Why Was Europe Left at the Station When America’s Productivity Locomotive Departed?

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Two Big Themes

• Europe’s Productivity Almost Caught up and is Now Falling Behind: In What Sectors is This Happening and Why?

• How Much Does Real GDP per Capita Understate European Welfare?
  – Interpretation of hours per capita
  – Other welfare differences
An Overriding Difference: The Consumer vs. the Producer

- The Fundamental Conflict between the Consumer and Producer.

- Everywhere you look, Europe protects the producer and penalizes the consumer
  - Wal-Mart as a Symbol. Protecting the Consumer while Squeezing the Employee to Achieve the “Low Prices Always”
  - Sitting in Europe vs. Standing in the U. S.
Qualifications

• Raw Growth Comparisons Lead to a *pro-US bias*
• Not enough Attention to U. S. Weaknesses
  – Inequality
  – Medical Care
  – Education
  – Protection and Pork Barrel
• Whenever I bring up a U. S. weakness, there’s always Ian jumping to the defense of the American Way (who is Ian?)
Productivity since 1870: Almost Catching Up is Not Enough
Productivity Post-1960: The Ratio Reaches 96.9% in 1995
Annual Growth Rate of GDP per Hour, EU minus US, 1870-2003
Where is the Difference? The Van-Ark Decomposition

- 55% retail trade
- 24% wholesale trade
- 20% securities
- Rest of the economy: ZERO
- U. S. negative in telecom, backwardness of mobile phones
Finding the Culprit Industries

Output per Hour by Industry Group, EU and US, 1990-2003

- US ICT Pro
- EU ICT Pro
- US ICT Using
- EU ICT Using
- US Non-ICT
- EU Non-ICT

1990-1995
1995-2001
The Big Question: What’s Wrong with Europe in Retailing?

- U. S. “Big Boxes” (Wal-Mart, Home Depot, Best Buy, Target)

- Stunning Finding from Micro Data: ALL of U. S. retail productivity growth has been achieved by new post-1990 establishments and the closing of old establishments. Continuing establishments contributed nothing

- Europe:
  - Land-use regulation, planning approval
  - Shop-closing restrictions
  - Central-city congestion, protection of central-city shopping precincts
The New Conference Board Report: *The Retailing Revolution*

- **Startling Numbers**
- **U. S. Retail Trade Productivity Growth**
  - 1980-95, only 2.6 percent per year
  - 1995-2002, jumped to 7.4 percent per year
- **U. S. Wholesale Trade**
  - Jumped from 4.1 to 8.5 percent over same time intervals
Five Factors Explain Europe’s Lagging Behind in Retail

• #1: U. S. got started first in converting retail from low-tech to high-tech

• #2: Europe’s regulatory obstacles
  – Regulation within individual countries
  – Inconsistent regulation across national boundaries

• #3: Reduced opportunity for cross-border scale limits Europe’s ability to exploit Economies of Scale
The Last Two

• #4: Europe’s Trucking Industry was deregulated only in mid-1990s (U.S. in late 1970s)
  – Inhibits complementary innovation in retail and shipping

• #5: Culture and taste differences among European Countries
Product Market Competition Imposes Costs

• Unbridled expansion of Wal-Mart and other U. S. retail “big boxes”
  – Tears up the countryside
  – Destroys Main Street businesses in small towns

• Protection of the European urban retail “pedestrian zone”: Efficiency is not the only priority, other values matter
Ian on Wal-Mart

• “Wal-Mart vs. inner-city pedestrian shopping zones . . .”
  – Not an issue of variety vs. homogeneity
  – It’s an issue of aristocracy vs. egalitarianism

• “To promote ancient downtowns at the cost of higher prices aids the rich and hurts the poor”

• My false dichotomy: IKEA in Sweden and a thriving downtown in my own Evanston
Turning to the Second Big Theme: Welfare Comparisons

- Blanchard (*JEP* Future of Europe Fall 2004)
  - Everything is OK
  - Productivity has caught up to 100%
  - The 75% Ratio for Output per Capita reflects Voluntarily Chosen Leisure

- But He’s Wrong on Productivity

- What about Output per Capita?
The Broad Sweep of 2 Centuries: Income per Capita
Since 1960: Europe Fails to Converge and then Falls Behind
The Europe / US Ratios Are Much More Dramatic
Output per Capita, Europe/US: Stagnation Since 1970
Ratios of Ratios: The Real Clue as to What is Going On
What are the Numbers that Go with these Lines?

<table>
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<th>(Y/N) / (Y/H)</th>
<th>H/E</th>
<th>E/N</th>
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<td>1960</td>
<td>119.8</td>
<td>102.4</td>
<td>115.9</td>
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<td>73.6</td>
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<td>2004</td>
<td>77.1</td>
<td>85.4</td>
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% Log Change

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<tr>
<td>% Log Change</td>
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Hours per Employee Declined in Tandem until 1970, then diverged
A Close-up of Hours per Employee after 1960
Employment per Capita back to 1870

Europe - 15

United States
An Outline of Issues for Discussion

• Europe’s failure to converge is not just a matter of voluntary vacations

• Much more of the change 1960-95 was the decline in employment per capita

• Even lower hours are not entirely voluntary
  – Ian: “If the French really wanted to work only 35 hours, why do they need the hours police?”
  – Alesina (NBER Macro Annual Conference 2005):
    • Short hours are a victory for unions and parliamentary politics, not for free choice
    • So is early retirement, a major source of falling E/N
What Matters for Welfare is Y/N + Differential Leisure, not Y/H

• Europeans have “bought” their high productivity ratio with every conceivable way of making labor expensive
  – High marginal tax rates (payroll and income taxes)
  – Firing restrictions
  – Early retirement (55! 58!) with pensions paid for by working people
  – Lack of encouragement of market involvement by teens and youth
The Decline in Europe’s E/N Matters more than H/E

• First, which age groups are suffering from higher unemployment in Europe?
• Second, which age groups experience lower labor force participation in Europe?
• Third, how does it come together in the distribution of low E/N by age group?
• Note: These graphs are for total population by age and blur male/female differences.
Leisure?
Unemployment by Age

Unemployment by age
The “Peaked Hump” in European LFPR
Putting it Together: E/N by Age

Employment rates

0 10 20 30 40 50 60 70 80 90

Decomposing the EU/US Difference in the E/N Ratio

<table>
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<th>age distribution</th>
<th>unemployment</th>
<th>LFPR</th>
<th>E/N ratio</th>
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<td>US</td>
<td>US</td>
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Welfare Aspects of E/N by Age Group

• Youth enter late into Market Employment

• If we are assessing extra European “leisure”, how much if any credit do we give to youth?
  – Disconnected from the market economy
  – American youth are expected to work

• Link with government support of higher education: tuition grants in Europe vs. peer-reviewed research grants in US
  – Plus state university subsidies
The Welfare Effect of Early Retirement: Back-of-Envelope Handout

- Baseline: work age 20-65, retire 65-84
- No saving, investment
- 30% tax finances pay-as-you-go pensions with balanced govt budget
  - Tax finances equality of consumption in retirement to consumption during work years
- Alternative retirement age at 55 requires tax increase to 45.6%, 25.1% decline in consumption during work years and retirement
Welfare Valuation of Leisure

• Work time is chosen to equate marginal utility of leisure to after-tax wage
• Diminishing marginal utility of leisure
  – Infra-marginal leisure valued > wage
  – Extra-marginal leisure valued < wage
• Back-of-envelope.
  – Value weekday and weekend leisure of both workers and retired = 4/3 after-tax wage
  – Value hours switched from work to retirement = 2/3 after-tax wage
Welfare calculation

- With 55 retirement age, after-tax wage is 25% less
- Extra hours switched from work to retirement leisure are low-valued (2/3)
- Total welfare = market consumption plus total value of leisure
- Market consumption declines 25.1 percent, welfare declines 22.6 percent, ratio 90% (i.e., leisure offsets 10%)
Conclusion about Leisure Offset

• Europe’s decline in H/E, not all of this is voluntary (Alesina)

• Europe’s decline in E/N due to unemployment and low labor force participation of youth and early retirees, virtually no leisure offset

• Freeman-Schettkat
  – Part of difference in H/N represents not leisure but household production
  – German mothers cook at home, American mothers go out to eat
Turn the Tables on the U. S.: The “Disconnect” between Welfare and PPP-Adjusted GDP

• GDP Exaggerates U. S. GDP per Capita
  – Extreme climate, lots of air conditioning, low petrol prices, huge excess energy use
  – U. S. urban sprawl: energy use, congestion
  – Crime, 2 million in prison

• How much is this worth?
A Shrinking Explanation: Declining Btu / GDP
The EU-US Difference is only 2% of GDP
Other Additions or Subtractions from Europe’s Welfare

- Urban Congestion?
  - London vs. NY? Paris vs. Chicago?
  - Time spent in London underground vs. in a Chicago automobile?

- Prisons, perhaps 1% of GDP

- Undeniable U. S. superiority: housing
  - People value interior square feet (2X in US)
  - People value exterior land (4X in US)
Ian on Urban Density

- “We overspend on highways, they overspend on trains”
- “We live in suburbs and have long commutes, they live in cramped homes and are closer to work”
- “We have options: in Chicago I can live in a suburb and drive OR live in an apartment and walk to work”
- However, many Americans lack such options
  - Inner city African Americans seeking suburban jobs
  - Many medium and small cities have virtually no public transit options, and there are few jobs where you can “walk to work”
Putting it Together for 2004

- EU/US Y/N = 68.8
- EU/US Y/H = 89.2
- Raise Europe:
  - 67% of H/E difference (11.8) is leisure = 7.9
  - 10% of E/N difference (8.6) = 0.9
  - Half of Energy use difference = 1.0
  - Prisons and other = 1.0
- Europe’s welfare vs. U. S. = 79.6
A Solid Reason why the U. S. Welfare Level is Truly Higher

- Hedonic regressions show: people value square feet of housing and exterior land
- The average American housing unit is more than double the average European unit
- The land area is at least 4x, maybe more
- The time cost of commuting may be less when all the delays of public transit are taken into account
Aggregation in U. S., Lack of Aggregation in Europe

• Puzzle is not failure in Europe, it’s heterogeneity in Europe
• If you disaggregated the U. S., you’d find similar differences in Productivity growth and IT use:
  – Silicon Valley = Ireland + Finland
  – New England = Denmark + Sweden
  – Austin Texas = Australia
  – Heartland = France or Germany
  – What’s Missing in U. S. is Olive Belt (IT+PO+SP+GR)
    • But we’ve got it south of the border in the Tequila Belt
Finally, A Set of Qualifications about the Apparent U. S. Advantage

- #1. Europe is not Homogeneous
- #2. Secondary Education in U. S.
- #3. Chaotic and Inefficient Medical Care
- #4. Astounding Results on Inequality
- #5. Perverse Public Policies
Qualifications about the U. S.

- Education
  - Poor elementary and secondary schools dependent on wildly unequal finance across school districts
  - U. S. ranks low on world league tables of science and math knowledge by teenagers
The U. S. Medical Care Non-System

- Medical Care Insurance Tied to Employment, not a Right of Citizenship
  - Artificial creation of part-time jobs
  - Toyota builds its new plant in Canada
  - The noose around the neck of the legacy firms (GM and Ford)

- 4% of GDP wasted on paperwork

- Economists are Making this worse – confusion about moral hazard
Some New Results About Inequality: Shares of Growth in Real Wage and Salary Income, 1997-2001

- 0-20: 1.9%
- 20-50: 10.8%
- 50-80: 23.4%
- 80-90: 14.8%
- 90-95: 11.0%
- 95-99: 14.3%
- 99-99.9: 16.2%
- 99.9-100: 7.7%
- 100+: 14.8%
Percent of Real Income Growth Accounted for by Top 10 Percent

Figure 12.
Share of Top 10 Percent in Increase of Real Income, $2000, Selected Intervals, 1966-2001

- Labor Income
- Nonlabor Income
- Total Income

Percent of Real Income Growth Accounted for by Top 10 Percent

- 1966-79
- 1979-97
- 1997-2001
- 1966-2001
Government Intervention in the U. S. is off the Rails

- Farm subsidies: hurt LDCs, promote obesity
- Steel Tariffs
- Medical Care: Run in the interest of giant insurance and pharmaceutical corporations
- Starvation of Public Transit and Subsidization of Interstate Highways
- Pork-Barrel Energy Bill and Transportation Bill, the Bridge to Nowhere in Alaska
- Local Zoning and Inequality of School Finance
- Tax Deductibility of Mortgage Interest
Ian on Farm Subsidies

• “To complain about American subsidies seems odd considering that the average cow in Europe earns more income in subsidies than the median income of the world”

• OK, Europe and U.S. are equally guilty on farm subsidies

• The rest of my list is intact
Conclusion: Persistence of American Exceptionalism

• America:
  – Long work hours, short vacations
  – Low-density metro areas
  – High fertility
  – Role of immigration interacts with flexible labor markets
Are Tastes Endogenous?

- Europe and U. S. have Settled down in Two Different Equilibria?
- Can One Side Converge to the Other?
- Policies, Constraints, Influence Tastes
- The Best Prediction is: Still Different in 50 years
Let Ian Have the Final Word

• “In Europe you have to pay higher prices so that rich people get variety”

• “If you want half-decent higher education, you have to leave the continent”

• “If you’re poor, you can’t rise because it’s hard to start a company and you can’t work more than 35 hours per week”

• “Show me a European Richard Grasso (former CEO of the New York Stock Exchange), a man who didn’t go to college and got fired for making too much money”