Boom and Bust
Sheri Berman
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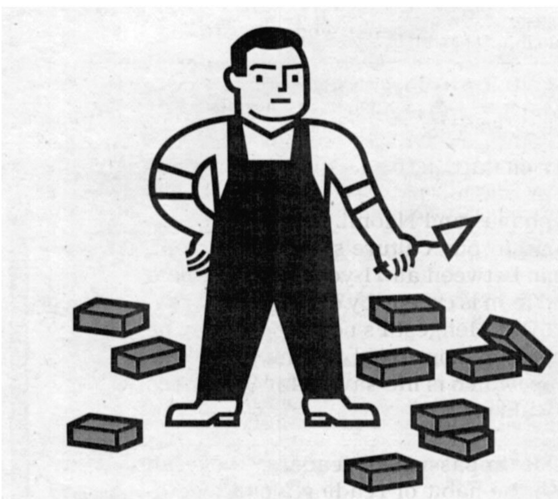
For three decades after World War II, the European economy thrived. Then it stalled.



THE EUROPEAN ECONOMY SINCE 1945
Coordinated Capitalism and Beyond.
By Barry Eichengreen.
495 pp. Princeton University Press. $35.

By SHERI BERMAN

POSTWAR European history falls neatly into two periods. From 1945 to 1973, the countries of Western Europe recovered rapidly from the almost unimaginable devastation caused by World War II and then took off, growing faster than the United States and more than twice as fast as their own historical trends. From 1973 to the present, however, their economies have struggled with low growth and high unemployment, lagging behind both international competitors and their own earlier success.

As a result of this divided history, the so-called European model has both cheerleaders and naysayers. Social democrats and others on the left focus on the first period, applauding the continent's ability to generate high living standards while cushioning individuals and societies from the ravages of unfettered markets. Right-wing critics and free marketeers focus on Europe's contemporary problems, arguing that the continent's generous welfare benefits and heavy regulation condemn it to continuing decline.

Both views contain some truth. But since the same conditions that led to success in one era have produced problems in the next, neither interpretation fully explains the story. In "The European Economy Since 1945," Barry Eichengreen, a professor of economics and political science at the University of California, Berkeley, presents not only a comprehensive account of Europe's postwar economic experience but also an important analysis of capitalist development more generally.

Drawing on his credentials as both an economist and a political scientist, Eichengreen argues that the key to understanding Europe's initial triumphs and later troubles lies in recognizing that the recipe for growth varies, depending on one's position in the economic race. In the years after 1945, Europe needed to recover from the war and catch up with the United States. This involved what economists call "extensive growth" — essentially, increasing the number of workers doing familiar kinds of jobs. Extensive growth requires adopting existing technology, using labor more efficiently and generating high levels of investment. After the war, Europe developed a variety of institutions well suited to these tasks.

Large trade unions, employer organizations and corporatist arrangements, Eichengreen shows, helped labor-market partners reach and sustain long-term agreements to limit wage demands, ensure high levels of investment and plan for routine industrial restructuring. Unions agreed to hold down labor costs and in return were given either representation on corporate boards (Germany), influence over government planning and policy making (Sweden and France) or the ability to dole out government jobs and funds (Austria). Strong welfare states helped cement this bargain, providing workers with generous benefits to offset their wage restraint and the unemployment generated by industrial restructuring.

Schools and training programs, meanwhile, were designed to turn out workers adept at handling existing technology and equipment. Banks developed long-term relationships with their corporate clients, lending money for business expansion that relied on known technologies. And the government bureaucracies of nationalized industries helped mobilize and coordinate

the resources necessary for the relatively clear-cut tasks associated with catch-up growth.

All this worked just as it was supposed to, generating prosperity across the continent. By the early 1970s, however, the potential for extensive growth had been largely exhausted. Europe's businesses and infrastructure had been rebuilt, its labor force transferred from agriculture to manufacturing, the latest technology imported and adopted. At this point, Eichengreen says, "the continent had to find other ways of sustaining its growth. It had to switch from growth based on brute-force capital accumulation and the acquisition of known technologies to growth based on increases in efficiency and internally generated innovation" — that is, to "intensive growth."

The problem, of course, was that Europe was now saddled with institutions ill suited to the creativity and flexibility that intensive growth demands. As Eichengreen puts it, "the continent's very success at exploiting the opportunities for catch-up and convergence after World War II doomed it to difficulties thereafter." The new situation called for flexible and mobile work relationships, technological novelty and the financing of risky ventures — none of which Europe's postwar institutions were good at. In other words, the same structures and practices that had led to the continent's golden age have now produced a malaise. (Eichengreen adds that a similar dynamic has played out in Eastern Europe, since Soviet institutions were not bad at extensive growth but awful at intensive growth.)

Eichengreen backs up his argument with reams of data and detailed examples, yet he writes well enough to make his book accessible to general readers. He reminds us that economic development calls for much more than simply the unleashing of market forces; it demands institutions capable of generating the resources, skills and relationships necessary to handle the particular economic challenges a country has to face at a particular time. And by demonstrating how institutions helpful in one era can become counterproductive in another, Eichengreen has important lessons about the future to teach both policy makers and publics.

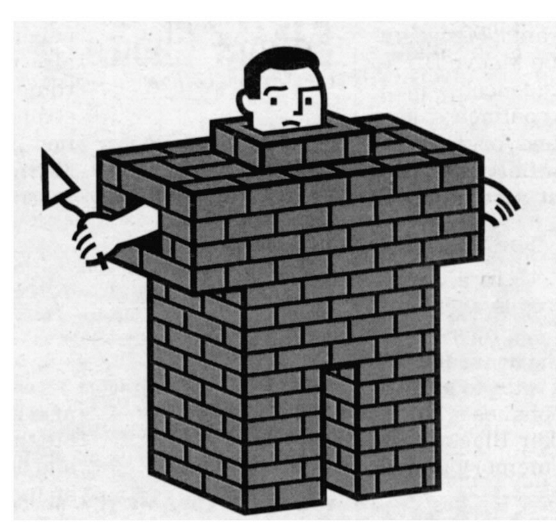
"The European Economy Since 1945" should make readers wary of universal prescriptions for economic policy, since it shows how the fit between policies and circumstances is clearly more important than the nature of either in isolation. The strategies and institutions a country should adopt will depend not only on its particular preferences, but also on what role it can reasonably expect to play in the international economy.

So what should the nations of Europe do now that the advantages of their "economic backwardness" have been fully exploited? Without settling the debate between the European model's supporters and detractors, Eichengreen suggests that international competition is compelling Europe to abandon its distinctive model and become more flexible.

This will not be easy. Eichengreen himself stresses the difficulty of institutional change, and so readers may come away from his book concluding that Europe's economic future is bleak — at least in a contest with other developed countries that provide few government benefits.

Yet thanks to political will and creative policymaking, as Eichengreen points out, some countries on the continent, particularly the Nordic ones, have managed to adapt successfully. They are keeping themselves internationally competitive even while continuing to provide social benefits in health, education and social insurance far above American standards. Others, like France and Germany, will have to follow their lead. Otherwise, they will probably face the decline the pessimists have long been predicting. □

Europe's economic success after World War II, Eichengreen says, doomed it to the problems it faces today.



Illustrations by Christoph Niemann

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