different model of capitalism. That would mean abandoning the European model -- characterized by a high degree of social security and employment protection -- for the neo-liberal model, with its reduced social security and flexible labour markets.

This booklet compares the growth and innovation performances of France and Germany with those of the U.K. and the U.S., as well as with those of Sweden and Finland. These comparisons reveal the need to question, at the very least, the current rhetoric of the uncontested superiority of the neo-liberal model. I underline that even if the different models are capable of providing comparable overall performances, they do not have the same consequences in terms of income distribution and coverage of social risks. Consequently, choosing a model, by its very nature, is a political choice. Therefore, choosing the reform means choosing to forge ahead with changes that took place during the Conservative Revolution in the U.S. and the U.K. (i.e. the Margaret Thatcher and Ronald Reagan years). A new dimension of this debate is that centre-left parties are adopting the political project of converting to the neo-liberal model, which is usually only associated with conservative parties.

This text concludes by examining two scenarios of structural change. The first scenario envisages the completion of the reform and the transformation of the European model to a neo-liberal one. The second scenario involves a transition towards a social-democratic model of capitalism. Neither scenario is without significant political consequences.

REFORM (v) […] make changes in (something, typically a social, political, or economic institution or practice) in order to improve it....

The New Oxford Dictionary of English

1. Reform Looming Large in Europe

If there is any word in vogue in current European public debate, it is *reform*. The press has adopted the theme to explain that Europe in general, and France and Germany in particular, have fallen significantly behind the United States, and that their only choice is to modify substantially their economic institutions. In other words, reforms must be implemented if continental Europe is to have any hopes of saving itself from decline. It is amusing to think that France, in particular, has turned around its public image so quickly: it was not that long ago that the British weekly, *The Economist* [1], otherwise little inclined to francomania, devoted its cover to France's spectacular and successful adaptation to the new economic environment thanks to its conversion to the "Anglo-American" model.

The subject of reform, however, runs much deeper than current media hype. It is a central theme in contemporary economic analysis. In fact, reformists claim many areas will need changing. For a start, they say social protection will become impossible to maintain at its current level over a long period. Medical costs will skyrocket, making it impossible to continue financing the social security system. The ageing of the population will endanger the financing of state retirement plans, given that the pathologies unique to the European labour market will lead to a limitation of the proportion of the actively employed population able to contribute to state pension plans. Labour market institutions will thus prevent several categories of the population from accessing employment: women, low-skilled workers, young workers, those close to retirement age.... These institutions will protect unfairly those already employed -- the *insiders* -- to the detriment of those excluded from the labour market -- the *outsiders*. Taxation, redistribution mechanisms and labour unions' influence will lead to salary scale limitations. This will have the double effect of making the least productive workers unemployable while discouraging the most qualified workers, those with high incomes.

The flexibility of the labour market will be insufficient, reformists predict, hindering adjustments to employment. This in turn will weaken companies subject to adverse supply or demand shocks, companies which will then want to decrease their workforce, discouraging them *ex ante* from hiring, and thus from producing. Product markets will be excessively regulated, slowing down the entry of new firms and, consequently, reducing industrial dynamism. This will guarantee protected income and a peaceful existence, with no need to innovate or improve productivity, for firms already in the market, which will have in turn negative consequences on that sector and employment in general.

The education system will lack incentives, especially at the post-secondary level. Here again, the lack of competition will promote laziness (at the very least intellectual) in lecturer-researchers and dishearten the best students…. The same will apply to research, which will supposedly lack both public and private funding: public because of heavy taxes and social spending; private because of the lack of incentive to innovate, deriving from the absence of competition in industry, and again punitive taxes. Finally, the organization of financial systems in Europe will not leave enough room for market mechanisms, and legislation on the matter will overprotect company managers to the detriment of shareholders, hindering the latter from closely monitoring the former.

There is abundant literature on each of the preceding themes. A recent document that summarizes fairly well the majority of these positions is the "Sapir Report" (Sapir, 2003), commissioned in July, 2002, by the President of the European Commission Romano Prodi. The aim of this report was two-fold: to assess the European Union's (E.U.) economic strategy and to draw up a coherent strategy to achieve stable growth by 2010. According to the Agenda of the Lisbon conference, by 2010, the E.U. is to become "the most competitive knowledge-based economy…" (see: http://europa.eu.int/comm/lisbon_strategy/index_en.html).

This leads us to believe that the reform theme has been placed high on the agendas of European political leaders. Limiting our observation to France and Germany, consequential institutional changes have been implemented in the previously mentioned areas over the last few years, and more structural modifications have been announced. In Germany, Chancellor Gerhard Schröder has grouped these changes into a political program called *Agenda 2010*. This program aims, among other things, at reforming the labour market, notably to make it more flexible and to favour market mechanisms; at reforming the tax system, starting with a general lowering of taxation, and particularly that of the highest incomes; and at reforming social security by making agents more responsible for themselves. Parallels can be drawn with the reforms undertaken in France under Lionel Jospin's and, particularly, Jean-Pierre Raffarin's governments. The areas affected in France are more or less the same as in Germany: taxes, retirement, social security….

Given the long list of areas to transform noted at the beginning of this section, it appears that reform is not so much an adaptation process limited to the demands of contemporary capitalism as it is a radical change that is affecting the economy and all the various institutions. Seen in this light, it seems appropriate to speak about *the reform*, rather than simply *reforms*, since it implies changing social models. The question is thus to find out if the current and anticipated changes truly signify the end of the European economic model as we know it.

2. The Diversity of Capitalism

Answering this question requires the ability to define the European model, and more generally, an economic model or a social model.[2] We can start with a relatively simple idea to accept: capitalist developed economies are not all similar as regards their institutions. The functioning of the labour market in European countries differs considerably from that of the United States, whether looking at hiring regulations, employment protection, wage setting, etc. Europe's financial systems are also specific. The German financial system, for example, is founded on principles different from the U.S.-U.K. systems. The same observation can be made for the educational and training systems…. Multiplying the examples, taken from as many areas, shows that contemporary developed economies, although comparable in terms of their level of development, are not replicas of the same model.

In order to speak about the differences in the models, institutional particularities cannot be anecdotal; they must exert determining influences on economic behaviour, and above all they must be systematic. It is the job of theories of institutional complementarity[3] to provide analyses of these system effects, by which different kinds of institutions are mutually reinforced. The idea behind complementarity is that each institutional arrangement in a given area is reinforced in its existence or functioning by other institutional arrangements in other areas. For example, under certain conditions, a labour market where negotiations allow for stable compromises on employment protection or the level of salaries may favour the acquisition of high-level training or education on the part of the workforce, or incite them to make a much greater effort. This is especially the case if the training program in question is specific to the firm or the industry. A guaranteed, stable employment relationship decreases the risks associated with such an investment by workers. This employment stability serves as an incentive for workers to acquire the skills required by the firm or the industry. Furthermore, if investment in physical capital is made easier by the existence of durable, close ties between banks and companies, such relations will facilitate setting up long-term investment projects. If, in addition, complementarity exists -- for example, technical complementarity -- between long-term physical investments and a highly qualified workforce (in the sense of the specific skills mentioned above), institutional complementarity will exist between the institutions that favour stable employment relations and the institutions that guarantee close financial ties between banks and firms. Indeed, in facilitating the acquisition of specific skills, the institutions particular to the labour market make long-term investments more attractive. Consequently, a financial system based on the establishment of long-term financial relationships (favouring investments in certain kinds of industrial projects) increases workers' incentives to acquire specific skills. It is also possible to envisage an opposing configuration in which a flexible labour market, in facilitating the mobility of personnel, would be complementary to a financial system that makes it easy to reverse engagements and to liquidate investments. Whether examining a stable or flexible labour market, it is clear that the industrial model in question is characterized by the presence of two kinds of institutions which mutually reinforce each other.

It is possible to extend this perspective to more than just two areas and consider more complex complementarities. The field of possible complementarities can be extended to the areas of innovation, professional training programs, etc.[4] An economic model is not necessarily based on pre-paired institutional complementarities. It is possible for one institutional form to neutralize partially some of the effects of another by watering down some of its characteristics and weakening some of its consequences on agents' decisions.

If countries possess significant institutional particularities, does that mean that each one represents a different model? The response to this question depends on the level of analysis and the point of view adopted. No evidence points to what the most suitable level might be for approaching such a question. For practical reasons, the national level has often been favoured. For many reasons, however, choosing to consider only national models can present more drawbacks than advantages. Starting with national specificities often means adapting analytical frameworks to each case, in other words, applying a French analytical perspective to the study of France, a German one to the study of Germany, etc.

The challenge is to exploit the results of these national studies jointly, which without a common analytical framework are nothing but a collection of case studies. That is why it is sometimes more interesting to approach the problem by first establishing the existence of different types of capitalism, and leave until later a consideration of nations' respective positions within these types.

Among the studies on the variety of types of capitalism, Hall and Soskice's recent contribution (2001) focuses on the opposition between liberal market economies (LMEs) and coordinated market economies (CMEs). It is indeed the coordinating mechanisms between agents that separate the two kinds of capitalism: coordination between companies; work relationships; financial relationships and firm owners' control over managers; relationships between managers and workers…. For LMEs, the principal coordinating mechanism is the market; prices guide agents' decisions. In CMEs, on the other hand, other types of coordination are favoured, namely negotiations and long-term agreements -- what Hall and Soskice have somewhat awkwardly named "strategic coordination". These differences in principle have consequences on agents' behaviour and on economic equilibria. Thus, LMEs are characterized by a market-based financial system with a bias for short-term financial relationships; by a loosely regulated, "flexible" labour market, in which hiring and layoff decisions cost little; by a training system that encourages agents to invest in easily transferable assets; by general rather than specialized education; by very competitive product markets, etc. In such an environment, adaptability, flexibility and reversibility of obligations are the key elements.

CMEs, on the other hand, are characterized by a mostly bank-based financial system, in which banks maintain long-term relationships with companies (in any case, longer term than financial markets). Labour relations are based on collective negotiation; high quality professional training is guaranteed; relationships between firms are less competitive than in LMEs, which favours the establishment of common norms, employee qualification and product quality standards, but which also implies less intensive price competition. These differences between the varieties of capitalism also extend to business specializations; industrial development is favoured in CMEs while service industries thrive in LMEs. Within industry, CMEs are specialized in businesses in which competitiveness is based on the accumulation of specific skills, with innovation being created in increments. LMEs, on the other hand, are more likely to give rise to radical innovations, orienting specialization toward industries where reaction speed to market changes is a determining factor of competitiveness.

This capitalist dichotomy reflects, above all, the opposition of two countries: the United States represents an almost perfect example of an LME, and Germany that of a CME. Hall and Soskice's theory of the varieties of capitalism is based almost entirely on one dimension -- the dimension that sets market mechanisms and "strategic coordination" in opposition to one another. One of the main arguments found in all theories of the diversity of capitalism is that there is not just *one* good capitalist model (good in the sense of overall macroeconomic performance, growth, competition…), but *several*. Like all one-dimensional analyses, Hall and Soskice's study distinguishes two good models of capitalism -- CMEs and LMEs. Nevertheless, it can be difficult to take into account the full diversity of national cases within this one dichotomy. Their analysis implies that "intermediary" models of capitalism, meaning those that do not clearly belong to the categories of CME or LME, have inferior macroeconomic performances. Some countries, notably France and Italy, but also Japan, are relatively difficult to categorize using Hall and Soskice's criteria; these two countries are obviously closer to CMEs than LMEs, but nonetheless do not share these models' most striking characteristics. At the same time, France and Italy's long-term macroeconomic performances do not seem to have been considerably inferior to those of Germany -- the quintessential CME.

Table 1. Comparative statistics on ICT (1999)
Data Source: Eurostat (2001) *Towards a European Research Area: Key Figures 2001*, Publications Office of the European Union

	ICT as % of GDP	ICT production per capita (euros)	Number of individual computers per 100 inhabitants	Internet users per 100 inhabitants
E.U.-15	5.63	1356	25	26.25
U.S.	7.51	2655	52	56.14

Is not a typology of the different kinds of capitalism, based, in short, on a binary opposition, too narrow for analysing the existing diversity? This author thinks so. I have proposed a theoretical and empirical analysis of the diversity of capitalism[5], which leads to the distinction of not two, but five types: neo-liberal capitalism (close to LMEs), continental European capitalism, social-democratic capitalism, "Mediterranean" capitalism, and Asian capitalism. The institutions of these types of capitalism differ in the areas of product market competition, labour market and labour relations, social security, education systems, and financial systems. The institutional complementarities associated with these particular kinds of institutions are also specific; they define distinctive types of capitalism. Without going into detail, this classification makes it possible to distinguish between what is usually called the European model -- here, distinguished as the continental European model -- and other types of capitalism that are similar, but that possess specific characteristics in the areas of social security and labour market regulation. To name just two, the social-democratic model (Sweden, Finland and Denmark) places greater emphasis on social security and less emphasis on employment protection; the Mediterranean model (Spain, Greece, Portugal[6], but also Italy) is characterized by less social security, but greater labour and product market regulation. It is also possible to associate particular technology or industrial specializations with these different kinds of capitalism.

3. Europe's Woes

What underlies all the analyses on the diversity of capitalism is the question of its potential stability. The different models obviously are not rigid and are regularly modified by their own dynamism and changes to their respective environments. Thus, the question arises of whether some principle of evolution and selection exists among the different types of capitalism. For a large number of economists, the selection principle is relatively simple; it is based on macroeconomic performance: the ability to increase income per capita (growth), made possible by the capacity for trading on international markets (competitiveness). A model that obtained inferior performance in these areas over a long period would surely disappear.

This is precisely the question that concerns Europe now, at the beginning of the 21st Century. Numerous contributions have dealt with the issue of the diversity of models of capitalism, the evolution of these models, the question of the existence of a convergence towards a single configuration, the superiority of one model or another, or the future of the

European model.

For this text, I have chosen to focus on one particular and recent source, the Sapir Report (Sapir, 2003), whose main thesis can be summarized succinctly in the following way. The European Union is suffering from poor economic performance compared to the United States. Its poor performance is due not to inappropriate macroeconomic policies, but, on the contrary, to institutions distinctive to the European model failing to adapt to the demands of modern capitalism, especially in terms of innovation. Europe's institutions were perfectly adapted to the Fordist period[7], says the Sapir Report. During that period, European countries caught up with the United States both in terms of economic and technological performance through importing and adapting the most cutting-edge techniques. Markets were dominated by large firms (oligopolistic), and their stability allowed them to establish long-term labour relations.

The Fordist model would be obsolete in today's environment characterized by globalization and strong pressure from external competition. The new growth regime would be marked by greater emphasis on innovation, itself made easier by the flexibility and competitive nature of the markets. To adapt, Europe would need to have companies that were less vertically integrated, favouring instead mobility both within the firm and between firms. It would also be essential to promote training, labour market flexibility, easy access to external financing (and particularly to stock markets), and greater investment in research and higher education. The institutions inherited from the Fordist period would be dinosaurs in this environment. It would thus make sense to proceed with the reforms that the Sapir Report calls "microeconomic". That would mean opening markets and, more generally, applying the principle of competition to institutional areas where it is most absent. Consequently, the institutional and organizational changes envisaged are radical.

Before analysing the consequences of these proposals for the European model, it is worthwhile first to examine the pessimistic diagnosis presented by the Sapir Report. The first observation concerns Europe's weak growth compared to that of the United States. One of the Report's graphs (Chapter 4, p. 21), which presents the evolution of GNP per capita from 1950 to 2000[8], shows the stagnation of the European Union at 70% of the U.S. growth rate since the mid-1970s. From the perspective of innovation-led growth, this fact bears witness to Europe's inability to innovate, showing it stuck in its catch-up model. Europe's weakness in the area of innovation manifests itself in mediocre performance compared to the U.S. in terms of research and development expenditure, the registration of patents, educational expenditure….

One field alone is capable of illustrating Europe's difficulties in adapting: new information and communication technologies (ICTs). ICTs represent a key business activity of the new growth and innovation regime. Their role is two-fold. Due to their specific dynamism, ICTs have experienced an exceptionally elevated rate of progress, with productivity gains significantly superior to those of other sectors, and with product innovation occurring at a very fast rate. The ICT sector thus directly propels innovation. Moreover, the diffusion of ICTs throughout the economy as a whole allows other sectors to improve their productivity and to modify their supply and demand in a way that favours innovation. These technologies also serve to spread innovation to all the sectors of the economy. Thus, it is quite obvious that ICTs have spread less throughout Europe than the United States (Table 1). It is a short step to the conclusion that the European model's economic institutions are the culprits: the different entry barriers and the markets' lack of flexibility prevent or slow down the structural changes necessary to the spread of new technologies and the emergence of new industries.

The message of the Sapir Report is this: the European model is dying, but it continues to inflict damage by dragging down European growth and innovation. It is therefore essential to implement reforms about which a few hints have been given. Doing so would complete the single market. In other words, it would extend it to include a large number of service activities, most notably in the area of finance; pursue deregulation, supposedly favouring the entry of new companies and thus industrial and innovative dynamism; facilitate job mobility, and in fact flexibility, by lessening employment protection; invest in infrastructure; modify the system of credit attribution to research and development by creating independent agencies and attributing funding on a European rather than national scale.

These propositions, taken together, do not constitute an attempt to save the European social model or to ensure its long-term "sustainability", but rather, an attempt to replace it with the U.S. model or, more generally, a market-based (Amable, Barré and Boyer, 1997) or neo-liberal model (Amable, 2003). The Sapir Report is aware of the implications such a change would have on Europe's cohesion, and notably its social cohesion, the latter still constituting one of the Commission's main stated objectives. Liberalizing the labour market, in particular, would increase inequalities and risk upsetting Europe's social cohesion. The Sapir Report thus defends implementing specific measures that are completely separate from market regulation.

4. Reform: A Miracle Cure?

The Sapir Report's line of argument (which is representative of a large body of discourse on reform, in general, and Europe, in particular) combines statistical comparisons made considering the E.U. as a whole with institutional comparisons and considerations that concern the European model. In a typology of the models of capitalism, this European model is close to the continental European model in Amable (2003). The term "European model" will be used henceforth to denote the continental European model. The model is also close to what some authors refer to as the "European social model", which stresses the importance of social security institutions in the institutional complementarities that make up the foundation of this model. The Sapir Report's main argument is that the institutions specific to this model are responsible for the E.U.'s slow adaptation, in the heart of which, in fact, several models of capitalism co-exist: naturally, the European model (France and Germany or notably Austria), but also the Mediterranean model, the social-democratic model and even the neo-liberal model (the United Kingdom). One side of the problem thus involves being able to link real performance to the model being studied and then to verify whether the same conclusions are reached.

France and Germany have been the main targets of criticism aimed at the European model, and so will be taken as representative of it; the United Kingdom, being the most free-market economy in Europe, will represent the neo-liberal model. Two non-European countries that also belong to this model are Australia and Canada. Examination of the graph on page 21 of the Sapir Report gives certain impressions that are lent partial confirmation by the relative levels of GDP per capita in France and Germany (Figure 1). The catching-up process is indeed interrupted, but more since the 1980s than the 1970s, corresponding to the same period that restrictive anti-inflationary policies were implemented. Note that Germany's relative level before reunification is not as dishonourable as one might think: about 90 percent of GDP per capita in the U.S. The impact of reunification, the inclusion of new *Länder* with low levels of development from former East Germany, have reduced Germany to the French level.

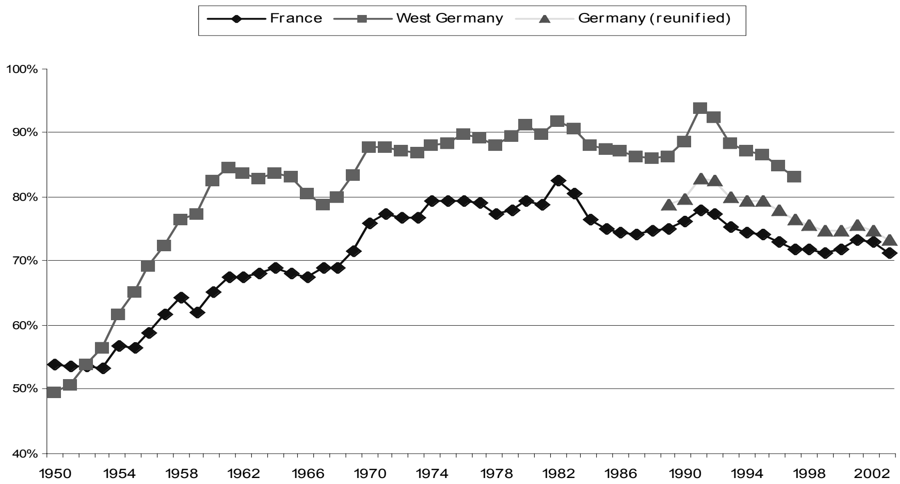

Figure 1. GDP per capita as a percentage of U.S. levels.
Data Source: *Groningen Growth and Development Centre and The Conference Board, Total Economy Database*, February 2004, http://www.ggdc.net

How then have the neo-liberal countries fared? If the partisans of reform are to be believed, a radically different image should be obtained, yet Figure 2 does not clearly show the crushing superiority of neo-liberal model institutions in those countries' attempt to catch up with the U.S.'s level of development. One might even go so far as to say that the problem hounding continental European economies (France and Germany) -- relative stagnation -- has existed longer in neo-liberal economies. The United Kingdom's GDP level has stagnated at 70 percent of the United States' level since the 1950s. Moreover, the changes that took place after Margaret Thatcher came to power do not seem to have radically changed the result. Australia and Canada's relative levels are higher, but the overall conclusion is about the same. Figure 3 shows that the social-democratic model produces comparable performances. Sweden appears to have stagnated since the 1970s, but Finland's catching-up and Denmark's maintaining a high GDP indicate that an elevated level of social security is not an obstacle to growth. In likening the neo-liberal model to the U.S. alone, ignoring the performances of the other countries that belong to this model, it is easy to lose sight of the "superpower's" specificity and performance, particularly over the last decade. In turn, the effect of the market model institutions alone, which are present in other less economically and technologically advanced countries, has probably been overestimated.

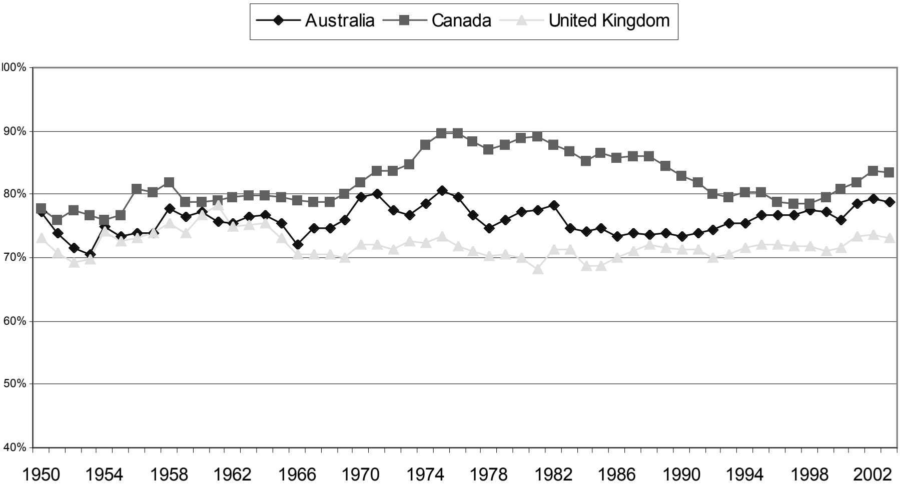

Figure 2. GDP per capita as a percentage of U.S. levels.
Data Source: *Groningen Growth and Development Centre and The Conference Board, Total Economy Database*, February 2004, http://www.ggdc.net

What happens if the focus switches to the relative levels of GDP per hour worked, thus taking a measurement that is closer to that of productivity? Here again (Figures 4, 5 and 6), it is difficult to deduce from these numbers that the neo-liberal model is systematically superior to the European model. Indeed, France's productivity curve seems to level off after 1990, but at a *higher* level than the United State's. Germany's curve does not seem to indicate any particular deficiency either. The performances of countries representative of the neo-liberal model seem modest in comparison, with here again relative stagnation at the end of the period, but at a *lower* productivity level than that of the United States. Once again, the neo-liberal model does not prove to be superior to the social-democratic model (Figure 6). The significance of these results must not be exaggerated, of course. Since some countries are closer to full employment than others, differences cannot be interpreted uniquely as gaps in efficiency. Cette (2004), in correcting France's productivity data on the employment rate and working week, estimates France's "structural" productivity to be below the U.S. level. It is almost certain that an increase in the rate of activity in France would decrease performance in terms of relative productivity. Another question entirely is knowing whether the U.S. rates and working week are necessarily the right bases for estimating "structural productivity". Nonetheless, these corrections do not change the U.K.'s situation, the country that represents the neo-liberal model in Europe. The U.S.'s performance is indeed exceptional, but this must not be confused with the performance of the neo-liberal model in general.

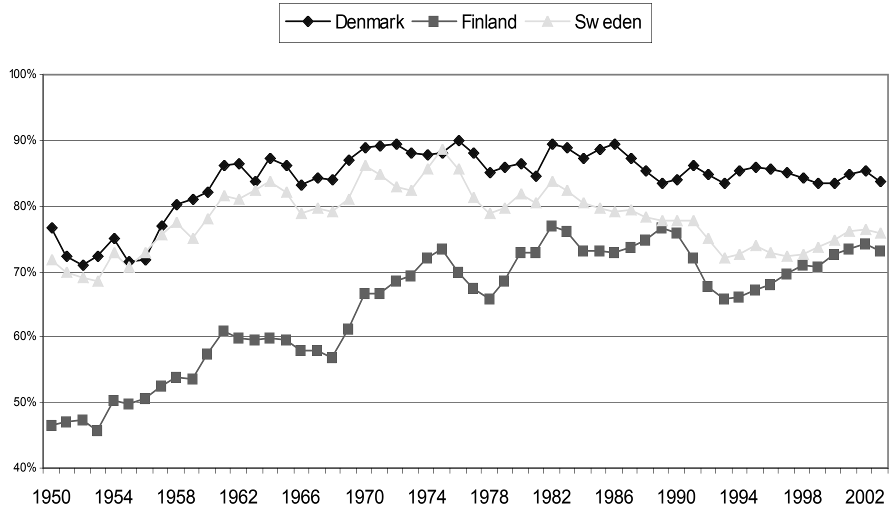

Figure 3. GDP per capita as a percentage of U.S. levels.
Data Source: *Groningen Growth and Development Centre and The Conference Board, Total Economy Database*, February 2004, http://www.ggdc.net

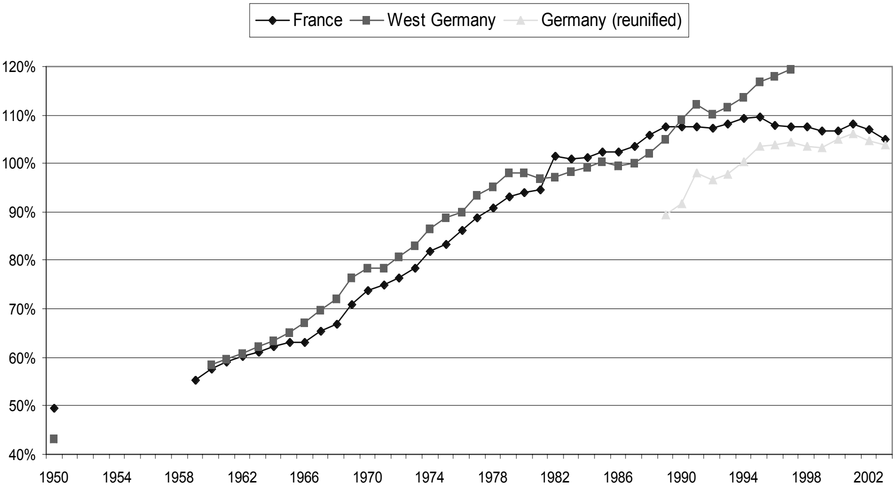

Figure 4. GDP per hour worked as a percentage of U.S. levels.
Data Source: *Groningen Growth and Development Centre and The Conference Board, Total Economy Database*, February 2004, http://www.ggdc.net

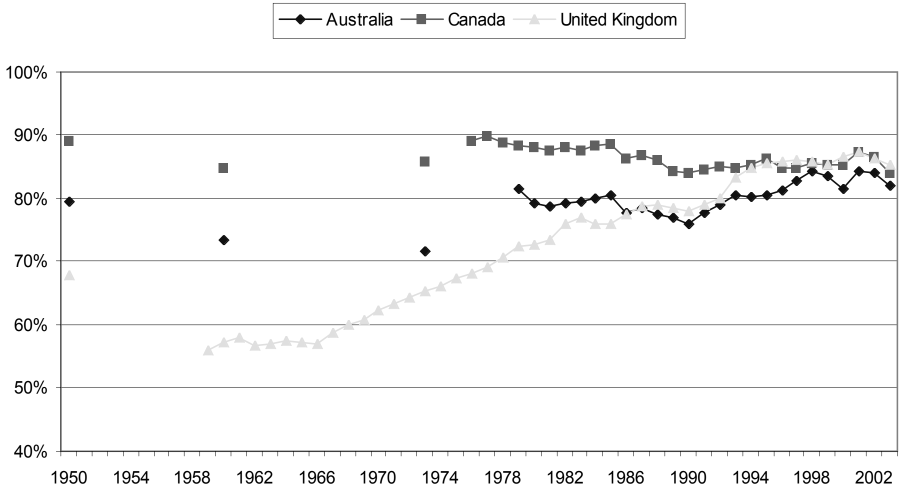

Figure 5. GDP per hour worked as a percentage of U.S. levels.
Data Source: *Groningen Growth and Development Centre and The Conference Board, Total Economy Database*, February 2004, http://www.ggdc.net

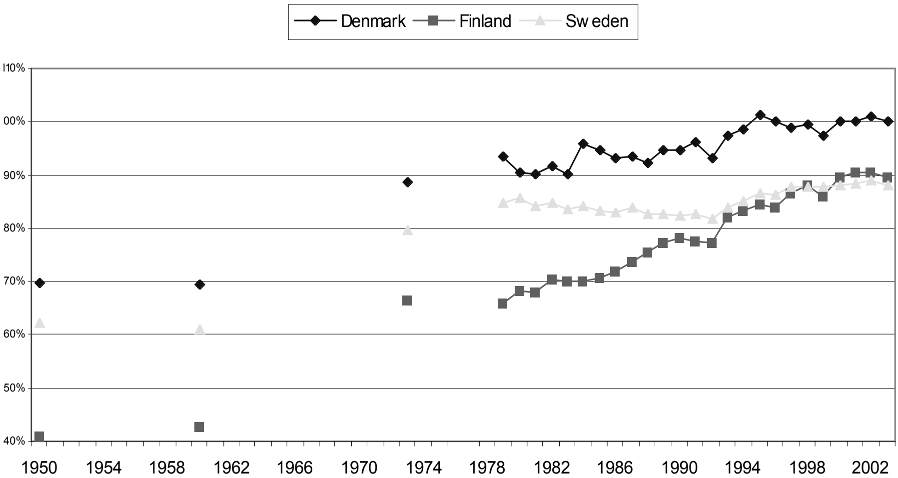

Figure 6. GDP per hour worked as a percentage of U.S. levels.
Data Source: *Groningen Growth and Development Centre and The Conference Board, Total Economy Database*, February 2004, http://www.ggdc.net

Table 2. Statistical indicators of science and technology. Unless stated otherwise, the latest numbers are given (1999 or 2000).

	U.S.	France	Germany	U.K.	Finland	Sweden
R&D expenditures; average annual growth 1995-2000 (%)	5.7	1.0	3.8	1.8	13.5	5.1
R&D/GDP Ratio (%)	2.69	2.15	2.48	1.86	3.37	3.78
Business sector R&D as a percentage of total R&D	75.3	64.0	71.4	65.6	70.9	75.1
R&D financed by the private sector as a percentage of industrial output	2.09	1.61	2.10	1.40	3.17	4.27
Number of researchers per thousand workers	8.08	6.20	6.45	5.49	13.08	9.10
New doctorates in science and technology per 1000 people in the population.	0.48	0.76	0.81	0.68	1.09	1.24
Doctorates in science and engineering per 1000 (ages 25-34)	0.41	0.65	0.81	0.68	1.01	1.24
Public and private spending on higher education as a percentage of GDP, 1999	2.3	1.1	1.1	1.1	1.8	1.7
Number of scientific publications per million people in the population	926	779	780	1152	1320	1657
Venture capital investments as a percentage of GDP, 2001	3.26	0.80	1.30	1.68	1.57	3.85
Share of registered patents in 1999 : patent (E.U.) in %	33.7	6.3	17.6	5.6	1.2	2.6
Share of registered patents in 1999 : patent (U.S.) %	53.7	2.7	6.3	2.6	0.4	0.9
Number of patents (E.U.) per million people in the population	144	128	270	113	283	306
Global share of patents (European) in biotechnology 1999 (%)	51.9	4.2	7.7	7	0.6	0.9
Number of patents (U.S.) per million people in the population	315	71	134	72	130	196
Global share of patents in nanotechnology 1991-1999 (%)	42	9.1	15.3	4.7	n.a.	0.9
Share of world market in high-tech products (%)	17.36	6.82	7.16	5.83	0.89	1.34
Share of added value in high-tech and middle-tech industries (%)	8.08	6.97	10.87	6.68	9.99	n.a.

n.a. : not available
Data Source: *Science, Technology and Innovation, Key Figures 2002. European Commission and Third European Report on Science and Technology indicators.* Publications Office of the European Union

Let us now turn to science and technology, two areas in which the neo-liberal model is assumed to have obvious supremacy. Here again, if the reform partisans are right, there should not only be a crushing superiority of the United States, but also of the United Kingdom. The figures in Table 2 admittedly show U.S. out-performance, but no clear-cut British superiority over France or Germany in terms of technology, despite Britain's good performance in science as the scientific publication indicator shows. To put it modestly, the neo-liberal model is far from outclassing the social-democratic model (Sweden and Finland). Research and Development (R&D) expenditure has increased noticeably faster in Germany than in the United Kingdom[9], and faster in Finland than for any other country presented in Table 2. It is also worth noting that the U.K. had the lowest private funding for R&D of all the countries in Table 2. Moreover, Germany's performance in technological innovation (patents) is markedly higher than that of the U.K. The R&D concentration of GNP is greater in France and Germany, and the production of high-technology goods in these two countries is superior to that of the U.K. R&D concentration is decidedly higher in Sweden and Finland than in any of the neo-liberal model countries. Thus, the figures in Table 2 invalidate the naïve belief that neo-liberal institutions lead inevitably to good performance in innovation. If there were one clearly superior model in this area, it would be the social-democratic one, *a priori* the one farthest from the liberal-market model.

It would be interesting to pursue a more systematic comparison of European performances, but that would take us beyond the scope of this text. It is worth noting, however, that Germany had a record year in 2003 for its foreign trade despite the spectacular increase of the euro in relation to the dollar. This is not an attempt to turn things upside down and claim that the performances of continental European countries have been satisfactory, but debate on reform tends always to centre on indicators unfavourable to the European model. Such is the case with the unemployment rate. France and Germany's bad performances (9.4 percent and 9.3 percent, respectively in 2003 according to the OECD) are systematically compared with the U.K.'s good performance (5 percent in 2003), while Austria, a typical continental European model country with an unemployment rate of 4.4 percent, remains overlooked.

These few comparative indicators might raise some doubts for European readers. In adopting the neo-liberal model, they are promised performances similar to those of the United States. Could it be possible, however, that in exchange for abandoning social security, employment protection, public services in general, they only obtain the performances of the U.K.? Looking at the cases of France and Germany might also spark doubt. These two countries actively have been pursuing market principles. The European model is obviously still very distinct from neo-liberal capitalism, but several structural transformations (the financial system, social security, the labour market…) that have taken place since at least the beginning of the 1990s (perhaps as early as the mid-1980s) have modified this model without notably improving French and German macroeconomic performances. Is reform perhaps not the miracle cure it has been made out to be?

A classic defence against this argument is that the reforms undertaken have not gone far enough. This defence is perhaps not as ill meaning as it might seem. In fact, following the logic of institutional complementarity, it is entirely conceivable that good macroeconomic performance be associated with very different economic models, their coherence residing in the institutional complementarity particular to each, which creates links among specific institutional forms. Under these conditions, a partial institutional change could weaken institutional complementarities and destabilize the model. The consequence could be a worsening of macroeconomic performance. In one sense, it might be possible to obtain a satisfying performance using a coherent European or social-democratic model (Sweden or Finland, for example), combining a well-developed social security system, relative employment protection, strong investment in training, and market regulation. In another sense, there is a very good chance that the neo-liberal model, with its minimum social security, flexible labour market (meaning no employment protection) and deregulated markets, would also obtain good macroeconomic performance. Under these conditions, if we consider that continental countries like France and Germany are halfway between a true social-democratic model and a neo-liberal model, why not go all the way? The reason perhaps lies in the fact that even if the two models can theoretically deliver overall satisfactory performances, they do not have the same repercussions in terms of income distribution. The issue of the political support underlying these capitalist models must thus be explored.

5. The Policies of Reform

The problem of model "sustainability" has been presented up to now in terms of macroeconomic performance. A sustainable model has been understood to be a model that is capable of providing a high growth level over a long period, so that the population benefits from an appreciable rise in its standard of living. Adopting such a criterion would seem natural, since the implicit assumption is that everyone benefits equally from advances in global productivity. Under such conditions, each person would choose between 1-2 percent growth in the standard of living per year. In that case, choosing an economic model would be fast and easy. It is rare, however, for such favourable conditions to be the rule. The institutions that underlie the various models have different consequences for agents according to their place in society. One kind of institution or another in a given area would have advantageous consequences for one or another group of agents. Conceivably, employers and unions do not have the same preferences in terms of employment protection, and more generally, of social rights; rich and poor households probably do not wish for the same types and levels of redistribution; shareholders' interests can differ not only from managers', but also from employees'; manufacturers' preferences for structural policies are not necessarily those of service firm managers…. It is thus necessary to think of agents' interests as different and potentially antagonistic and to envisage institutions as the result of political compromises between these different antagonisms. That means considering institutional configurations as a problem of political economy.

It is thus odd that the issue of reform has been presented in terms of general interest. The fact that opposition to reform, stemming from certain segments of society, even exists indicates that the general interest in question may not be so general after all. It is deceptive to present the debate as an opposition between the general interest (and the direction in which the reform will naturally go) and special interests (which will oppose the reform, and thus, the general interest). We can be certain that those whose interests are served by the reform will support this process while those who will be hurt will oppose it. It is thus the political decision-making process that will decide the future of the reform. General interest might possibly be interpreted as majority interest, but effective decision making concerning the different reforms depends on the given political system. This might be a majority system, meaning that a political measure that has majority approval is adopted. However, other democratic political systems[10] exist which place greater importance on protecting minority interests, and which require that compromises between different interests, enjoying collective representation, be reached. Moreover, it would also have to be possible to prove that the reform received majority approval.

Likening reform to a dentist appointment, as has sometimes been done in public debate, (it might hurt, but it's necessary, and you'll feel better afterward) is tantamount to propaganda. From an analytical perspective, it would be more interesting to distinguish the losers and winners and to try to identify possible political equilibria, and from there, the reform's chances of success or failure. We could also drop the hypothesis that agents are rational and assume that they are not capable of truly assessing what their own interests are, or that they need a certain amount of time to take note of the gains the reform has brought them. For Blanchard and Philippon (2003), for example, conversion to the reform is a function of agents' learning ability, which depends on the degree of confidence between capital and work. Thus, agents are not at first convinced that the new capitalism necessitates reform, but they will come to admit it. If such a configuration is *a priori* conceivable, it is nonetheless difficult to believe that this is a general case. Before casting doubts on certain agents' ability to understand where their interests lie, it is better to first explore another route, that of the easily identifiable divergences in interest between agents and groups of agents.

The politico-economic nature of the reform requires delving into the different political strategies behind this movement. As already noted, the reform can be interpreted as a project of institutional changes with the aim of spreading the institutions of the neo-liberal model (or liberal market institutions) throughout European countries. This project must be backed by a political strategy. During the 1980s and up until the beginning of the 1990s, the neo-liberal project was principally backed by conservative political parties, namely M. Thatcher's government in Great Britain and the presidencies of R. Reagan and G. Bush senior in the United States. The fundamental calling into question of the institutions inherited from the post-war years was qualified as a "conservative revolution". This political stance did not have the same success in Continental Europe. The electoral victories of the liberal parties after the second half of the 1990s might have signalled a shift in political leanings -- a return to the promotion of the European economic model -- the social-democratic model. Nothing of the sort occurred. On the contrary, the return to power of New Labour in the U.K. and the S.P.D. in Germany, after respectively 18 and 16 years of conservative government, was made along a political line -- the "Third Way". This political strategy was so aimed at transforming the European economies to neo-liberalism that the reform ceased to be the objective of conservative parties only.

The rhetoric of modernization has played a significant role in the Third Way project, going beyond the political marketing strategies of systematically presenting this political tendency as the "modern" Left, as opposed, we suppose, to the old-fashioned and outdated Left. This period will be known as one of "reflexive modernization", writes Anthony Giddens, the principal theoretician of the Third Way. Individuals will see themselves offered a much larger range of lifestyle choices, allowing them to construct their own identities. Social security institutions will be associated with keeping individuals in traditional roles, and thus not "modern".[11] In placing a high value on the active participation of the individual, notably in the workplace, according to the Third Way, institutions that hinder this "self-actualization" will be frowned upon. Third Way partisans claim that employment protection will protect *insiders* to the detriment of *outsiders* and wage-earning, male breadwinners to the detriment of women; social security will develop individualism, egalitarianism and the "culture of dependence", and so on.

The Third Way also opposes redistribution, preferring to promote equal opportunity rather than equal outcomes, *ex post*, equality which would remain difficult to measure given the increased differentiation among individual career paths in the reflexive modernization era. Finally, while the "old Left" positioned itself according to traditional splits of capital/labour, rich/poor, the Third Way prefers divisions of a "post-traditionalist" society: inclusive/exclusive, men/women, young/old…. A recurring Third Way theme that appears here is that of the irrelevance of the traditional social support base of social democracy: workers in industry and wage earners in the public sector. This traditional social base seems to be on its way to extinction, a specific consequence of globalization.[12]

The adherence of Continental Europe's left-wing parties to the Third Way is based on the belief in this strategy's effectiveness in the quest for power. If it was possible to bring an end to 18 years of radical conservative governments in the U.K. with this platform, what left-wing party would hesitate adopting it? This kind of reasoning neglects an important aspect of the issue. After 18 years of conservatism, Great Britain has emerged as a liberal market economy while most European countries have stayed close to the continental European model or the social-democratic model. Whereas the Third Way could have represented a political strategy in line with the structures of interests that had been profoundly modified by the conservative revolution, it instead came into conflict with the interests of the Continental economies. Under these conditions, it is not surprising that attempts made to implement such a political strategy, far from being a miracle formula for winning elections, signified a political defeat for left-wing parties in Italy, the Netherlands, Denmark, Norway… and even France. As for Germany, the Third Way strategy left the first Schröder government to face large-scale political problems: internal disputes in the S.P.D.; the resignation of Oskar Lafontaine; a series of defeats during the regional elections…, difficulties from which the Red-Green coalition only recovered due to the presumably hidden financial scandals of the C.D.U. and the abandonment of a strictly *Neue Mitte* political line. Nevertheless, it was the second legislature and the beginning of the implementations of *Agenda 2010* that caused the S.P.D.'s popularity to fall to levels unheard of since the end of WWII.

Although the term "Third Way" has mostly been abandoned, the fundamental elements of this doctrine make up the theoretical underpinnings of a political line that, as we have seen, likes to present itself as the "modern" Left. Its institutional project of transforming the European model into a liberal market model is, nonetheless, situated along the political line of M. Thatcher. That is why it does not seem exaggerated to use the term "conservative reform", conceived as the continuation of the revolution of the same name in a relatively softened tone. Thus, it was during the Trilateral (France, Germany, the United Kingdom) Seminar on the Future of European Social Democracy[13] in London that the non-British delegates, and in particular the Germans, complained that they, unlike the English, had no one to do the reform "dirty work" for them.[14]

It is interesting to note that the text presented by the main French participant in the trilateral seminar in London, Dominique Strauss-Kahn (2004), in some ways follows the line of L. Jospin, which has been qualified as the "quatrième voie" (the "Fourth Way") (Amable, 2003). This political line tries to make a synthesis of the traditional, social-democratic themes (such as redistribution and social security) and the now "traditional" themes of the Third Way: the "socialism of redistribution" appears alongside the "socialism of production" and the "socialism of emancipation". Several reasons explain the slight distance taken from the Third Way: competition within the socialist party[15] would make it dangerous to take a completely social-liberal stance, even though D. Strauss-Kahn's principal internal rival, Laurent Fabius, is associated with this line of ideas; the resistance, also found in Germany, of the left-wing party electorate to the Third Way themes; the wish not to be too closely linked with T. Blair whose image is tarnished in France…. The conditions under which social-democratic inspiration could be given new life and made compatible with the incentive structures largely based on market mechanisms are all but self-evident. Notably, political support for significant redistribution, beyond the minimum support of the poor, which constitutes the essence of neo-liberal social security, is only stable if a large segment of the population benefits from this redistribution. This assumes taxation at levels that are incompatible with the principal elements of the neo-liberal model. Wagering on a hybrid of the social-democratic and neo-liberal models is very risky if we believe in institutional complementarity. It remains to be proved that the "quatrième voie" is something other than a makeshift solution or a simple tactic for winning power within a political party.

6. What Verdict?

The proposed reform is an attempt to modify profoundly the institutions of Continental European economies to bring them into line with the model of capitalism, which can be described as "neo-liberal" or "market-based". The consequences of the reform are far from insignificant for European countries. Social security, wage bargaining procedures, employment protection, market regulation, the role of public utilities and services, redistribution and taxation are some of the areas that will be markedly affected. These structural transformations will not be neutral for agents and their situations; to put it trivially, there will be losers, and there will be winners. Under these conditions, any judgement on the benefits or, on the contrary, the harmful nature of the reform that neglects this political aspect will integrate, consciously or not, value judgements into the analysis. To avoid this, I have chosen to adhere as closely as possible to Max Weber's *Wertfreiheit* by clearly separating the positive terms from the prescriptive ones, and by clearly formulating the name of whom or what these possible prescriptions have been established.

The implementation of the reform relies on certain political strategies. In searching to find their place in the continuation of the conservative revolution of the 1980s, it is not surprising that the majority of conservative parties back the reform. The new phenomenon since the 1990s is that the reform has also become a war horse for the principal left-wing parties, which have chosen, at least in part, to stand behind the Third Way. The conversion of a segment of the left to the reform has contributed to depoliticizing the debate. In this light, structural transformations appear inevitable, reinforcing the spread of a rhetoric of conviction already used by M. Thatcher to promote her program: *There is No Alternative*. The main argument for reform is, therefore, technocratic in nature. Any political opposition is treated as an expression of the defence of special interests as opposed to the general interest, and is thus considered irrational. It is impossible to have a constructive debate under these conditions.

It might be conjectured that a stable political equilibrium in favour of a neo-liberal transformation of society does not exist in most Continental European countries. The elements that help validate this conjecture are the various past and present misfortunes of governments that have attempted to implement the reforms in question. This does not mean that it would be impossible to transform the European model into a liberal market model; it does mean, however, that this change would come at a high political price. On the other hand, a clear political strategy that supports a European model or a social-democratic model does not seem to have emerged. The political parties that are *a priori* the most likely to back a strategy of social democracy have preferred to explore the Third Way, despite the small electoral success it has had, probably because they are convinced that there is no real alternative. These parties are thus, more or less, suddenly losing a large portion of their electorate, who often join more populist parties whose objectives do not seem to promote a European social model either. Under these conditions, it is entirely possible for Europe to remain stuck in a paradoxical situation, in which a majority of the population hopes to establish a renovated European social model, but for which no political party seems to want to commit to setting up an active political strategy.

It is difficult to make provisions for the most likely path Europe will take, which is why I have limited myself to presenting two possible scenarios. The first scenario involves pursuing the conservative reform. Casually dismissing the social and political opposition, and perhaps, for some among them, convinced they are acting in the populations' best interest (despite them), governments have committed further to dismantling the institutions of the Continental European model. To this end, governments are: deregulating the labour market; weakening social rights; drastically decreasing employment protection; decentralizing wage negotiations; privatizing, especially public utilities; promoting competition as the only way of regulating markets; decreasing overall taxation and redistribution; privatizing and individualizing social security; privatizing education; pursuing the "financialization" of the economy…. At the end of this path of reforms lies a model that is *a priori* no less coherent than any other -- the neo-liberal model -- which will probably also lead to overall satisfying macroeconomic performance. As I have already noted, with these changes, some people will win and some will lose. It is unnecessary to develop the consequences that reducing redistribution and social security would have on low-income populations. Even in providing the mythical equal opportunity, which would be difficult to define independently of the structural constraints weighing on individuals, and thus on the inequality of outcomes, it would be impossible to eradicate the demand for social security and redistribution from the population for which equal opportunity would not have resulted in very positive outcomes, and which only has itself to blame, in the logic of the Third Way. Occasionally resorting to moral philosophy[16] to justify one measure or another that promotes social cohesion would not compensate for the lack of political support for real measures on income redistribution.

I can, however, highlight the consequences in terms of economic activity. If any regularity has been observed, it is that the neo-liberal model is not favourable to industry. The U.S. and U.K. deficits are a case in point, especially if activities linked to defence are set aside. Under these conditions, the service sector will grow at the expense of the industrial sector. A potential conflict of interest might arise in addition to the more classic conflict between those asking for redistribution and an upper middle class hostile to higher income tax payments. Pursuing a neo-liberal scenario presupposes that these various conflicts do not turn into resolute opposition relatively early in the transition process, in other words, before reform has changed agents' situations so much that they no longer have any interest but to let the reform run its course.

In the second scenario, political actors realize that there is a political demand for the maintaining of elements fundamental to the European social model. Contrary to what the public debate would have us believe, this strategy does not involve maintaining the status quo. Simply preserving the status quo in a context in which the reform has profoundly transformed the European model probably does not constitute a viable political strategy. Indeed, reform has been in motion since the 1980s, especially for important elements relating to the regulation of markets. The future of the European model can perhaps be found in the social-democratic model. In fact, this model is not simply the preservation of the European social model, but in many ways its further development. Social security is a good example. Pursuing this path means reversing the reform process in terms of market deregulation, the "financialization" of the economy, the decentralization of wage negotiations, etc. The social-democratic model is based on high taxation and redistribution. It is therefore certain that the project would be met with strong political and social opposition. The model is also based on a high level of competitiveness, relying on innovation, notably industrial, and skilled labour. To follow this path, serious efforts would need to be made in the areas of research and education. Given the structures of education and research in

Continental Europe, these efforts would have to be made by the public sector. Maintaining a high taxation rate would also mean settling the issue of possible fiscal competition between territories, which would probably mean returning to centralizing mechanisms in which the logic of decentralization had previously reigned. This would foreshadow a confrontation of models within the European Union between countries in favour of the neo-liberal model and those wishing to follow the path of social democracy. Under these conditions, the only way Europe could escape the conservative reform would be if some political actors decided to take up an unsatisfied political demand and develop new strategies to respond to that demand. There is no guarantee that this initiative, if taken, would come from the political left.

Endnotes

1. July 25, 1999
2. The use of the term "model" has no normative connotation.
3. This concept was initially presented in Milgrom and Roberts (1992) and Aoki (1994), (2000). Aoki (2001) proposes a general comparative theory, and Amable (2003) makes the link between complementarity and institutional hierarchy, political equilibria and the diversity of modern capitalism.
4. Amable, Barré and Boyer (1997).
5. Amable (2003).
6. As one can see, the geographical naming of the models are approximations, if not completely inexact. For greater detail on the insignificance of the geographical naming of the models, see Amable (2003), Chapter 3.
7. They do not use this exact term, preferring to call this period the "Golden Age of Capitalism".
8. I cannot resist the temptation of drawing the reader's attention to the same graph (for the 1950-1990 period) presented in Amable *et alii* (1997), Chapter 10, p. 317. See also Amable and Boyer (1994) for a discussion on Europe's difficulties in the fields of science and technology ten years before the publication of the Sapir Report.
9. We note with interest (and consternation) the very slow progression of French spending.
10. See Lijphart (1999).
11. For a more detailed presentation of the links between the Third Way and the neo-liberal project, see Amable (2003), Chapter 6.
12. The interview granted by the high-ranking official of the S.P.D., P. Glotz, obviously adept with the Third Way, with the French daily *Le Monde* (20 March 2004) is very telling: "A part of the group that traditionally voted social-democrat is becoming extinct, and others cannot be convinced of the necessity for change. They still think they are voting according to welfare levels. We need to seek out electors among workers, self-employed individuals, entrepreneurs…".
13. It is clear that the future of social democracy largely lies in the Third Way for the organizers of the conference in question. As Giddens writes (2000), the "old Left" cannot survive in this new era. Let us clarify some of this terminology. We call the "Third Way" or "Social Liberalism" the political trend that has been mostly inspired by the writings of Giddens. It questions the institutions of the European Social Model (redistribution, social security, but also industrial policies…). We restrict the title of "social democratic" to the political trends that defend the Social-Democratic Model or the European Social Model.
14. Reported in *Le Monde*, 27 February 2004.
15. See the different dilemmas of social democracy presented in Kitschelt (1999). Notably, the strongest themes for winning over a party are not necessarily the ones that will bring electoral victory.
16. See Amable and Palombarini (2004) on the links between institutional changes, depoliticization of the debates and the omnipresence of moral philosophy.

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