Free Markets versus Political Consensus

The International Competitiveness of Societies

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The debate on international competitiveness in recent years has increasingly focused on the structure of society. International competitiveness is seen not merely as a sign of a country's productive capacity, but also as reflecting the efficiency of its social and political structures. The following article examines the five most important western industrial nations in an attempt to answer the question as to which models of society are internationally competitive.

The economic crisis has made international competitiveness a prime concern of economic policy for countries everywhere. This new priority reflects not only the greater internationalisation of national economies but also an intensification of global rivalry over the distribution of growth. The view that the world economy is a hierarchical system, or even a zero-sum game, is gaining ground.[1] Since the mid seventies a growing body of works on the international competitiveness of individual countries has appeared.[2]

In this context, we do not construe international competitiveness as meaning the ability to offer goods and services particularly cheaply, in other words at low cost and hence with low factor incomes in the exporting country.[3] Such a notion swiftly leads to the paradox of demanding a cut in incomes in order to raise the country's international competitiveness while at the same time asserting that this will increase national income.[4] This applies typically to the case of (short-term) current account deficits and the measures designed to correct them.

Instead, international competitiveness as a meaningful economic policy objective over the long term should be defined as the long-term stabilisation or maximisation of real domestic factor incomes when expressed in international currencies.[5] As such, it depends on the supply of factors of production, the productivity of factor inputs, qualitative competitiveness (punctuality and customer service, for example) and the regional and sectoral pattern of foreign trade.[6] The most important element is productivity, which in turn depends not only upon efficiency at company level but also upon structural flexibility on the part of the economy, which must be able to adapt quickly to changes in the world economy. This requires factor mobility and generally also necessitates a high overall investment ratio.

Political and scientific analysis has focused increasingly on the structure of society in the course of the debate about international competitiveness. There has been a renaissance of classical political economy, which seeks the causes of the wealth of nations in their social structures, including the economic system in the narrow sense.[7] International competitiveness is not

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[1] Cf. M. Dauderstädt, A. Pfaller: The New Zero-Sum World. International Competition and Global Economic Growth, Bonn 1985; and A. Pfaller (ed.): Der Kampf um den Wohlstand von morgen. Internationaler Strukturwandel und neuer Merkantilismus, Bonn 1986.

[2] For the USA, see A. Bolling and J. Bowles: America's Competitive Edge. How to Get our Country Moving Again, New York 1982; J. Baranson: The Japanese Challenge to US Industry, Lexington and Toronto 1981; US Department of Labor: Study of US Competitiveness. Study of Export Trade Policy as Mandated in Section 1110 of the Trade Agreements Act of 1979, Washington 1979; J. Zysman, L. Tyson: American Industry in International Competition. Government Policies and Corporate Strategies, Ithaca and London 1983; for the EC, see P. Uri et al.: Bericht über die Wettbewerbsfähigkeit der Europäischen Gemeinschaft, Brussels 1971; Commission of the European Communities: The Competitiveness of the Community's Industry (III/378/82), Luxembourg 1982; for France, see R. Courbis: Compétitivité et Croissance en Economie Concurrencée, Paris, Brussels and Montreal 1975; A. Cotta: La France et l'Impératif Mondial, Paris 1978; C. Stoffaës: La grande Menace Industrielle, Paris 1978; for the Federal Republic of Germany, see D. Orlowski: Die internationale Wettbewerbsfähigkeit einer Volkswirtschaft. Konzeptionelle Grundlagen und empirische Messung einer wirtschaftspolitischen Zielgröße, Göttingen 1982; K. P. K. Kriegsmann and A. O. N. Neu: Globale, regionale und sektorale Wettbewerbsfähigkeit der deutschen Wirtschaft, Frankfurt and Berne 1982, or the economic research institutes' reports on the structure of the economy in 1980.

[3] Orlowski calls these definitions "enterprise-oriented concepts of international competitiveness" and criticises them aptly. See D. Orlowski, op. cit., pp. 9-62.

merely a sign of a country's productive capacity, it also reflects the efficiency of its social and political structures.

The renaissance of the classical approach also had an ideological bias. A large proportion of the literature assumed that free market systems were superior. State intervention in general, the welfare state in particular, strong trade unions or labour market regulations favouring the workers were held globally responsible for the crisis and for the decline in individual countries' international competitiveness.[8] Claims about the sclerosis of Europe or Germany's self-doubt at the time of the current account deficit from 1979 to 1981 are particular manifestations of this general theme.[9] Amazingly, Japan was presented in this context as a model society,[10] even though it is clearly not a typical market economy, as will be seen below.

So which models of society are in fact internationally competitive? To cast more light on the subject, let us examine the social aspects of the following three determinants of international competitiveness:

- the structure of capital allocation;
- the structure of industrial relations; and
- the welfare state.

All three factors have a fundamental effect on a country's adjustment to changing world market conditions and have been at the centre of the debate about international competitiveness. The role of these three sub-systems in the five most important western industrial countries (the USA, Japan, France, the United Kingdom and the Federal Republic of Germany) will be described briefly before we attempt to draw conclusions regarding the central issue, namely which social models are internationally competitive. Only occasional reference will be made to studies involving countries other than these five.

Capital Allocation

Structural change presupposes factor mobility; in that context, let us first examine capital. Capital allocation is determined by the interplay of the state, the banking sector and firms. In addition, all three sectors move capital to and from abroad, the net effect of which may be to reduce or increase the volume of capital available in the domestic economy. The business sector is crucially important for international competitiveness. Firms finance themselves partly from retained funds and partly by raising bank loans, issuing bonds and

[4] If such a reduction in costs is brought about direct or by devaluing the currency, it can indeed cause sectors with a low value added to remain competitive and thus viable. This phenomenon is the basis of the theory that the Federal Republic of Germany is overindustrialised because of the undervaluation of the Deutsche Mark; see K. W. Schatz: Wachstum und Strukturwandel der deutschen Wirtschaft. Analysen und Prognosen, Kieler Studien No. 128, Tübingen 1974; H. Riese: Strukturwandel und unterbewertete Währung in der Bundesrepublik Deutschland. Bemerkungen zur theoretischen Position des Instituts für Weltwirtschaft Kiel, in: Konjunkturpolitik, Vol. 24, No. 3, 1978. The converse is true in the context of the de-industrialisation debate with regard to the United Kingdom, a country with an overvalued currency on account of oil; see S. Blackaby (ed.): De-Industrialization, London 1978.

[5] Cf. D. Orlowski, op. cit., pp. 70 ff.

[6] Cf. D. Orlowski, op. cit., p. 85.

[7] For the foremost proponent of this view, see M. Olson: The Rise and Decline of Nations. Economic Growth, Stagflation and Social Rigidities, New Haven and London 1982; with regard to the debate in Germany, see J. Z. Zerche and M. D. Daubenbüchel: Sozialordnung und Wettbewerbsfähigkeit, in: Wirtschaftsdienst, No. 10, 1982; H. Besters (ed.): Internationale Wettbewerbsfähigkeit bei unterschiedlichen Sozialordnungen – USA, Japan, Bundesrepublik Deutschland, Baden-Baden 1982; M. Dauderstädt: Social Consensus and International Competition. A German View, Bonn 1983; M. Dauderstädt (ed.): Pluralismus unter Konkurrenzdruck, Analysen aus der Abteilung Entwicklungsländerforschung der FES, No. 101/102, 1982; and M. Dauderstädt: Societal Consequences and Condition of a Free Trade Regime, in: G. S. Sjöstedt and B. S. Sundelius (eds.): Free Trade – Managed Trade. Perspectives on a Realistic International Trade Order, Boulder and London 1986.

[8] As examples of many other works, see World Bank: World Development Report 1984, Washington, p. 1; and D. Lal and M. Wolf (eds.): Stagflation, Savings and the State. Perspectives on the Global Economy, New York 1986, pp. 4 f. For a theoretical treatment, see M. Olson, op. cit.

[9] See IMF: World Economic Outlook 1985, pp. 8 ff.; B. Nussbaum: Das Ende unserer Zukunft, Munich 1984; or O. Wolff von Amerongen: Die Konkurrenz im Nacken, in: Grenzen der Wettbewerbsfähigkeit, DIHT 200, Bonn 1982; and O. von Lambsdorff: Konzept für eine Politik zur Überwindung der Wachstumsschwäche und zur Bekämpfung der Arbeitslosigkeit, 9. 9. 82 (Bonn).

[10] With regard to Germany, see for example special issue No. 6/81 of WSI-Mitteilungen on the "Japanese model", or H. Besters, op. cit.

increasing their equity capital through share issues, but a further part of their resources may come from state subsidies and loans. The proportions differ widely from one country to another. When comparing, one must also take account of the fact that sections of the banking and business sectors have been nationalised in many countries, so that their financial dealings one with another are no longer autonomous.

Table 1 shows the financing patterns that are to be found.

Table 1
Debt/Equity Ratios of the Non-financial Corporate Sector[1]

	1966-73	1974-79	1980	1983	1984	1985
United States	0.54	0.96	0.77	0.78	0.90	0.83
United Kingdom	0.67	1.38	1.13	0.87	0.74	0.70[b]
France	1.17[a]	1.33	1.23	1.56	...	...
Japan	3.08	3.31	3.14	2.68	2.11	1.82[b]
FR Germany	2.38	3.36	3.85	3.48	3.42	2.39[b]

[1] The technical footnotes given in the source documentation have been omitted, since it is the qualitative findings that concern us here.

[a] 1970-73; [b] estimated.

Source: Bank for International Settlements, Fifty-sixth Annual Report, Basle 1986, p. 70.

There is a clear distinction between the United States and the United Kingdom on the one hand and France, Japan and Germany on the other. Whereas the former display a relatively high level of self-financing among non-financial enterprises, which raise funds mainly by issuing securities, the business sector in the other three countries is more heavily reliant on external finance. If one also bears in mind that the banking sector is largely state-owned in France and highly regulated in Japan, the capital allocation model is that described by Zysman[11] and reproduced in Table 2.

Crises in individual companies or sectors well illustrate the capital supply process, but so too does the promotion of technology-intensive industries. In problem sectors such as steel or motor vehicles[12] the patterns outlined above are confirmed, but the distinctions are less clearcut. Where technological competition is concerned, there is a general tendency for the state to provide subsidies, despite structural differences.[13]

Table 2
Capital Allocation Models

	Financial System	Model of Adjustment
Japan, France	credit-based with administered prices	state-led
USA	capital market	company-led
UK	capital market	unclear or ambiguous
FR Germany	credit-based, bank-dominated	negotiated

Source: J. Zysman: Governments, Markets and Growth. Financial Systems and the Politics of Industrial Change, Ithaca and London 1983, p. 287.

In the USA direct government intervention is rare, but not impossible, as demonstrated in the case of Chrysler, where the government guaranteed large loans, thereby facilitating the successful modernisation of the company. Trade measures are also used to improve the profitability of the car and steel industries, which finance modernisation mainly from their own resources.

The capital market, and especially the market in venture capital, is an important source of funds for growth industries in the USA, although the development of advanced technology also receives massive government support via the armaments budget. It is for this reason that the figures on subsidies in the USA appear to be so low (less than 0.5 % of GNP in the seventies).[14]

In the United Kingdom some of the industries in crisis are in state ownership. They have received substantial amounts of government funds (British Leyland, for example, has received more than £ 2.3 billion since 1975), although the Conservative government of Margaret Thatcher is persevering with its efforts to reduce them to viable proportions. Nonetheless, subsidies amounted to between 2 and 3% of GNP between 1975 and 1980; part of this was used to promote research and development.

In the Federal Republic of Germany it is primarily the coal and steel industries, and to a lesser extent the car industry, that are no longer able to modernise by their own efforts. Rescue plans for the declining industries have entailed the state and the banks providing capital or guarantees; the trade unions have also been involved, helping shape the modernisation programmes and easing their impact on the workforce.[15] Advanced

[11] This section on capital allocation is based on the important work by J. Zysman: Governments, Markets and Growth. Financial Systems and the Politics of Industrial Change, Ithaca and London 1983.

[12] These remarks are based on the proceedings of the international conference on "Sectoral Crisis Management in Europe and the USA", summarised in J. E. Esser and R. S. Staudthammer: Zwischen Gesundschrumpfen und Modernisieren. Industriepolitik in Krisensektoren, Bonn 1985.

[13] See G. Junne: Der strukturpolitische Wettlauf zwischen den kapitalistischen Industrieländern, in: Politische Vierteljahresschrift, Vol. 25, No. 2, 1984, pp. 134 ff.

[14] Figures on subsidies as a proportion of GNP in the five countries under examination are taken from "Le rôle du secteur public", in: OECD: Revue Economique d l'OCDE, No. 4, 1985, p. 73.

[15] See J. E. Esser, W. F. Fach and W. V. Väth: Krisenregulierung. Zur politischen Durchsetzung ökonomischer Zwänge, Frankfurt 1983.

technology is promoted by the Federal Ministry for Research and Technology and all the Länder. Subsidies total just short of 2 % of GNP; the centre-right coalition that has been in government since 1982 has barely reduced them, despite intentions to the contrary.

In France, where the banks and the bulk of the sectors in difficulties are state-owned, problem industries receive massive inputs of capital in the form of state aid and bank loans. The same is true of growth industries, which again include a number of state-owned enterprises, such as Thompson. Subsidies amounted to more than 2 % of GNP in recent years. Furthermore, among the major EC member states, France is the country most inclined to resort to protectionism to safeguard the profitability of its own manufacturers, as in the case of imports of Japanese video recorders.

In Japan the state provides fewer subsidies but organises modernisation via MITI by means of competition and trade policy measures. In problem sectors, such as coal mining, subsidies definitely play a role, alongside officially set prices and purchasing requirements. Banks provide a large proportion of business finance, particularly within the major corporate groups (zaibatsus), which are mostly grouped around a bank; at the same time, state regulation of the capital market is strong. This picture applies to problem and growth industries alike, although state promotion predominates in the field of R and D, as in the case of the programme to develop the fifth generation computer, a project that is highly respected in the West. Subsidies amount to well under 2 % of GNP.

The Labour Market and Industrial Relations

The pattern of state-inspired capital allocation examined above is partly motivated by employment considerations, particularly in declining industries; the aim is to safeguard jobs by maintaining the status quo or overhauling industries facing collapse. A society's capital supply model is therefore always at least one element in the "employment provision model", which we shall now examine, concentrating on the role of the trade unions.

In all of the OECD countries, the five largest of which are at the centre of this study, the labour market is primarily governed by market forces. However, in view of the strongly political nature of the market and the consequent prevalent state regulation of the employment field (unemployment insurance, legislation on strikes, protection from dismissal and, in some countries, incomes policies), the operation of the market is essentially a social and political phenomenon determined to a high degree by the manner in which workers and employers are organised.

There are three areas in which the behaviour of the workforce influences a country's success in international competition:

☐ Industrial productivity: the introduction of new products and especially new production processes in a plant depends on the willingness of employees to accept redefinition of their duties, to retrain and/or to change jobs. Industrial partnership, ranging from worker participation in management in Germany to the Japanese "quality circle", is essential if changes leading to an increase in productivity are to be implemented, particularly if they involve a loss of jobs, whether by "natural wastage" or enforced redundancy.

☐ Structural change at sectoral level: if unemployment is already high, it may not seem necessary to slim down or close old industries that are no longer competitive in order to provide labour for new growth industries. However, the declining industries may be tying up other scarce production factors, such as capital or

Table 3
Industrial Relations

	Degree of unionisation, percentage	Days lost through strikes, per 1,000 workers	Income distribution[b]		Year
	Average for 1965-80[a]		1st quintile	5th quintile	
USA	21.4	400.4	50.3	4.6	78
UK	44.9	329.3	39.7	7.0	79
FR Germany	31.5	11.6	39.5	7.9	78
France	23.9	150.9	46.8	5.3	75
Japan	16.4	69.1	36.8	8.7	79

[a] Source: D. R. Cameron: Social Democracy, Corporatism and Labor Quiescence in Advanced Capitalistic Society, paper prepared for the Social Science Research Council Conference on Order and Conflict in Western Capitalism, Buchenbach bei Frankfurt, 1983.
[b] Source: World Bank: World Development Report 1984.

Table 4
Productivity Growth
– in % –

	1965-73	1974-82	1983	1984	1985
USA	2.1	0.0	3.3	0.8	–0.6
UK	2.6	1.1	9.6	2.9	3.8
FR Germany	4.3	2.2	7.6	4.8	3.2
France	4.9	2.3	2.9	3.6	2.6
Japan	8.4	3.0	9.8	8.3	1.3

Source: for 1965-82, Bank for International Settlements: Fifty-fourth Annual Report, Basle 1984, p. 23; for 1983-85, Bank for International Settlements: Fifty-sixth Annual Report, Basle 1986, p. 17.

government budget resources. The closure of uncompetitive firms generally runs into bitter opposition from the workforce; modernisation is therefore greatly facilitated if the trade unions are willing for crises to be managed by consensus.

☐ A responsible approach to the distribution of national income: this affects international competitiveness in two ways. First, it engenders price stability and hence price competitiveness vis-à-vis foreign competitors that would otherwise have to be achieved by means of devaluation, which may potentially lead to inflation and a wage-price spiral. Secondly, it increases corporate profits, and hence the scope for the self-financing of investment. Entry to new growth industries undoubtedly requires such investment, although it could also be financed from external sources, such as the savings of wage-earners if wages are high.

In all sectors, the success of industrial adjustment strategies is determined by the scale of trade union activity, the "style" of industrial relations and the legal framework.[16]

Clearly, there are also marked national differences in the system of industrial relations, as Table 3 shows.

These data on industrial relations must be compared with the figures on the economic success of the various countries, which are shown in Table 4.

National Peculiarities

Industrial relations in the USA tend to be confrontational and the trade unions wield little power, except in certain industries. Industrial democracy is virtually non-existent. The US labour market is regarded as a highly flexible market in which employers are quick to fire but equally quick to hire and where the real wage level adjusts rapidly. Nevertheless, there is a time-lag before wages adjust in highly unionised industries and firms, where multi-year labour agreements are common. The very uneven distribution of income testifies to union weakness. On the other hand, low wages are partly to blame for the smaller degree of rationalisation by comparison with other countries (lower capital/labour substitution) and hence the smallness of productivity gains.

In the United Kingdom the trade unions are much stronger, although their power has diminished considerably since 1980. Industrial relations are highly confrontational, owing mainly to the strong fragmentation of the unions in occupational groups. Their resistance to change is regarded as one of the main causes of the decline of the British economy; see the figures on productivity growth, for example.

In the Federal Republic of Germany the trade unions are mainly industry-wide unions with corresponding responsibilities at sectoral and macro-economic level. Worker participation in management at company level requires and facilitates the co-operation of employees when changes are foreseen within the firm. Both of these factors have helped keep industrial disputes at a much lower level than in other industrial countries. One consequence was the satisfactory increase in productivity, another the more egalitarian distribution of income.

France has three large, politically oriented trade union confederations. Industrial relations are confrontational – *vide* the poor income distribution – although the unions do have some say in macro-economic planning.

The Japanese trade union movement is very weak. Worker representation operates mainly at company level, and even then it is very compliant. Life-long employment, the bonus system and other mechanisms mean that workers identify closely with the fortunes of the enterprise, with correspondingly positive implications for productivity. This picture applies mainly to large, modern industries, however; very few workers in traditional small and medium-sized industrial firms are members of unions.

Until the end of the seventies, the countries with industrial relations based on co-operation had the edge in international competition. The Federal Republic of Germany and Japan, and to a lesser extent France, modernised their economies faster[17] and recorded higher productivity growth than the USA and the United Kingdom. The workers and trade unions played a part in this process and reaped the benefits in the form of higher wages and, in Germany and Japan, a better distribution of income.

The reasons are to be found at all three levels of influence mentioned above:

☐ At company level, the consensus-based models of worker participation (Germany) and co-operation (Japan) enabled high productivity gains to be made. Since demand was buoyant, this had little adverse effect on employment; the productivity gains that were not absorbed in profits or passed on to customers in the

[16] See R. Czada: Konsensbedingungen und Auswirkungen neokorporatistischer Politikentwicklung, in: Journal für Sozialforschung, Vol. 23, No. 4, 1984, pp. 421 ff.

[17] See R. Czada: Zwischen Arbeitsplatzinteresse und Modernisierungszwang, in: H. Wimmer (ed.): Wirtschafts- und Sozialpartnerschaft in Österreich, Vienna 1984, p. 148.

form of price reductions were passed on to employees in the form of wage rises and reductions in working hours, and affected income distribution and strike behaviour accordingly.

□ Against the background of full employment, there was little resistance to structural change at sectoral level. Unlike their British counterparts, in particular, the German trade unions did not set their sights on protecting the interests of dying occupations but on maintaining the competitiveness of the industry as a whole.

□ Finally, at national level the industry-wide trade unions were better able to win their demands for a corporatistic management of economic activity – and especially of prices and incomes policy – that safeguarded real wages without having inflationary side effects. As a result, industry remained competitive against countries with higher rates of price increase without detriment to domestic purchasing power.

The picture seems to have changed since those days; productivity growth has accelerated somewhat in the USA and especially in the United Kingdom. Although it is difficult to be certain as to the cause, there are indications that the conservative and often anti-union policies of the Thatcher and Reagan governments have succeeded in breaking the shackles that were holding down productivity. Strong growth and the attractiveness of these two economies for international investors also seemed to suggest that greater reliance on market forces and confrontation produced industrial relations that were superior to the more state-led, consensus-based model.[18] This belief was prevalent in the crisis years of the early eighties, but by 1985 at the latest it had given way to a more sceptical assessment, supported by more recent figures on productivity trends. Moreover, the rise in wage costs in the United Kingdom, in particular, outstripped productivity gains.

Even on the employment front in the narrow sense the successes of more market-oriented, confrontational industrial relations carry little conviction. Real wage rigidity is worst in France and the United Kingdom, and even the USA has a worse record than Japan and the Federal Republic of Germany.[19] Jobs were created in the USA mainly because the US services sector is relatively unproductive (74.4% of the output per employee in industry, compared with 80.5% in Germany) and large (68.8% of total employment, compared with 53.4% in Germany).[20] But the services sector contributes little to international competitiveness.

The Welfare State

Finally, there is another variable that can be assumed to influence the adjustment of the employment system to the needs of an internationally competitive economic structure: government economic and social policy. Conservative critics of the welfare state often claim that state interference with market mechanisms impedes external adjustment; they assert that social policy in particular adversely affects labour mobility. It is also presumed that high ratios of government expenditure and taxation to GNP jeopardise growth and employment. On the other hand, there are those who argue the opposite, pointing to the complementarity of private and public investment in infrastructure and human capital or stressing that mobility is heightened by national social security systems, as opposed to reliance on family or local assistance mechanisms.

Government economic and social policies also differ widely in structure and scope among the countries under consideration, as Table 5 shows. Ranking according to the scale of state activities suggests a different order of countries than that based on the state's role in the supply of capital. Here Japan is the society with by far the lowest level of state involvement, followed by the USA, while all the European countries have much higher ratios of government expenditure and social security expenditure to GNP. Japan will probably continue to close the gap in this respect, however; social security expenditure grew more rapidly in Japan than in any other OECD country both between 1960 and 1975 and between 1975 and 1981.[21] Spending on pensions

Table 5
Public Expenditure and Social Security Expenditure

	Public expenditure[a] as a percentage of GNP		Social security expenditure as a percentage of GNP	
	1960	1982	1960	1981
USA	27.6	37.6	10.9	20.8
United Kingdom	32.6	47.4	13.9	23.7
Fed. Rep. of Germany	32.5	49.4	20.5	31.5
France	34.6	50.7	13.4	29.5
Japan	18.3	34.2	8.0	17.5

[a] At current prices.
Sources: "Le rôle du secteur public", in OECD: Revue Economique de l'OCDE, No. 4, 1985, p. 31; and OECD: Social Expenditure 1960-1990, Problems of Growth and Control, Paris 1985, p. 21.

[18] See W. Streeck: Neo-korporatistische Kooperation und weltwirtschaftliche Konkurrenz, in: M. Dauderstädt (ed.), op. cit., pp. 11 ff.

[19] According to an OECD study quoted in The Economist, Vol. 301, No. 7470, of 1. 11. 86, p. 76.

[20] See Bank for International Settlements: Fifty-sixth Annual Report, Basle 1986, p. 21. Figures on output relate to 1983 (USA) or 1982 (Germany); those on employment relate to 1985.