Creating Sustainable Growth in Europe: Reflections

This essay by a distinguished international economist draws on the findings of the Anglo-German Foundation's *creating sustainable growth in europe* initiative to pose challenging questions about the nature of societies in the capitalist world and their underlying moral values and to explore the ethical principles on which societies base their actions. Sir Tony Atkinson explores the fault-lines – demography, generational conflict and inequality – that could derail societies and analyses a range of positive responses. His 'messages for key actors' plot a way forward, not in terms of specific policy options, but rather as a set of principles about how governments, citizens, employers, trade unions and non-governmental organisations can tackle the interlocking problems facing the world today.

Sir Tony Atkinson chaired the Academic Advisory Board of *creating sustainable growth in europe*. He is Professor of Economics at the University of Oxford and Fellow of Nuffield College, of which he was Warden from 1994 to 2005. He is a Fellow of the British Academy, and has been President of the Royal Economic Society, the Econometric Society, the European Economic Association, and the International Economic Association. He served on the Royal Commission on the Distribution of Income and Wealth, the Pension Law Review Committee, and the *Conseil d'Analyse Economique*. He was knighted in 2001 for services to economics, and is a *Chevalier de la Légion d'Honneur*.

The findings of *creating sustainable growth in europe* are summarised in four reports, together with an accompanying volume of *reflections*:

Explaining Productivity and Growth in Europe, America and Asia by Tobias Kretschmer
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creating sustainable growth in europe: reflections by A B Atkinson
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Creating Sustainable Growth in Europe: Reflections

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Anglo-German Foundation for the Study of Industrial Society

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Author's Note

These reflections are my own personal response to the challenges set by the *creating sustainable research in europe* initiative. They draw on the reports of the csge research programmes, and on the discussions of the Academic Advisory Board, but neither the Anglo-German Foundation nor members of the Board nor the research teams should be held in any way responsible for the views expressed. I am most grateful to Wendy Carlin, Ray Cunningham, Christopher Pick and Chiara Saraceno for their comments on the first draft, which have led to considerable improvements.

Foreword

For over 35 years, the Anglo-German Foundation for the Study of Industrial Society has promoted study and discussion of the processes of wealth generation and social development in the United Kingdom and Germany. Over this time, it has made a significant contribution to our understanding of modern industrial society, and has been instrumental in establishing focused comparative research as an essential component of evidence-based policy development.

Towards the end of 2004, the Foundation's Trustees recognised a need to draw together the various strands of work funded over the preceding three decades. They were increasingly concerned that the traditional organisation of research into distinct academic disciplines and associated policy domains was leading to a damaging compartmentalisation in government, so that policies adopted by one department often ran counter to the objectives of policy in other departments. The pressing need, the Trustees believed, was for a broader, more integrative approach, rather than for ever more detailed and specialised knowledge.

The Foundation therefore decided to launch a major project designed to counter-act that tendency while building on the comparative knowledge and expert networks established in its traditional priority areas. The title of the new initiative – *creating sustainable growth in europe* – confronts the central challenge facing both countries over the coming decades: how to reconcile the desire for growth with environmental and social sustainability.

An international Academic Advisory Board was convened under the chairmanship of Professor Sir Tony Atkinson, the distinguished economist and former Warden of Nuffield College Oxford, to advise the Foundation on the structure and content of the initiative. It was decided that the research should be organised in linked but largely autonomous programmes, each addressing one or more core themes within the general topic. The themes chosen were:

- innovation, productivity and growth
- environment and resources
- welfare, employment and social justice.

The initiative was formally launched in spring 2005 with a call for proposals. The research communities in Germany and the UK were invited to submit bids for programmes lasting up to three years and addressing one or more of the three core themes. The budget for the initiative was over £4 million. At the end of a rigorous selection process, the Foundation awarded grants to four programmes:

- Explaining Productivity and Growth in Europe, America and Asia (based mainly at LSE London, ZEW Mannheim and LMU Munich, and led by Professor Tobias Kretschmer, Ludwig-Maximilians-Universität Munich)
- Resource Productivity, Environmental Tax Reform and Sustainable Growth in Europe (based at six centres: King's College London (KCL); GWS Osnabrück; FU Berlin; Cambridge Econometrics; the University of Economics, Prague; and SERI, Vienna, and led by Professor Paul Ekins, then at KCL, now at University College London)
- The Economics and Politics of Employment, Migration and Social Justice (based at WZB Berlin, the Universities of Frankfurt and Hannover, and UCL and LSE London, and led by Professor Christian Dustmann, University College London)
- Sustainable Welfare and Sustainable Growth (based at Queen's University Belfast and FU Berlin and the Universities of Bremen, Edinburgh, Göttingen, Kent, Oxford and Southampton, and led by Professor Jochen Clasen, University of Edinburgh).

Meeting the challenge of sustainability will require far-reaching changes in institutions, processes and lifestyles. In launching its initiative, the Foundation wished to demonstrate the key role research could play in defining those changes and in identifying a fair division of the costs and burdens they would impose. Behind the innovative structure of the initiative lay the intention that each programme's distinctive contribution to knowledge and policy within its own academic and political area would be informed by contact with ideas and approaches from other disciplines and policy domains; and that the four programmes when viewed as a whole would add up to more than the sum of their parts. Their contribution would extend to how policy-makers think of their task – the breadth of data and knowledge to be drawn upon, and the nature and range of the implications to be considered.

The economic and political assumptions prevalent when *creating sustainable growth in europe* was launched have now been severely shaken. Many commentators argue that the present unprecedented conjuncture of financial, economic and ecological crises represents a crucial moment in the trajectory of capitalism. Many also argue that these crises represent an urgent call, and also a unique opportunity, for systemic rethinking, of a kind that happens only once in a generation. The findings of *creating sustainable growth in europe*, as summarised in the Foundation's series of four reports and in this accompanying set of *Reflections* by Tony Atkinson, are thus even more relevant and urgent than was originally foreseen. Taken together, they represent the essence of a generation's work by the founders, Trustees, staff and researchers associated with the Anglo-German Foundation, and the key part of its legacy.

Ray Cunningham
Director, Anglo-German Foundation
September 2009

1 A Major Research Initiative

The Trustees of the Anglo-German Foundation for the Study of Industrial Society (AGF) made a bold decision in 2005 in allocating their remaining resources to a single major research initiative on *creating sustainable growth in europe* (*csge*). The theme of the initiative went to the heart of political debate, and – viewed from four years later – its selection was remarkably far-sighted. 'Sustainability', 'growth' and 'Europe' are all major issues confronting today's policymakers. They pose key questions to which answers are urgently needed. What is more, these issues must be seen in conjunction, and must be tackled in a broad context.

The findings of the four *csge* research programmes, carried out over a three-year period and drawing on different social science disciplines, are rich and varied. From the programme reports, the reader can see their evident value in contributing to the public debate about the future of our societies. Policy in many different fields – energy use, education and training, pensions, and family policy, to name just a few – can benefit from the conclusions reached. The results demonstrate the value of the research programme format, bringing together teams of researchers and providing them with significant budgets. The researchers have been able to exploit common data sources, and have developed new methodologies (as in the programme on *Explaining Productivity and Growth in Europe, America and Asia*). A concerted programme can yield more insights than a set of independent research projects. Even if, in retrospect, one wishes that there had been more interchange between the four programmes, there were considerable synergies within the individual programmes.

The individual programme reports summarise the research findings, and it is not my intention to provide a summary of summaries. Rather, I seek to set the findings in context, taking advantage of the fact that a major research initiative of this kind offers an occasion to contemplate broader issues – even the fundamental objectives of our societies, or the 'ends of life', to recall the title of the recent book by Sir Keith Thomas (2009). Relatively rarely do we consider the nature of fundamental social objectives. Our aspirations are typically taken for granted in public discussion. Within my own discipline, economics, much less room is given than in the past to the study of our underlying welfare judgements. In public policy, there are goals and targets, but little analysis of their relation to the fundamental values of our societies. Yet the criteria by which we judge our performance and set our policy objectives need to be made explicit and continually reviewed in the light of new challenges and new political structures. One has only to contemplate the changes that have taken place in the world since the Anglo-German Foundation was created in 1973. At that time, the United Kingdom had only just joined the European Communities. Berlin was a divided city, and the world as a whole was similarly divided. Today the world, if still unequal in resources and power, is much more interconnected. Now, as the Foundation comes to an end after 36 years, is a good time to consider the nature of 'Industrial Society' in a very different global context.

Such a reflection is given even greater cogency by the fact that I am writing about a research initiative that was launched at a time when the economic climate was very different from today's (summer 2009). The world is now grappling with the consequences of a financial and economic crisis. The International Monetary Fund is predicting the 'deepest post-World War II recession by far' (*World Economic Outlook,* April 2009, page xii). The word 'growth' may appear otiose when world gross domestic product is expected to fall for the first time since 1946. Since I am not in the business of economic forecasting, I will not comment on the economic circumstances that are likely to have materialised by the time these reflections are read. One conclusion that can, however, already be drawn is that we face not only a *financial* or an *economic* crisis. We are facing challenging questions about the nature of our societies and their underlying moral values. It is striking when reading commentaries on the economic crisis how often they contain – explicit or implicit – moral statements. The debate is about not just financial regulation and macroeconomic management but more fundamentally about ethical principles. The *Financial Times*, in an editorial (9 March 2009), said that the crisis was due to the 'intellectual and moral failure of those who were in charge' of the social system. The President of the Federal Republic of Germany has called for the rediscovery of a moral compass in business and politics to guide us out of the crisis.

The achievement of our social objectives depends on a number of key actors. In the latter part of this essay, I reflect on the messages for public and private actors. What can be learned from the research? A major goal of the Foundation throughout its existence has been to build bridges between practitioners and researchers. In the case of the present initiative, the researchers come from diverse intellectual backgrounds, and they were free to develop their research within the fields specified in their proposals. Indeed, one of the virtues of the programme format is that it allows researchers to follow the logic of their research as it develops rather than feel constrained to continue along blind alleys just because they were listed in the original proposal. This does not however necessarily lead to a tidy set of conclusions. Centrifugal forces tend to be stronger than centripetal. At the same time, the Foundation has made impressive efforts to bring the researchers together, and to present the initiative as a whole.

The *public* actors are, first and foremost, national governments. It is to be hoped that the governments of Germany and the UK have benefited from the findings of research supported by the Foundation since 1973 and will continue to benefit from the findings of the final *csge* initiative. But, over the period, power has shifted both upward and downward. While the European Union is now a leading world player, increased responsibilities are also being assumed by regional or local governments. In this latter respect, the UK today looks more like Germany than it did in 1973. The role of *private* actors is one of the elements emphasised by the *csge* programmes. Many of the findings are relevant to managers, to social partners, and to families and households. Their decisions about work, consumption, energy use, and savings are all affected by government actions. Policy conclusions are often framed in terms of providing the right incentives. This is important, but we must also consider the principles by which people are guided when responding to these incentives. People may respond to higher energy taxes so as to reduce their outlays, but they may also be motivated by a concern for the future of the planet. The ethical principles with which I begin are also relevant. In that sense, my essay comes full circle.

2 Social Goals: Sustainability

The title of the Anglo-German Foundation's initiative is both a description and a call to action. *Creating Sustainable Growth in Europe* serves well to introduce my discussion of social objectives, where I take in turn each of the elements: 'sustainability', 'growth' and 'Europe'. I do so to provide a structure to the discussion, but also because I want to probe the meaning of these concepts further than was perhaps possible in the individual programmes. On studying the programme reports, I felt that there was need for greater discussion of what we mean by 'sustainability' and its relation with the standard treatment of growth by economists; I felt that we need to reflect on the definition of Europe and its role in the world.

I begin with a parable. The author of a history of the Fitzwilliam family (Bailey, 2007) reports how the 6th Earl died in 1902 leaving an estate with a present-day value in excess of £3 billion. At that time, the future of the family looked assured. They owned the largest private house in Britain (Wentworth Woodhouse in Yorkshire); they had large estates; and – most importantly – they owned the rich Barnsley coal seam. Yet, less than a century later the title had died out; the house had been sold; and the mines had been nationalised and then closed. Why had such a situation, so secure in 1902, proved to be unsustainable? There are three elements in this family history that seem relevant to the Foundation's research initiative and the question whether growth in Europe is sustainable. The first is coal. The family's wealth rested on a wasting asset and one whose use contributed in a major way to carbon emissions. This may be taken as a metaphor for environmental sustainability, which I take up when discussing growth in the next section. The second element is the relation with the outside world. The Fitzwilliam family were well regarded as employers, but the gulf between the living standards of the aristocracy and those of the miners who generated their wealth was surely too big to be sustained. Taking the Fitzwilliam family as a metaphor for today's citizens of a rich Europe, we can see that the same issue of sustainability arises in a world struggling with global poverty. This is taken up in the section on the role of Europe in the world.

The third element – the subject of this section – concerns the threat to sustainability from within. In the case of the Fitzwilliam family, the succession in 1902 of the 7th Earl (grandson of the 6th Earl) was disputed by his aunts and uncles, who claimed that he was an impostor, having been substituted at birth for a girl (this took place in a remote part of Canada). Later that century, the title became extinct in 1979 when the 10th Earl died without a male heir. This family history highlights the three internal fault-lines on which I want to focus: demography, generational conflict, and inequality.

The demographic situation underlies a number of the research projects carried out as part of the programme on *Sustainable Welfare and Sustainable Growth*, particularly those concerned with family policy and with migration. The projections for the EU as a whole show fertility as remaining low, being in all countries far below the natural replacement rate (European Commission, 2009, which is also the source for the figures quoted below). The average number of births per woman is expected to be 1.57 in the EU in 2030, compared with the natural replacement rate of 2.1 births. The total EU population is expected to rise slightly from 495 million in 2008 to 520 million in 2035, but this is the result of increased life expectancy and net inward migration. Total population is then projected to fall back to 506 million in 2060.

As with a single family, the low rate of fertility calls into question the sustainability of the European population. Certainly, we are not in a steady state. The population is becoming increasingly dominated by older people. The ratio of people aged 65 and above to those of working age (15–64) is expected to double in the EU by 2060. This demographic development requires major social adjustments. We have already seen steps in the direction of raising pension ages. It is important to bear in mind, however, that the key variable is the length of working life, not the age of retirement, and that the working life can be extended at both ends. The effective age of entry to the labour force has been rising, and we need to examine the barriers in Europe that prevent many young people entering employment. Of course, entry may be delayed for good reasons. More people today complete high school and go on to tertiary education. This is the second form of adjustment – investment in human capital to raise the productivity of the labour force – and one where policy will be informed by the findings of the programme on *Inequality, Education and Comparative Political Economy.* The comparison of German and UK experience, notably in the field of apprenticeship training, highlights the key role of employers and their commitment to investment in skill formation.

A third adjustment is via immigration. Net inward migration is running at a current annual rate of some 1.7 million (0.33 per cent of the total EU population), but is expected to fall to around 1 million by 2020. In all some 60 million people are expected to migrate to the EU in the next 50 years, of whom over a quarter will go to either Germany or the UK (*European Economy*, 2009). Even so, the total population is projected to fall. This raises the question whether the EU should plan to encourage a higher rate of inward migration by people of working age. Would this be sustainable in terms of the capacity of societies to absorb new members? Here the research by Burkhardt and Mau (2009) in the programme on *Sustainable Welfare and Sustainable Growth* is of great interest. In particular, they discover significant differences in the way immigration is perceived according to the institutions of the welfare state. In both Germany and the UK, respondents recognised migrants' positive production contribution to society, while expressing concerns regarding welfare dependency and segregation. But there was a more negative perception of the welfare impact in the UK, which can be attributed to the fact that social transfers are less closely related to contributions. In recent decades, social insurance has been increasingly displaced by social assistance and tax credits, and one unintended by-product may have been increased hostility to immigration. This underlines the need for a holistic approach to this sensitive policy area.

All three forms of adjustment to the ageing of the EU population do however involve an increase in national output, and face the questions of environmental sustainability considered below.

The second fault line – that between generations – is already evident from the discussion of the burden of dependency, but it appears in a wide range of policy issues from short-run macro-economic management to action on long-term climate change. Debate about the burden of the national debt is often framed in terms of paying higher taxes today or in ten years' time, but the key issue is less 'when' than 'who' pays the higher taxes. If government borrowing means that today's older generations can avoid paying, then there is a genuine shifting of the burden. In the same way, the climate change debate is couched in terms of costs borne today versus costs in 2050, but many of those who will be alive in 2050 are already alive today. The crucial question is *which* generation should bear the costs. Should the Baby Boomers (born 1946–1959), during whose working lives a considerable part of the environmental damage was done, bear most of the cost, sparing Generation X (born 1964–1974), who are likely to have lower lifetime earnings? As (nearly) a member of the Baby Boom generation, I could certainly be persuaded that we should bear much of the cost and would volunteer to pay higher taxes to this end. What is needed is an explicit intergenerational contract.

The third fault-line concerns inequality within generations. A society may cease to be socially sustainable if the gap becomes too wide between rich and poor. Such concerns date back a long way. Plato argued that 'if a state is to avoid… civil disintegration… extreme poverty and wealth must not be allowed to arise in any section of the citizen-body' (*Laws V*, quoted by Cowell, 1977, page 26). In modern times, the legitimacy of the economic and social system may be challenged if the rewards appear disproportionate to underlying merits or needs. This is one reason for the interest, both scientific and popular, in the explanation of rising earnings dispersion in many countries. Is it that skilled workers have gained from globalisation and new technologies? Or has there been a shift in bargaining power? In this regard, the study of earnings dispersion by Dustmann, Ludstek and Schönberg (2009), as part of the programme on *Inequality, Education and Comparative Political Economy,* provides intriguing evidence for Germany and the UK. They find that technical change has favoured skilled workers in the upper half of the distribution, but that the lower half has been adversely affected by institutional changes, notably the decline in unionisation. If the latter leads to a growth in the number of 'working poor', for whom a job does not guarantee security from the risk of poverty, then societal tensions may well develop. One cannot simply assume that a policy of raising employment rates will be sufficient to combat poverty and social exclusion. The resolution of such tensions is possible, but it will require an integrated approach to economic and social policy.

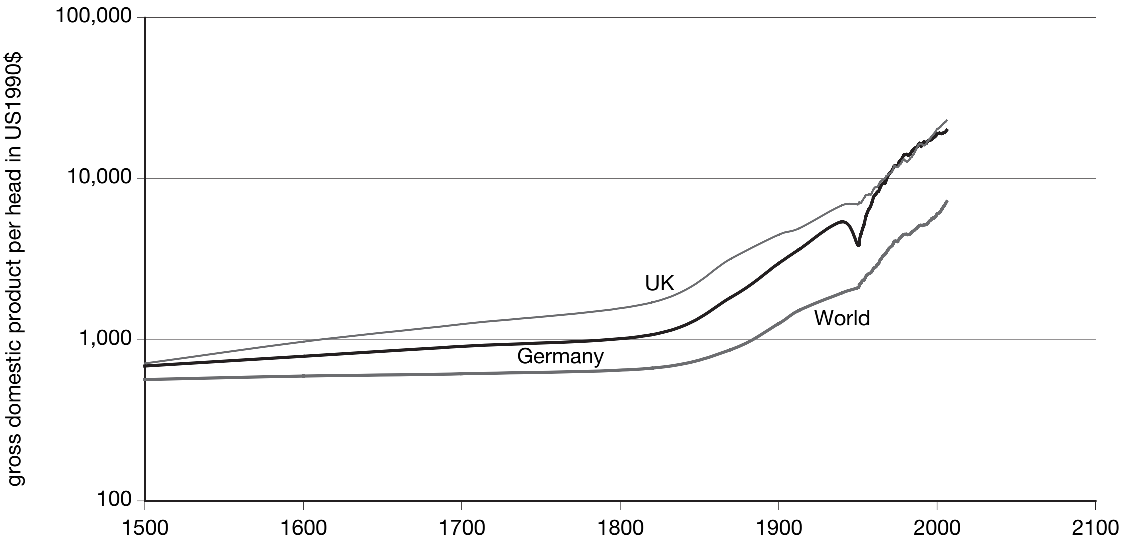
In sum, internal sustainability depends on not allowing fault-lines to open up. The three such lines that I have explored – demography, generational conflict, and inequality – all have the potential to derail our societies. At the same time, there are positive ways in which we can respond, providing that we are willing to think imaginatively and holistically about policy options.

3 Growth and Environmental Sustainability

The title of the Anglo-German Foundation's initiative is evocative of the goals set out by EU Heads of State and Government in the 2000 Lisbon Agenda: to make Europe 'the most dynamic and competitive knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion'. The launching of this EU Agenda was much influenced by the experience of the 1990s, when the European economies appeared to be stagnating by comparison with the United States. The citizens of Europe felt that their standards of living were not keeping up. It is important, however, to maintain a sense of historical perspective. At the beginning of the 1980s, it was the United States that was concerned that it was falling behind in economic terms. In 1980, the American Economic Association organised a session at its annual meeting on the 'current retardation in U.S. productivity growth'.

I begin therefore with long-run economic growth, showing in Figure 1 estimates of gross domestic product (GDP in terms of 1990 US$) per person. The estimates for earlier years are surrounded by a greater margin of possible error than the more recent figures, and it is not easy to allow for differences in purchasing power across time and across countries. Nevertheless, the broad picture is informative. As can be seen, economic growth at today's rates is a relatively recent phenomenon. (The scale is logarithmic, so that a straight line corresponds to a constant proportional rate of growth.) The growth of world GDP

Figure 1
World gross domestic product per head



Source: These estimates of gross domestic product per head were made by Angus Maddison, Emeritus Professor of Economic Growth and Development, University of Groningen, and are available from his website, www.ggdc.net/maddison per head between 1500 and 1820 averaged a rate of 0.05 per cent per year. Growth really accelerated after 1950: between 1956 and 2006 the annual world growth rate averaged 2.1 per cent.

What is the likely continuation of the economic story of our planet? Is the earth engaged in a process of transition to a path where all countries are growing at a steady proportionate rate? Or is there an ultimate limit to the process, with world GDP per head attaining a new higher level? There are indeed reasons to expect growth to slow. After all, if we look in greater detail at the European experience over the period since 1950, we find that the growth rate after 1973 was under 2 per cent, compared with 4 per cent from 1950 to 1973. The recent *Blueprint for a Safer Planet* by Nicholas Stern, author of the Stern Review,states that 'a picture of indefinite expansion is an implausible story of the future' (page 10). The German President has warned against the dogma that growth is the answer to all our problems. Indeed, we may ask whether the rise in world economic prosperity is a temporary phenomenon. Will GDP per head reach a peak and then fall over some period in the future? Are the inhabitants of the Earth to be congratulated on the transformation they have achieved, or is this all unsustainable?

The widely (but not universally) accepted definition of sustainability is that articulated in 1987 by the Brundtland Commission, which was established by the United Nations to address growing concerns about the environment: '[to meet] the needs of the present without compromising the ability of future generations to meet their own needs'. This concept of sustainability involves the integration of economic, social, and environmental spheres. But these precepts leave much room for interpretation, and there is considerable disagreement about the concrete conclusions to be drawn. Some consider 'sustainable growth' to be an oxymoron, holding that no growth can in the long run be consistent with environmental stability: zero growth in output is the only viable objective. Others point to the equation

$$\text{environmental impact} = \text{population} \times \text{affluence} \times \text{technology}$$

and argue that reductions in the last term offer a resolution. We do not necessarily have to reduce the first two terms. The reductions in 'technology' may be achieved by causing firms and consumers to make different choices from the existing technologies. Through the kind of instruments considered in the programme on *Resource Productivity, Environmental Tax Reform and Sustainable Growth in Europe* (such as environmental taxes or carbon permits), firms may be induced to choose less damaging or less resource-intensive activities. Or the reductions may be brought about via the development of new technologies. After all, it is technological change that has largely generated the world's industrial growth. On the other hand, the success of this technology is judged by a measure – gross domestic product – that is itself contested, not least for failing to account for the environmental impact and the using up of natural resources.

I referred earlier to the dissatisfaction of European citizens with the economic performance of Europe. In fact, contrary to claims that 'the European social model has been a complete failure' (Edmund Phelps, *Financial Times*, 12 May 2009), there *has* been growth in Europe: GDP per capita in 2006 in Western Europe is 25 per cent higher than in 1995. But even the most ardent supporter of economic growth is unlikely to argue that we can return to the growth rate of 4 per cent per year achieved in the period 1950–1973. And, with growth rates of 1.5 to 2 per cent, a sizeable part of the addition to output is going to be absorbed by the pension and healthcare costs of the ageing population and the resources required to offset the costs of environmental damage. If that is the case, then we can no longer expect future generations to enjoy ever-increasing standards of living relative to those of their parents.

A more realistic aspiration is that each generation can continue to enjoy the same standard of living. Of course, future generations will have different opportunities. They will live longer and have the benefit of products and technologies that we cannot imagine. But they will not necessarily be better off in terms of annual living standards. Responsible stewardship means that they should be no worse off. Some people have described such a stewardship objective as a 'sterile' stationary state. But this would be wrong. Implicit is a rapid rate of technical progress to offset climate change and the depletion of natural resources. It would however be a shift in our aspirations. And it would change our economic thinking. In the debate about the costs of climate change, for example, the case for discounting future benefits (and costs) depends on the expected future growth of standards of living. Differences about how to treat this growth lead to differences in discount rates that seriously affect the conclusions. With a stable standard of living, there is no growth term, and this reason for discounting disappears.

Such a shift in our aspirations for overall living standards means that we have to confront directly the issue of *distribution*: the significant differences in living standards within countries and the gross differences between countries. In the past, it has often been suggested that poverty can be overcome by economic growth: that the benefits will trickle down to an extent that the poor benefit disproportionately from the gains in national income. Such confidence is not borne out by the recent experience of Europe, where national income has grown by around a quarter, with no reduction in the proportion of the EU population estimated by Eurostat to be at risk of poverty. But if there is no overall growth, then poverty and inequality can only be addressed by redistribution.

The challenge to us, and our political leaders, is that we have to reframe our social objective as *equitable stewardship*. Both stewardship and equity have to be conceived at a global level, and this brings us to the role of Europe in the world.

4 The Role of Europe in the World

In 1838, in a speech to the House of Commons, Disraeli warned that 'the Continent will not suffer England to be the workshop of the world'. In the twentieth century it became clear that Europe as a whole (and indeed all rich industrialised countries) needed to heed the same warning. By the start of the twenty-first century, it was already evident that the geography of the world economy was changing rapidly. The situation was unsustainable in which Europe represented 8 per cent of world citizens but produced (in 1980) 24 per cent of total world GDP.

This evokes a number of issues, of which I discuss two here. The first is that of world distribution. In terms of production, the estimates of GDP per capita for 1820, a few years before Disraeli spoke, show that Germany and the UK had already moved well ahead (see Figure 1), but that the distribution of output in the world as a whole had not reached a state of great inequality. GDP per capita in the UK was some three times that in India, nothing like the ratio of 11 times reached by 1950. Seen in terms of countries, the world distribution was much less unequal than the distribution among persons within a country such as the UK. By 1975, the reverse was true: the distribution between countries was more unequal than that among persons within a typical OECD country. The difference has recently started to narrow, notably with the development of China and India, and, as Disraeli foresaw, the ambition of all countries is to catch up the OECD countries. They may indeed overtake, just as in past centuries economic leadership passed from the Netherlands to the UK and from the UK to the US.

Earlier I referred to the Lisbon Agenda, with its ambition of establishing Europe as a world leader. This Agenda has undoubtedly served as a catalyst, with its welcome focus on the problem of creating jobs and its explicit recognition of the objective of social inclusion. But, seen in a global context, it hardly seems reasonable to suppose that Europe will be the 'most dynamic' economy in the world in the sense of achieving the highest growth of GDP per capita. Convergence at a global level, and not just within the EU, must surely be the underlying assumption as we look ahead over the twenty-first century. Interestingly, the baseline projections in the report of the programme on *Resource Productivity, Environmental Tax Reform and Sustainable Growth in Europe* show the EU27 share of world GDP falling from 22 per cent in 2005 to 17 per cent in 2020. (The industrialised countries as a whole would see their share of production fall from 60 per cent to 46 per cent.) In this sense, Europe must revise its aspirations downwards.

What does this shift in the distribution of world output imply for the distribution of world consumption and the standards of living of the poorest? Strong economic growth in developing countries has allowed significant progress to be made towards the United Nations Millennium Development Goal (MDG) for income poverty reduction (halving the proportion in extreme poverty between 1990 and 2015). According to the World Bank's *Global Monitoring Report* 2009, the target remains 'within reach at the global level' (page 15).

But the *Report* also expresses grave concerns about the non-income human development goals: 'based on current trends, most human development MDGs – especially for child and maternal mortality, but also for primary school completion, nutrition and sanitation – are unlikely to be met at a global level' (page 15). In order to meet these non-income goals, there has to be an expansion of spending, both private and public. In this respect, the current global imbalances, notably the role of the US as the 'borrower and spender of last resort', absorbing the savings of China, are operating in diametrically the wrong direction. There has to be a redistribution of world consumption, in which Europe has an important part to play. Put differently, the achievement of the development goals is intimately bound up with the resolution of the global macroeconomic problems.

The second issue regarding Europe's role in the world concerns regional groupings and regional integration. Here, Europe should be pleased that other countries are seeking to emulate the model that it has espoused. Custom unions are not new, and colonial empires allowed extensive trade, but the map of today's free trade areas is an impressive one. Mercosur in South America, the North American Free Trade Agreement, the African Free Trade Area, are all examples of national governments agreeing to reduce barriers to trade and, in some cases, to allow the movement of capital and workers. But the success in exporting this model of integration raises in turn a further question: are land masses the appropriate regional definition? We have come to assume that transport costs are smaller across land than across water, but this was not always the case. To a degree, the Baltic has become an economic focus. Is the Mediterranean equally going to become a focal point rather than a barrier? What then is the appropriate definition of 'Europe'?

Taking together these two considerations – convergence and regional groupings – we may ask whether it is reasonable to aspire to a situation where rich countries are grouped with poorer countries, not necessarily in the same continent, and where convergence is an internal goal for these regional groupings? As my colleague Adrian Wood (oral communication) and Anthony Clunies-Ross (2005) have separately suggested, the EU could open its membership to African countries willing to accept the *acquis communautaire* (the accumulated body of EU law). On an optimistic note, this would be enlightened burden-sharing. After all, there are approximately the same number of people living on less than $1 a day as there are people living in aid donor countries. The inhabitants of rich countries may be willing to take on a proportionate share of the necessary redistribution of consumption where this takes place within a framework of mutual recognition of responsibilities. On a pessimistic interpretation, such a scheme would simply be a revival of empires dominated by rich countries; it would increase the inequality of trading relationships; and would heighten the risk of inter-regional conflict. Moreover, a number of the key issues – such as climate change – can only be addressed fully at a global level.

In this research initiative the Anglo-German Foundation has widened its focus from Britain and Germany to Europe, reflecting not just the political reality of the EU, but also the much greater interdependence of European economies and societies. The question that I have raised – and not answered – is whether the next shift should be to a global level or to a wider 'Europe' extending well beyond the continent.

5 Messages for Key Actors

The *csge* research programmes contain a wealth of findings relevant to key actors. The programme on *Resource Productivity, Environmental Tax Reform and Sustainable Growth in Europe* is concerned with fiscal reforms. The reforms would switch the burden of revenue-raising from labour or capital towards activities that use up resources or cause pollution. The proposed measures are quite broad, including both taxes (such as the eco-tax) and the auctioning of permits in an emissions trading scheme. Of particular note is the fact that the researchers investigate the impact on the environmental industries. All too often discussion of taxes concentrates on the downstream effects on users and consumers to the neglect of the effects on producers.

The programme on *Explaining Productivity and Growth* contains a number of findings that provide novel insights into policy design. For example, they find that it is beneficial for companies to have researchers located abroad. The establishment of research and development facilities overseas may therefore be an activity to be encouraged, rather than regarded as a negative brain drain. They find that family firms, on average, are badly managed, and suggest that this calls into question the fiscal privileges given to the transmission of business assets. They find that the positive relationship between labour productivity and IT intensity is not affected by the proportion of older workers. This suggests that older workers do not need to be targeted by IT training programmes; rather it is unskilled workers of all ages who should be helped. They conclude that the UK's climate change levy had a strong impact on energy use and no significant adverse effect on productivity.

The programme on *Inequality, Education and Comparative Political Economy* has produced many findings of interest to policymakers. Evidence about the distribution of earnings, described above, casts light on the role played by the minimum wage and by collective bargaining. The studies of education have highlighted the contribution of literacy and numeracy programmes in the UK and produced fascinating new insights into tracking procedures and school starting-age in Germany. I referred earlier to the comparison of apprenticeship training in the two countries and to the central role of employers. The research findings suggest that past policies in the UK to strengthen firm-based apprenticeship schemes may have insufficiently focused on engaging the commitment of firms, a key element of the German system. All in all, these findings are highly relevant to contemporary policy issues.

The programme on *Sustainable Welfare and Sustainable Growth* has generated valuable findings in the field of social policy, where the comparative perspective is particularly instructive. The study of personal pension arrangements in Germany and the UK, for example, suggests that there are serious questions in both cases about their effectiveness in guaranteeing an assured income and preventing poverty after retirement. In the field of family policy, there have been significant changes, with different challenges in the two countries, but with both facing the core issue of reconciling the protection of individual welfare and concerns about societal well-being. I have already cited the findings regarding immigration and the implications of different forms of welfare provision.

The above paragraphs give a flavour of the specific findings. Here I draw more general lessons for governments, on the one hand, and citizens, employers, trade unions and non-governmental organisations, on the other.

Governments

I consider three messages for government, or, more accurately, different levels of government. The first concerns getting things done. I have described some of the ambitious goals that our societies may adopt, but their achievement depends on political action and political coalitions. The political economy of policy reform has been explicitly addressed in the programme on *Inequality, Education and Comparative Political Economy.* This comparative study casts interesting light on the way in which the political system has influenced the restructuring of German and UK economic institutions, notably the labour market and the macro-economy. The report identifies a shift in the political and industrial coalitions that had hitherto underpinned support for lower-income groups and argues that these pressures were exacerbated by the nature of the macroeconomic regime.

The second message concerns the need to connect different areas of policy. This need is clear from the research findings. The different research programmes deal with different areas of policy, but there are evident overlaps and interactions. Management styles are relevant to the delivery of education and social programmes. Training and apprenticeships are relevant to the development of management effectiveness and to the development and application of energy-saving technology. When we move to a global level, we see even more clearly that measures to tackle climate change depend on progress on North–South issues. Resolution of the financial crisis depends on measures to deal with global imbalances, but these affect the distribution of world consumption and the investments needed to reach the Millennium Development Goals. The agenda for policy-makers is a broad one. US commentators have been criticising President Obama for trying to make progress on too many fronts at the same time. However, what he may see, and what they may not, is that progress may only be possible if all the issues are on the table.

To be more concrete, I give an example of one particular policy interaction: that between the financial crisis and policy towards pensions, covered by the programme on *Sustainable Welfare and Sustainable Growth*. The growth of the financial services sector, notably in the UK but also elsewhere, has been strongly influenced by the move towards private funded pensions and the scaling back of state pensions. This move has been encouraged by the OECD. It does however involve a transfer of risk. Households in the UK did not necessarily choose to take risks, but were forced to do so to replace the reduced benefits from state schemes. Equally, they moved towards buying property as a security for their old age, the 'buy-to-let' phenomenon, in part fuelling the UK house price boom. Policy in one area – pensions, the responsibility of the social security ministry – had major consequences for other areas – such as housing and financial regulation – that were the responsibility of other ministries.

We have therefore to see problems as inter-related. Policy cannot be made solely in ministry 'silos'. In the specific case that I have just identified, we need to integrate economic and social policy, and this message has more general applicability. There are a number of reasons why consumers have been slow to respond to stimulus measures, but one important group of consumers are pensioners, and unlocking the structural problems of pensions will help the macro-economy. It was no accident that the 1930s saw President Roosevelt introduce the US social security system. It was no accident that Keynes, in constructing the UK's post-war economic institutions, worked closely with William Beveridge, the architect of Britain's post-war welfare state. At that time, economic policy and social policy were seen as working together; they were seen as complementary. They should be so seen today.

The third message concerns the balance between public and private provision of services. The tightening of fiscal constraints, coupled with demographic pressures on pension and healthcare provision, means that the boundary is going to be a matter for active debate. At the same time, the example I have just given – of private pensions – illustrates the fact that one needs to spell out fully the implications of moving the boundary. If the state reduces its engagement in certain areas, then there will have to be alternative provision, either by private purchase, private insurance, trade union provision, or employer mandates. Such provision may be more efficient and may offer consumer choice. But it may also have unintended consequences. In my book *The Economic Consequences of Rolling Back the Welfare State* (1999), I pointed out that the growth of private pension funds as major shareholders in publicly quoted companies may have had the effect of rendering these firms more short-term in their investment decisions. The message for governments is that they need to look carefully at both sides of the private/public choice.

Citizens, social partners and social associations

Governments are elected by voters, and in this respect citizens have an important role to play, even if they are frustrated by wishing to vote for 'none of the above'. But citizens are also active in making their own decisions, and these are highly relevant to the policy issues discussed here. They make these decisions as individuals and family members, as employers, or as members of trade unions or of social associations.

At all stages of the life-cycle, individuals are faced with choices that have implications not just for them but for the wider society. There is a general belief that we need to invest more in education and training. These are influenced by public policy, but the most important decisions regarding education, and the greater part of the investment, are made by individuals and families. Once they have entered the labour market, people are confronted with many decisions. As they get older, they have to decide how to make provision for their retirement. As consumers, their choices can have far-reaching consequences: for example, for the energy-intensity of the economy.

The same individuals are workers, employers, members of trade unions, and are active in social organisations. In these roles, they take daily decisions that may have far-reaching consequences. Their employment decisions and their managerial style affect the productivity of the economy. The comparison of German and UK experience, notably in the field of apprenticeship training, highlights the key role of employers and their commitment to investment in skill formation. Employers and trade unions come together as social partners, although one of the striking differences between Germany and the UK, well documented in the political science literature, lies in the relative importance of social dialogue in the former and its relative unimportance in today's UK. But UK citizens are certainly active in social organisations, including charities engaged in welfare provision at home and abroad.

In making decisions in these different roles, people will be guided by their own interests, and it is commonly assumed that these will be paramount. Much of the discussion of policy in the programme reports is concerned with presenting people with the right incentives. Raising environmental taxes means that people will travel less and install double-glazing. Firms pursue family-friendly policies because there is a business case. People may act altruistically but only regarding collective decisions made by voting. As the economist James Meade put it, 'the ideal society would be one in which each citizen developed a real split personality, acting selfishly in the market place and altruistically at the ballot box' (1973, page 52). In the same way, the philosopher John Rawls (1971) considered that his principles of justice apply to societal design: to the basic structure of society, not to individual conduct. This does not however seem to me fully satisfactory, either as a maxim or as a description of how people actually behave. It has long been clear that utility maximisation is too restrictive a model of economic behaviour. For the nineteenth-century Oxford economist Francis Edgeworth, 'the concrete nineteenth century man is for the most part an impure egoist, a mixed utilitarian' (1881, page 16). Employers have long had the concept of being a 'good employer', among other things playing a responsible role in the local community. Today, with much public debate about climate change, individuals are asking what they can do personally to prevent global warming. Ethical investment funds attract a significant volume of savings.

We must therefore consider the relation between ethical principles and individual codes of conduct and behaviour. It is not just a question of providing people with the right incentives. People may be persuaded to change their decisions by arguments concerning proper behaviour. Reading Peter Singer's *The Life You Can Save* (2009) may cause people to give more to Oxfam even without a larger tax deduction for charitable donations. Employers may offer apprenticeships because they believe they should invest in the future, not because their own enterprise will directly benefit.

The standard argument against such a mixing of social norms and individual interest is that competition will drive out those who act altruistically. The days of the 'good employer' are gone because this behaviour did not maximise shareholder value. Is this necessarily the case? Let us consider, for example, the determination of earnings in the labour market. Workers differ in their talents. An employer may offer a pay scale where pay rises with the contribution to output but less than £1 for £1. In other words, the company 'fair pay' policy is basic pay plus a percentage performance bonus. Such a pay policy is redistributive, in that those with low productivity get paid more than their contribution and vice versa for those with high productivity. Following such a pay norm is seen by both workers and employers as 'good practice'. Can this however be sustained? Suppose that another employer offers jobs where people get paid simply according to productivity. Will this render the fair pay firm uncompetitive? Not necessarily if there is a cost, in terms of lost reputation, to workers and employers who deviate from the pay norm. The fair pay firm will lose some of the high productivity workers, but the loss is limited to those for whom the gain in pay more than compensates for the loss of reputation. Moreover, the other firm suffers not only a loss of reputation but also attracts workers who are less principled and who pursue their own interests at the expense of those of the firm, reducing profits. There are therefore countervailing forces. We may then have a mix of firms, some of them following the pay norm, and others paying people on productivity alone. The proportions will depend on, among other things, the extent of belief in a norm of fair pay. This can provide one explanation for the changes in the distribution of earnings described in the programme on *Inequality, Education and Comparative Political Economy*. As I have argued in my recent book on the *Changing Distribution of Earnings* (Atkinson, 2008), one explanation for the fanning out of top earnings has been a switch between the two types of firms. More people are paid according to performance and fewer according to the pay norm. This switch in turn can be attributed to changes in the time horizons of firms, but it may also reflect a reduced adherence to the notion of fairness in pay.

The general point that I am making is that ethical principles enter into individual decision-making and that debate regarding these principles may be as important as the provision of correct incentives. This has long been recognised. In 1690, John Freame, the founder of Barclays Bank, avowed that the current generation had a duty to instill sound values in the next: 'To implant in [young] minds a sense of piety and virtue, and to train them up in the best things. This would prove more advantageous to children than getting a great deal of riches for them.' This brings us back to the choice of social objectives with which I began.

6 Envoi

The world is confronted with major problems: the financial crisis, the recession, the challenge of climate change, meeting the Millennium Development Goals, and ending world poverty. These interlocking problems have to be tackled in conjunction. It is therefore crucial to appreciate how different parts of the problem fit together. Equally, the problems have to be tackled with a clear understanding of our social goals and how far they are shared. In making these goals explicit, we have to be realistic in our aspirations, and I have suggested – in a personal view – what this realism may entail. In order to preserve internal sustainability, we have to adjust to demographic developments, to make explicit the intergenerational contract, and to ensure that economic and social policy work in harmony, not in opposition. In balancing growth and environmental impact, we should be thinking in terms of an 'equitable stewardship'. Worldwide, convergence at a global level, and not just within the EU, must surely be the underlying assumption as we look ahead over the twenty-first century. To achieve objectives of global equity such as those embodied in the Millennium Development Goals, there has to be a redistribution of world consumption.

In the 1660s, Edward Burrough, an English Quaker facing persecution, said 'if you should destroy the vessels, yet our principles you can never extinguish, but they will live forever, and enter into other bodies to live and speak and act' (quoted by Hill, 1991, page 386). The Anglo-German Foundation is going out of existence voluntarily, but its contribution to understanding our societies will similarly live on. The Foundation has, over its 36 years, supported a wide variety of research on social and economic issues affecting industrialised societies, and has sought to make the lessons known to practitioners. The research will certainly go on under different auspices; and it is to be hoped that others will continue the tradition of effective dissemination established by the Foundation.

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