

## **A Little German Reform Would Go a Long Way**

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The major economies of the European Union have performed poorly since the early 1990s. They suffer from high unemployment and slow growth in productivity. Still, most governments, intellectuals, and economists until recently denied the need to introduce major reforms. This is why a public appeal made this summer by 300 economists, most of them German, for extensive reforms in labor and other markets is a noteworthy event. Practically all the better-known German economists signed on, including Reinhard Selten, the nation's only Nobel prize winner in economics.

They argued that Germany needed to relax the regulations for layoffs, reduce sharply the maximum duration of unemployment benefits, abolish incentives to retire early, increase competition in the health sector to lower the cost of medical coverage, and reduce public expenditures so taxes become less onerous. They concluded: "Nothing less than the future prospects of this nation will depend on the successful outcome of the current reform process."

I have been advocating these policies for over a decade because the present system discourages companies from hiring and reduces the incentives for unemployed people to seek work. I have also suggested a weakening of nationwide collective bargaining by unions and a movement toward local bargaining. National bargaining makes it difficult for companies in high-unemployment regions, such as eastern Germany or southern Italy, to lower wages and attract jobs.

Europe's inefficient regulatory and tax policies have discouraged investments that help improve productivity. A comparison with the U.S. shows that America's output per hour from 1995 to 2000 grew considerably faster than did Europe's -- 1.97% per year vs. 1.42%. This gap has widened in the past three years. American productivity improvement accelerated to 2.5% per year, exploding during the third quarter of 2003, to more than 8%, while Europe's actually slowed, to 0.89%.

Throughout the 1990s, leading Europeans generally attributed their mediocre economic performance to a recession in world demand, to new technologies that reduced the number of possible jobs, to Europe's greater concern for the unemployed and elderly, and even by some to excessive immigration. They vociferously opposed copying the "Anglo-Saxon model" of Britain and America with its (relatively) flexible labor markets, less generous benefits to the unemployed, later retirements, and smaller role for unions.

Such opposition may explain why even the conservative governments of Germany and France did little to improve economic policies. Helmut Kohl, during his long tenure as German Chancellor from 1982 to 1991, made only halfhearted efforts to reform, while French President Jacques Chirac has not rolled back the 35-hour workweek passed by the socialist government that preceded him.

In his first term as German Chancellor, Social Democrat Gerhard Schröder, also opposed major reforms. A year ago, however, Schröder did an about-face and opted for reform of the state pension system, expansion of part-time work, cuts in jobless benefits, and other long-overdue changes leading to greater flexibility. Much more should be done, but these are important initiatives toward improving the German labor market. These initiatives stimulated strong protests from trade unionists and the left, including members of Schröder's own government. A rally against reforms in Berlin drew 100,000 demonstrators.

The economic picture in Italy is no better. The government of Prime Minister Silvio Berlusconi is aware of the need to shake up the economy, but even his modest proposals for changes in the state pension system and labor regulations have generated strikes and even violence. The Italian police recently arrested members of a radical group for the murder of two economists who supported labor market reforms. Spain has moved further than the other larger nations of Western Europe toward liberalization, but it still is a considerable distance from the British and American models.

Germany has led Western Europe since its economic miracle after World War II. If Germany does overcome the opposition and introduces reforms to reduce unemployment and raise productivity, many other nations in the European Union will surely follow. Then Europe will wake up from a long slumber -- and may begin to perform up to its capabilities.