Executive Summary

This book is about what works economically – policies and approaches that have succeeded in bringing jobs and growth to economies which once faced crippling problems. The book examines Ireland, the Netherlands, Massachusetts, Michigan, and Georgia.

This is also something of a mystery story. Who, or what, beat the dickens out of once dynamic economies in the Netherlands, Massachusetts, and Michigan? What medicine did they take to become stronger economically than ever before? In cases like Ireland and the American Deep South, who or what was poisoning the well water, leaving these economies so weak for so long? What changed to transform such doddering wrecks into great wealth generators and job creators?

These economies vary hugely in structure, history, geography, and resource endowment. The causes of their economic problems also vary considerably, from deep policy mistakes in the Netherlands to the onset of fierce foreign competition that wrecked Michigan's economy.

This variation is a strength. It raises a most interesting question: Do successful economic polices, in such differing environments, have important elements of commonality that can be applied to other economies?

The strategy utilized in successful jurisdictions boils down to a surprisingly simple, even obvious, idea which can easily be duplicated, albeit in different forms, in widely varied economic jurisdictions.

Put simply, the strategy is to reduce costs in the economy, to allow investors to reap increased profits. In Ireland and the Netherlands, this was accomplished through tax reductions and cooperation between unions, business, and government in holding down wage growth. Even the union leadership argued in favour

of wage moderation on the grounds that profits needed to be improved.

A similar story emerges in the United States. Georgia's powerful economic growth has been fuelled by low costs both in taxes and wages. State governments in Michigan and Massachusetts reduced expenditures and cut taxes to speed recovery.

Flexible, largely self-equilibrating labour markets in the United States put downward pressure on wages during recessions, reducing costs. This was the same result, wage moderation, as was achieved in Ireland and the Netherlands. In the United States, it occurred through market mechanisms. In Ireland and the Netherlands, it was accomplished through an explicit policy decision to rein in wages in favour of profits.

All this – lower taxes, wage moderation – opened more room for profits, which attracts further investment. Profits provide investors with the means for further investment and the incentive for increased investment. New investment generates jobs and wealth.

Still, this approach has been criticized as a "race to the bottom", sacrificing workers' income and government's ability to provide services. In fact, the exact opposite is true. Typically, tax cuts result in greater government revenues within a year or two, as increased growth quickly makes up for the cuts.

Similarly, *real* wages in Ireland and the Netherlands grew more rapidly after unions shifted from tough bargaining to a policy of wage moderation explicitly intended to increase business profits. This had two positive effects on longer-term wage growth. As investment, attracted by profits, increased, so too did the capital/labour ratio. This naturally made workers more productive and their labour more valuable. And, as employment grew, learning-by-doing and other forms of training also increased the value of labour. This created the room for real increases in wages that did not cut into profits, holding open the door to further investment and wage increases.

In the United States, relatively weak union power allows wages to adjust to changing economic conditions. In times of economic

distress, wage growth in the United States weakens or declines much more readily than in Europe. This maintains profits. Yet, despite or because of weak unions, U.S. workers are the best paid in the world.

Ireland

For generations, Ireland had been the most economically backward nation in northern Europe. Unable to generate enough prosperity and jobs for even its small population, Ireland exported people rather than goods and services. Independence did little to change this dismal situation. Ireland still lagged all its neighbours, and economic refugees continued to flee the island.

From independence to the late 1950s, Ireland tried to generate jobs by closing its economy and fostering import substitution. This was an unmitigated disaster. It only isolated Ireland from the powerful wave of growth and prosperity that swept through western Europe after the end of World War II. The results were so dismal that even the architects of the closed-door policy reversed course, opening the Irish economy to world competition at the end of the 1950s.

Thus began Ireland's first golden economic age. Ireland generated jobs and wealth faster than it ever had in its history. But this was a short-lived golden age. Skyrocketing public expenditure, soaring taxes, increased government intervention in the economy, bloated debts and deficits, and growing union militancy increased costs in the Irish economy. Profits virtually disappeared and so did investment. Unemployment rose and "the culture of employment" was lost to a whole sector of Irish society, people who joined the rolls of the long-term unemployed. As bad as things had been in the past, this proved to be the most dismal economic period in recent Irish economic history, for the earlier glimpse of prosperity had turned to ashes.

Bad times concentrated policy thinking. Irish society as a whole reached a consensus in the late 1980s that costs in the economy had to be reduced. Unions adopted wage moderation as their creed. Government slashed expenditures and taxes. Profits rose

rapidly, creating a magnet for further investment.

The results were nothing short of miraculous. They did not simply better Ireland's own dismal economic history; Ireland's record of GDP growth is now the strongest in the developed world. In the early and mid-1980s, Irish unemployment had climbed to nearly 20 per cent. Now Ireland faces a labour shortage.

Tax cuts and wage moderation, far from reducing tax revenues and real wages, led to dramatic increases. Revenues are far higher now than when tax rates were at their peak. The Irish have gone from being one of the most poorly paid people in the developed world to one of the best paid. What many feared would be a "race to the bottom" became a rapid climb to new economic heights.

The Netherlands

The Dutch and the Irish economies followed similar roads to economic ruination. Then they took strikingly similar paths to economic salvation.

After the end of World War II, Dutch economic growth was powered by a society-wide agreement on wage moderation. This policy was so successful that, by the 1960s, Dutch labour markets were extremely tight, and workers found they could successfully demand much higher wages. The consensus on wage moderation collapsed, and wage costs soared.

At the same time, government hubris increased. Both taxes and expenditures skyrocketed. Unfortunately, expenditures had the faster take-off. The Netherlands began running huge deficits, which increased the cost of capital and costs related to uncertainty – fear of inflation and worry about high future taxes to pay off the debt. What followed was the worst period in Dutch peacetime economic history.

Slowly, through fits and starts in the 1980s and 1990s, the Dutch got their economic house back in order. Although a breakthrough labour agreement in 1982 ultimately failed in its goal of establishing durable wage moderation, further work in 1993 and 1994 succeeded in building a strong basis for moderation.

Similarly, the Dutch attack on government spending in the early

1980s faltered late in the decade. And it was never accompanied by a firm commitment to reduce taxes. The Wim Kok government, elected in 1994, changed all that, though Kok himself was the leader of the leftish Labour party. The new government forcefully tackled both expenditures and taxes. It has had considerable success in bringing both down.

It is the period after the aggressive reforms initiated in 1993 and 1994 to moderate wages and reduce taxes that became known as the time of the "Dutch miracle". As costs were reduced and profits restored in the Dutch economy, strong economic growth resumed. Real wages have increased. The Netherlands has gone from having one of the highest unemployment rates in Europe to one of the lowest anywhere in the world, and Dutch economic growth is again strong.

The United States

The United States has little in the way of regional programmes, yet regional problems do not endure long in the U.S. economy. Lagging regions have shown strong convergence with leading regions, and states tend to recover quickly from regional recessions.

The flexible labour market in the United States and low tax levels play important roles in this adjustment process. Moreover, the lack of regional programmes may be beneficial. Such programmes can artificially inflate a regional economy. This raises costs and replaces private-sector activity with public-sector activity. This shrinks the economic base and leaves the economy ever more dependent on government.

Two of the states examined, Michigan and Massachusetts, faced severe external shocks. For Michigan, it was foreign manufacturing competition. For Massachusetts, the winding down of the Cold War devastated the state's defence-contracting industry. As well, changes in technology destroyed the minicomputer industry, which was at the heart of Massachusetts's high-tech industry.

In both states, wages adjusted downwards in response to economic malaise. Both states also cut state government and reduced taxes. These factors made the states cost-competitive, drawing in

new investment and powering the states' recovery. Both states have experienced powerful growth. Unemployment is lower now than it was before the onset of the regional recessions in Massachusetts and Michigan.

Georgia is a Deep South state, once the weakest economic regions in the United States. Georgia built its economic attractiveness on the twin pillars of low taxes and low wages. Now the state boasts one of the most dynamic economies in the world. Per capita state GDP exceeds the national average. Wages have grown strongly with new investment and are now higher than in Canada, yet low enough to permit healthy profits. This continues to power Georgia's growth.