BANCA D'ITALIA

# Temi di discussione

## del Servizio Studi

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by Paul A. Samuelson

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## WHEREIN DO THE EUROPEAN AND AMERICAN MODELS DIFFER?

**Paul A. Samuelson** *

The 1950s and 1960s were a period of strong catch-up by Europe on America. It is not that we grew poorly here, but that the Common Market was able to narrow down our technical advantage in a way that had not happened after World War I. Then in the 1970s, productivity suddenly grew less fast all over the advanced world. Even Japan was no exception. Oil, harvest failures, and other supply shocks had, initially, to be part of the new story. But we cannot rule out simply an exogenous global deceleration of productivity growth that has persisted for the last quarter of a century at the frontier of technology.

Particularly in the 1990s economists in America have been surprised by how good or how lucky has been our macro performance compared to our peers abroad. We pinch ourselves and ask: "What went right?" And, by implication, authorities in Europe must be looking in their mirror and wondering: "Where had we been going wrong? What one fool can do, why can't another?"

All this gets overdramatized in the notion of two different macromodels: the Greenspan-Clinton Cadillac versus the EU-*Bundesbank* Mercedes-Benz. Thus, when I write for numerous Japanese newspapers I am wont to pen stuff like the following:

> Japan in the nineties has been the worst governed economy in the world. Endowed with strengths and reserves, it continues to endure an unnecessary stagnation. Maybe those law school graduates in the Bank of Japan and the Ministry of Finance should be forbidden to learn *Bundesbank* German and instead be made to bone up on modern intermediate macroeconomics and Volcker-Greenspan Congressional testimonies.

While Europe has attained and maintained two-digit rates of unemployment, in America there have been created tens of millions of new jobs. And for the most part this has not been bought at the expense of accelerating price inflation and a short-lived full employment.

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* Professor Emeritus, Massachussets Institute of Technology. Address delivered at the Bank of Italy, 2 October 1997.

## Pride Goeth Before a Fall

Wall Street has hypnotized itself into believing that America has moved into a new era of perpetual capital gains. We are told, the business cycle is dead. Stiff market competition can effectuate freedom from inflation. Corporate downscaling can contrive steadily-growing real profit rates. Applying a scalpel to government spending can swell the take of the private economy and at the same time invigorate the sustainable growth rate of the total social pie. The tides of prosperity will raise all the ships that deserve to rise. A disciplined government will want to balance its prudent full-employment expenditures with enough tax revenues to discourage the excess consumption that could crowd out resources from the capital formation needed in a progressive society. But fiscal austerity can be prevented from undermining job opportunity provided the Central Bank (the Federal Reserve in our case) pursues a dynamic golden mean between too-tight and too-loose credit policy. So goes the current Panglossian hype.

Let the reality principle sober down wishful dreams. As we experts best know how to measure real productivity in a modern services economy, there have been no 1990s miracles of productivity here in America; or in Europe; or in Japan. The only regions of current rapid per capita annual growth have been those where historically productivity had primarily been backward: by imitating affluent technologies and remedying educational shortcomings, some societies in Asia and Latin America have been able to achieve generation-length sprints of almost two-digit annual real growth; but no bicycle racer has yet been able to overtake the leaders and then proceed to continue the miracle pace undiminished.

Nor is there credible evidence that speculative markets have become free of crashes, panics, bubbles, or manias. Even the Growth Tigers, when blown by winds of animal spirits of confidence and despair and gales of currency over- and under-valuations, do experience at century's end *real fluctuations* comparable to those in the economic-history textbooks of the century's beginnings.

In short, it is a false dichotomy to contrast an American utopia with a European nightmare.

Nevertheless, the American model seems in the 1990s to behave quantitatively different from that typical in Europe. Today I want to give my explanation of what has become different. If anything my exposition will, for the sake of the argument, exaggerate the present differences.

I lay stress on two main factors, both new and neither one predicted in advance by any economists writing in the 1980s.

One. In America we now operate what I call The Ruthless Economy.

Two. In America we now have A Cowed Labor Force.

These two features are interrelated; but they nonetheless are somewhat distinguishable.

## The New RUTHLESS ECONOMY

America ended the 1920s as essentially pure Capitalism. I recall well this fact of my infancy and youth. But after the Great Depression and the New Deal, we went into and came out of World War II as a Mixed Economy -- a Welfare State much like Europe, Britain or even Sweden. America moved politically toward the Europe that traced its roots to Otto von Bismarck, Louis Napoléon, William Gladstone, and the young Winston Churchill.

The early editions of my *ECONOMICS* were written just before my teacher Joseph Schumpeter died in 1950. He changed his brilliant mind considerably in the 15 years I knew him, and broadly I believe he agreed with my 1948 picture of the Fortune-500 Corporations as possessing considerable "oligopoly power" both at home and abroad. They were not run by John Kenneth Galbraith's Technostructure, but neither were they run by owner-managers or majority shareowners. Berle-Means had corporate governance pretty much right in their 1932 classic book. Managers with negligible ownership were secure and fairly autonomous in their jobs and policies for the reason that non-cohesive minorities characterized corporate shareowner democracy.

Trade unions had been unimportant in the America of the 1920s, having a foothold only in some AFL crafts. But after the Great Depression brought in Franklin Roosevelt's revolutionary New Deal, the Fortune-500 elite corporations bought appeasement with their union and non-union workers by sharing some of the oligopoly rents with them. That is what was meant when my 1948 textbook first talked of good and peaceful industrial relations: while male blue-collar workers in manufacturing enjoyed superior real wages in large- and medium-size American companies which produced mostly only for our domestic market and who were secure in their hold on those markets.

To a remarkable degree by now our Fortune-500 companies have lost their absolute-monarch status within their niches. With the evaporation of their oligopoly power, these largest corporations have become constitutional monarchs who reign only so long as they do not autonomously rule. Why this change in basic economic structure?

The simple answer offered is that foreign competition has cut into the market power of the big three Detroit automakers; and into the power of U.S. Steel and Eastman Kodak. In the 1950s it was the Common Market miracles of European growth that impinged on America and -- according to that thesis nominating *foreign* competition as the prime mover -- later it was Japan and such Pacific Rim Tigers as

Hong Kong, Singapore, Taiwan, and Korea that eroded away the monopoly power of our largest firms.

The argument has merit; but it is overly simple to impute the change solely or even mostly to new *foreign* competition. Such a thesis, which is most persuasive politically to xenophobic protectionists, provides probably less than a third of the total explanation. *New competition at home in America accounts for most of the change I am describing.*

Steel rather than autos is most indicative. To start a fifth or ninth giant steel complex would have cost billions of dollars in the 1930s. That inhibited serious threats to oligopoly power. But when technology changed, so that small electric furnaces using steel scrap could operate effectively with non-union labor, oligopoly power rapidly evaporated. Similarly, when trucks were invented, hundreds of thousands of independent drivers took away much of the business of the regulated railways with their strongly entrenched union restrictions on productivity.

As we look into the new century ahead, foreign competition will come increasingly into its own as a prime shaper of domestic market structure. There are a billion Chinese and a billion Indians who still work for one-tenth the European and North American real wage rates. Using mobile modern know-how and effectuating education reform, their productivity can assuredly be brought to within 25 percent of the best in the West. The same might eventually be said for a quarter billion people in what used to be the Soviet Union and its satellites.

Under a regime of future free trade, how can such a vast evening up in effective GNPs fail to alter drastically *domestic* patterns of competition? America I discern has gone earlier and farther into the new global pattern than as yet France, Germany, and Europe have. Partly that is because, contrary to historical reputation, America is a less protective country than the European Union generally.

Let me make a hasty but important digression. Neither Europe nor America is likely to be able to succeed by policy use of autarkical protectionism in restoring real rates of GNP progress back to the growth paces of the 1950s and 1960s. Economic history suggests -- it can never prove anything -- that going the route of isolationism and autarky hurts rather than helps the trend of average national affluence and of average real wages.

Now I return to the subject of the new Ruthless Economy. Worldwide there has been a trend back from an unlimited welfare state. Margaret Thatcher in Britain was an extreme case. But the same story applies in post-Reagan America and in most of Western Europe. Even Scandinavia, Australia, and New Zealand have been finally forced into more reliance on the market mechanism.

I am known as a do-gooder. But experience has persuaded me to speak of the *Limited* Welfare State, which knows it must ration the less-than-50-percent of the

GNP that can be efficiently made available for transfer-tax payments which mitigate the inequalities certain to be meted out by a market mechanism lacking in both heart and integrated brain.

One way to move toward the market is through privatization and deregulation. No longer can American unions count on the Federal Government as an ally that will by legislative force prevent corporations from breaking strikes by denying them the right to replace strikers *permanently* with willing non-union recruits. Under prevailing regimes of competition, short-run union victories are at the cost of more rapid decay of former comparative advantage.

**Downscaling and the Economics of Running Scared**

What is the result of the new competition and the shift of middle class voters toward the Right? In America we have witnessed the emasculation of trade unionism. At age 80 I came to see again what used to prevail when I was eight: few union members and scarcely any economic power possessed by collective bargaining and organized labor.

Time is scarce. Still I have to mention that nowadays corporate takeovers, mergers, and split-ups are epidemic. The CEO's of today know they can be fired tomorrow. And so it is down the line.

In the old days if you were an educated male in the corporate management bureaucracy, effectively you had lifetime tenure. As you aged and grew tired, your paycheck rose! All was supposed to even out on a lifetime basis, not on a month-to-month or year-to-year productivity basis. Berle-Means patterns of autonomous managers today seem gone forever. The gasoline that enables corporation raiders to run their races is, often, that they cast off corporate obligations toward employees' benefits and job security. This explains massive downscalings.

Here is the perfect example. American Tel & Tel announced its split up into three separate companies. 40,000 employees are to be discharged. The stock market reacted by sending AT&T shares way up in price. Was it bad public relations to announce, along with the downscaling news, an increase of CEO's salary by millions of dollars? Main Street cared, but Wall Street didn't. This is the same AT&T that used to be regarded as the quintessential utility monopoly with the most bureaucratic of executive hierarchies.

In the Ruthless Economy all of us feel a new anxiety. At age 55 even we Harvard Business School elite graduates may be retired with short notice. And maybe we'll never have another job unless we eventually condescend to be an assistant manager at a McDonald's fast food restaurant.

## Explaining New American Macroeconomics

Most of what I have been talking about you would put in the category of microeconomics. That was not Maynard Keynes's specialty. But I have been Machiavellian in my exposition. My purpose has been to help you understand our sea change in *macro*economics since about 1975-1980.

When I spoke of more than 30 million new U.S. jobs net since then, did you think I was boasting and was being complacent? Let me set the record straight. The new jobs that Americans have been winning have tended to be *mediocre* rather than high-paying jobs. Average take-home wages have been more-or-less stagnating if not falling since 1977.

Inequality has increased in America since 1980. Property owners have gained a bigger share of the fruits of progress than have workers, especially unskilled and poorly-educated workers who lack human capital. Mind you, under the hypothesis I have been spelling out, these property profits and capital gains have not been the rents of monopoly and oligopoly positions. *Au contraire,* as we say in English. The perfection of competition has if anything improved. With the speed of light, computer-driven trading does arbitrage away many temporary aberrations attributable to ignorance.

Just when technological and market-structure trends exacerbate inequality, the political swing to the right reduces the mitigating income transfers from the state. That is positive fact and not normative complaint. There is even a sniff of paradox in the fact that, when the people need social insurance most, there is less of it available. And there will be even fewer safety nets in the future.

The overall share in the GDP of government programs does not yet fully reflect this basic change. That is because the entitlement programs for old age pensions and medical care legislated in the past become automatically ever more costly as the population ages demographically and as scientific medicine becomes ever more elaborate and successful while at the same time being released from rationing by the purse.

## America's Cowed Labor Market

The United States had its bouts in 1950-1980 with stagflation and cyclical fluctuation. I used to envy Germany its "Phillips Curve" and wish that we in America could better avoid our wage-price price-wage spiral. Now the shoe pinches on another foot. I am happier in the 1990s with the mechanics of our labor market than with those of Europe.

Earlier I spoke of the Ruthless Economy. And of the trend back toward the market and toward limits on the Welfare Transfer State. Now I need to analyze what might be called our Cowed Labor Market. Paul Krugman speaks of America's *Intimidated* Labor Force. My stress, rather, is on how cowed and uncertain income receivers have become, and not on some powerful bosses who can now exploit or intimidate them. The employers race in the same rat run, too. Ruthless competition, which constantly demands, "What have you done for me lately?" is what puts all of us into a kind of visceral anxiety.

Employers in America are tougher in bargaining, hiring, and firing than they used to be. Human charity and altruism is not what has changed. Rather it is this: when you lack oligopoly power, continuing to follow your heart rather than head in human relations is a sure recipe for a short life of benevolence. After you have tapped away at shareowners' wealth, the market action will have moved elsewhere anyway. Under modern market competition, social Darwinism is not a creed; nor it is public relations apologetics. Rather it is a reality.

As a humanitarian I lament that the markets for blue-collar, white-collar, and professional workers do not clear at full employment widely-shared real wage rates and benefits that are nicely rising. But still I would rather have people accept the so-so jobs that can actually be there rather than hold out for the better jobs that are just not there.

I give much causality credit for a decade of successful Federal Reserve monitoring of the real U.S. economy, not primarily the brilliance and wisdom of Paul Volcker and Alan Greenspan, or their expert and informed back-up experts. We have indeed been lucky in them. But what basically has mattered most is this fact about macroeconomic analytics. It is easier to control tolerably well an economic system that approximates better toward Say's Law than to accomplish this with a system characterized by structural rigidities. I am not talking about modern Lucas dogmas concerning applicable rational expectationism. The post-1978 economic history speaks against *ex post* confirmations of *ex ante* speculations by that School. I speak rather of our non-Europe-like institutional model in which Americans will largely accept modest market-clearing wage rates rather than stay unemployed while relying on welfare-state transfer payments. *That* kind of New Classical Paradigm, while we have it, defangs the stagflation paradoxes that no central bank can cope with well.

**The Europe That Is Not American**

I do not believe that Germany or France or the typical EU country has as yet arrived at the American pattern I am describing. There unemployment remains just above high one-digit levels for a long time. Long-term European unemployment does not erode. Up to forty percent of French youth lack jobs, and a quarter of them have done so for a long time. The Spanish picture is even worse: redundant labor of one in five has no potency to hold down wage rates for the lucky minority who are accorded absolute seniority and freedom from layoff. By contrast almost any American can be laid off on limited notice, and many are learning this every day the hard way.

Of course, all Europe is not homogeneously alike in a pattern that never changes. Post-Thatcher Britain does seem a bit closer to the U.S. paradigm and has done better than most. In Denmark, we are told, workers can be laid off and sometimes even with trade union assent. The comprehensive Dutch welfare state, it seems, is beginning to scale down. As Sweden tries to squeeze down its high marginal tax rates, it still remains true that almost all its net new jobs since 1970 have been in the public sector, with the expected adverse effects on measured per capita real-income growth.

It is part of my informal thesis that there will be some future convergence of Europe toward the new American pattern. And as I will explain in my later doubts about Greenspan's benign monetary-policy neglect, America may begin to lose its closeness to a quasi-Say's Law economy.

## Why I Suspect Greenspan Is a Bit Too Loose

I want to conclude this initial discussion of America's key differences with Europe -- our ruthless competition and cowed labor force -- with an application of it to the big issue of contemporary Fed policy. The Greenspan Federal Reserve, without using the language of "fine tuning," has since 1990 been contriving a *tour de force* of successful leaning against the wind which has kept America on a soft landing.

Greenspan tightened credit in late 1987 when we were growing too fast. When that was the trigger which burst the stock market bubble all around the world, Greenspan took a page from Walter Bagehot's 19th century book and went from Zag tightening to Zig loosening. When that in turn worked well and finally even too well, it was back to Zag tightening and the mild-cum-short Gulf War Recession. An early dose of Zig loosening then brought the U.S. out of recession promptly and long before either Japan or Europe. Now, ever since a brief 1994 tightening, Fed inaction has coincided with ever-lower unemployment and no worse inflation. The conservative Alan Greenspan was following neither the Milton Friedman nor the Robert Lucas prescription but something he was doing was working well.

Why then since the summer of 1996 have I, an old-time Keynesian and bleeding heart do-gooder, been advising Greenspan *et al.* to be tightening credit a little bit? It is because I know we are *not* in a new paradigm in which the business cycle is dead. It is because I am interested in a 5-year horizon and must consider it a bad bargain to let too fast growth lower unemployment for the next year or two but at the expense of killing off the running-scared economy which conduces to longterm growth-cum-price stability and which I diagnose to be a fragile flower that will self-destruct under over-full-employment job opportunity.

Yes, I applaud using inflation acceleration as a signal for monetary tightening. No, I cannot agree that here-and-now inflation or incipient inflation around the corner are the only signals that warrant monetary tightening. Even a steady price-level economy will still be subject to real business cycle fluctuations; if we use up now a bucket of capital formation needs, there may well be later a dearth of such needs. And this even if the inflation bell has never sounded a serious warning. To be sure future interest rate reductions can staunch the retreat of investment and the hemorrhaging of job opportunity. But heroically successful future fine-tuning, ancient and recent economic history tells, is not something good policy will want to have to count upon.

I come into the court of monetary controversy with clean hands. If I turn out to be wrong in advocating some tightening, and that turns out to entail incipient recession weakness, I will be the first to counsel Greenspan *et al.* to reverse their helm. It is good optimal control to tack to the wind and from the wind, and this is not the sign of an indecisive and empty mind. "Steady as you go, stay the course, " is the worst slogan a central bank governor could operate under. Only under the most singular and rare scenario could a Friedman-rule of frozen rate of growth of an $M_{17}$ money supply be optimal by coincidence. Nor is it a second-best or tenth-best strategy for creating minimal longrun squared deviations from high unemployment-cum-tolerably stable price levels.

My genuine fear is that America's near-to-Say's-Law temporary phenomenon is a *fragile* condition that will erode when inaction tolerates shortrun vigor that won't be sustainable. Having said that, I must agree that so far the facts have not proved Dr. Greenspan to be wrong. I hope that it is *I* who will be proved to be wrong. For, what is my vanity next to the nation's welfare? But we must keep reminding ourselves that wishful hopes are not a safe basis for thoughtful social policy.

## Discussion

### Governor Antonio Fazio

Professor Samuelson, in your speech today you have given further evidence -- proof -- of a characteristic which impressed me very much when I first attended your classes at MIT, that is, the ability to descend from very highly theoretical "heavens" into earthly matters, with a great ability to understand and to give advice, of a very broad nature of course, on practical matters. I remember when you used to pass from aspects of theory to the GDP growth of that period. It was a period of new economic policy, so you explained to us how a theoretical model could be applied to explain what was happening. This is now taught in our universities, but when I was studying in the fifties in this country, there was a complete break between theory and practice. Maybe at the Bank of Italy not; at the Bank of Italy there has always been a good tradition in this respect. Perhaps at a certain moment there was too much insistence on practice. Probably there are very good theorists, but at a certain moment there was an excess of practice. Thank you very much, Professor Samuelson, for this exposé of your vision, not only of the U.S. economy but also of the European economy, and the world economy, and of some of its fissures with respect to one central aspect, which is employment and growth. Professor Samuelson will kindly reply if you have any questions and observations.

### Professor Mario Baldassarri

You said that you have suggested a little tightening of monetary policy in the United States with a view to having a higher growth rate in the long run. Now, what would you suggest in the meantime in Europe if in the next few months there will be an increase in interest rates in the United States? Should Europe react to American interest rates and to the strength of the dollar *or* should Europe follow a policy of benign neglect, letting the dollar go up and thus receiving a push to the European Recovery? I do agree with your suggestion to the Federal Reserve, but I am also very interested in knowing whatever suggestions you may have for the Bundesbank. Thanks.

### Professor Paul A. Samuelson

Well, I'm asked a very difficult question. What would I prescribe for Europe on the basis of the thinking I've been doing? Let me begin by saying that I believe most

American economists -- and this goes across the spectrum between the conservative economists and the liberal, in the American sense -- are a little bit skeptical about the importance of the European Monetary Union. Having said that, let me make clear that America's own interests are pretty much neutral. We have a floating exchange rate and if Europe wants to go that route -- and I believe you will be going that route -- as far as any political or economic interests of America are concerned, that's fine. If Europe chooses not to go that route, as far as those things in America are concerned, that is also fine. So we come into court as neutrals.

Second, I am not an expert but if is my guess that the Maastricht arrangement is going to start, if not in one precise month, not long afterwards. I suspect it would be a grave disadvantage to Italy if it were not in at an early stage, although being in at the *very* beginning is not so important. I think that's why the UK, which has mixed feelings on entering, would still not like to be left out. As I have been reading the commentary and some of the editorials -- I'm not speaking of the Italian press particularly but of *The Financial Times* and so forth -- there is a considerable likelihood that for the next few years the EU will be extremely old-fashioned and credibility-minded in their policies. They will say, "We don't want the European dollar, the euro, to be Gresham's-Law inferior to America's dollar, so we must be more Catholic than the Pope."

For a Europe, which has a structural unemployment problem of a two-digit level to, so to speak, condemn itself for the first five years of the next century to an over-austere policy -- that I think might be a pity. I am not preaching to Italy itself, because Italy's problem, of course, internationally is that it has a reputation as a bad boy, earned over many previous years. So Italy needs to wear a very clean, starched, white shirt, for a period of time and maybe be a little more austere. What I hope is that you will not forget Machiavelli, the patron saint of your own country, and that you will follow that role with a certain amount of measured duplicity, a duplicity which does not deprive you of your limited credibility. I believe there will be a macroeconomic opportunity in the next few years for Italy to be able to break away from the Bundesbank pattern in some limited degree; and, without losing your new temporary reputation and without re-accelerating inflation, to get a definite advantage with respect to employment opportunity so that your double-digit unemployment rate could move downward.

I ask you to contemplate and think about what Paul Volcker did in 1982. This is the Paul Volcker who engineered, by all kinds of Machiavellian policies, from 1979 until 1982, to break the back of America' s stagflation. He set us on the right course. We had two recessions -- the first one very mild -- back-to-back, within a year of each other. In the summer of 1982 Volcker saw that the recession was not ending when he thought it would; and he saw therefore in mid-summer a window of opportunity where, without unduly jeopardizing the gains on inflation, he could stimulate the recovery. America has had good luck -- there was an element of gamble in his move - but if you have to work with perfect certainty don't try to be a central banker.

Italy has some very strong characteristics going for it, such as your medium-sized, and small-sized, and even in some degree your underground economy. You won't have all the difficulties and will have some of the opportunities that France will not have. But you have to work within the framework of reality, of trying to be for a while in the European Monetary Union and trying to live down your former reputation.

Now, one last word. Why am I so neutral on EMU? It's not because I am neutral on the European Union itself. I think the EU is one of the greatest events in history. But what is important about the EU is not a Parliament in Strasbourg, or a new central bank in some geographical place. It is the freer trade within this vast, important area of the world and the freer mobility of resource movements. That's what you must not lose, even if EMU starts and after a few years a number of countries like the UK find themselves falling out of that bed again. The UK poet Lord Tennyson put it well: It can be better to have loved and lost than never to have loved at all. So it is with the new EMU: better to be in it, even if in the end you can't stay in it, or may not want to pay the price to stay in it. Nothing is for ever these days and especially in the new century to come. Thank you.

**Mr. Giancarlo Morcaldo**

You focused your explanation of the different performance in the recent past between the United States and the European countries mainly on two factors: competition and market structure on the one side and labor market flexibility on the other. There is a third factor that is often cited as playing an important role in these differences: the higher burden of taxation. What is your assessment of the role of taxation?

**Professor Paul A. Samuelson**

When I spoke of the *limited* welfare state I was touching upon that. When Sweden or the Netherlands begins to have 60-65% of the GDP passing through the hands of the government, experience seems to suggest that something happens to two things about the welfare state: 1) increasing inefficiency and 2) increasing non-responsiveness to the real needs of the populace. I take for granted that societies need to move towards a *limited* welfare state. Now, if you talk about the United States, some 30-35% of the GDP goes through the hands of government, and actually in the post-Thatcher post-Reagan era that is shrinking a little bit. But in debates between conservatives and center people and left-of-center people, I think what the macroeconomic effects of that will be is exaggerated.

When America was growing fastest in the post-World War II period, I was paying enormously higher marginal tax rates than I am now. You will get some increase in efficiency if you lower tax rates. But, if we can judge the testimony of studies of productivity growth -- by Angus Maddison, Edward Denison, the University of Pennsylvania's comprehensive studies -- you will not confirm what the radical right of Reagan said at the beginning of the 1980s. They said we would suddenly move to an enormously more rapid rate of growth of the social pie, so don't worry about the division of the pie because it will all filter down.

That's my main answer. But my answer to you is not an answer for an Italian classroom; it's an answer for a world classroom. (It's not that I keep two sets of books, one where I come to a country and learn what they want to hear and then I give them that version.) But there's nothing to be said for the past Italian system where much of the government expenditure is inefficient, a lot of it has been corrupt, and where the entitlement programs make very little sense. This is a nation which is about to go through a demographic sea change -- there are no babies, no *bambini,* that I see in Italy when I come here. And I know that's going to change the economics of old-age pensions. For such a country to be staying in a pattern where people are encouraged to retire by the age of 55 because they have a certain number of years of seniority, is the opposite of good policy.

There are many microeconomic things in public finance which, with great advantage, in a country like Italy, but also in the other countries I've been talking about, can be done. What we must do is ration altruism, for the reason that there is so little of it. We must make it go as far as possible. In my own country I have to preach about a Medicare system which could become a monster and swallow up an increasing proportion of GDP.

**Professor Giorgio La Malfa**

There are two key provisions in the Maastricht Treaty for the European Monetary Union, once it takes place. One has to do with monetary policy: the independent central bank is, so to speak, compelled and invited to keep track only of price stability and to behave accordingly. The second one stems from an agreement among European governments concerning budgets: the budgets of the EU countries will have to show a surplus in the medium term or at least to be in balance if governments don't want to be fined. Now, I have been in favour of the steps leading to European Monetary Union because they brought us lower inflation and great price stability, but can you comment on the wisdom of having a system which, so to speak, enjoins economic policy for ever and whether this is tenable in the medium term?

**Professor Paul A. Samuelson**

I have some fears for different parts of Europe in a new set-up where one central bank will be able in the future to impose a common policy. The United States is a big continental system, almost as big as the EU, and we have only one Federal Reserve. But we have something which you do not have: true mobility of our labor force. Our studies show that when West Virginia is running heavy unemployment, what subsequently equilibrates that is not that we have a central bank which gives a lower rate of interest in West Virginia. Rather the people move and thereby effectuate equilibrium.

In Europe, in the new Europe, there is more mobility than there used to be. But it still is the case that you can move thirty miles and encounter a new language so people *de facto* do not move. So, some of Italy's luck of the past three or four or five years, compared to France's and Germany's, will not be possible in the new system. You will not have the relatively favourable exchange rate which you now have in the current valuation of the lira. That has been a safety belt for you. The Germans are still the conductors of the orchestra. Many of the things which Germany does to itself, it can tolerate: but the effects upon France of Germany's policies are much worse than the effects upon Germany itself. The same thing, to a degree, could become true of Italy in the new order.

What the level of budgets will be is not quite so important for me in today's classroom on macroeconomics for a variety of reasons. The main action in macroeconomic stabilization policy has moved towards the central bank monetary policy. The opposite was true in the early editions of my textbook, written at the time of the Great Depression, in a different situation. There is one thing worse than not getting your heart's desire and that's to get your heart's desire. If you end up in a very austere, over-austere EMU, then for some years Italy and some other countries may pay an unnecessary price. Now, as you know, my colleague Franco Modigliani has a scheme to solve most things and his view is: an EMU, yes, but an EMU that follows more closely Modigliani lines of advice. Those are very good lines of advice, but it isn't always the case that the world is ready for them. I think you are going to get the EMU you're going to get, not the EMU that Franco Modigliani would like to have you get.

**Governor Antonio Fazio**

There is room for another question and then we have to stop. Professor Giovanni Magnifico was formerly economic advisor to the Bank of Italy.

**Professor Giovanni Magnifico**

Professor Samuelson, you stated that in bringing about the "ruthless economy" in the United States foreign trade and foreign competition probably did not count for more than one third, whereas *domestically* generated competition has up till now been mainly responsible for the change. Then you illustrated the point by referring to the use of steel promotion, where the introduction of small electric furnaces made possible the competition by new entrants. Similarly, in transportation the introduction of trucks has replaced to a large extent oligopolistic, regulated railways. One would conclude, therefore, that technology really played a major role in bringing about the new competitive pattern. My question is: how does the new pattern, in turn, affect technology and the rate of application of technological innovations to actual productive processes? Of course, you pointed out in your exposition that technology has been an important factor; could you now, please expound a little bit on this point? Thank you very much.

**Professor Paul A. Samuelson**

An important question that I'm being asked is this: the new technology which has been one of the important causes of the new ruthless economy: how is technology itself being affected by the ruthless economy? I wish that Professor Schumpeter could be brought from the grave to discuss this with him, because there was a change in his thinking that took place between 1935, when I stepped into his classroom for the first time, and 1950 when he died. In 1935 he believed that no large corporation could keep its innovational skills. He would expect this of Olivetti, of Fiat, of General Motors. By the end of his life he asked, Why does the public keep picking on General Electric and General Motors? Don't they know that most of our innovations have come from these big oligopolies? So, I think if his mind had frozen at the time just before he died, he would say this new ruthless economy is going to hurt technological advance.

But where is the actual cutting edge in the computer industry? Is it in the old AT&T and the old GE? Those were the advanced corporations that I worked with at the Radiation laboratory -- where I worked as a mathematician in war time -- they were way ahead of everybody else. But since then it's the Microsofts; it's three hundred new small companies. I could almost say it's the Italian pattern of small industry, that abounds in Boston's Route 128 and in California's Silicon Valley. Although the ruthlessness of the competition means that a patent is not as important as it used to be, and you have less motive to invest a lot of money in building up technology, still I have to say that our new ruthless economy is probably what gave us back what we were losing in the 1950s and 1960s: our primacy over Japan and

Europe. But I'm not dogmatically confident on the correctness of my answer. It works both ways in many directions.

**Governor Antonio Fazio**

Thank you, I think that we have to stop here. We have stayed together for ninety minutes. Classes at MIT were ninety minutes, like a soccer game. They also had some other characteristics of a soccer game because they were also rather fought. You generally won, but there were rather lively discussions. Today, the audience is much more cowed than it used to be in your classes. We are really, apart from the joke, very grateful to you Professor Samuelson for what you have told us today. And I told you on another occasion, we are very, very grateful to you for what you did in your life -- your research. That is the most important aspect I want to underline here now. And we invite you, maybe not in fifteen years from now, but maybe five years from now, to the Bank of Italy.

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