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Transatlantic Differences

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## Competition between the US and Europe: which model is economically more successful?

### 1. DEFINITION OF PERFORMANCE AND PLAN OF THE PAPER

Evaluating the success of an economic or social model requires a clear definition of the goals the model is designed to achieve. Narrowly defined, the objective of an economy is to secure high incomes for its citizens. Furthermore, economic behavior implies that incomes should be generated with the least amount of effort, which leads to the goal of efficiency (relation of output to input). Thirdly, technical innovations and – this point is not uncontroversial – human nature induce people to strive for more than they have or have had in the past, implying a desire for income and productivity growth. Summarizing these elements, the narrowly defined goals of an economic system are to maximize income and productivity and to foster the dynamic generation of income and productivity over time.

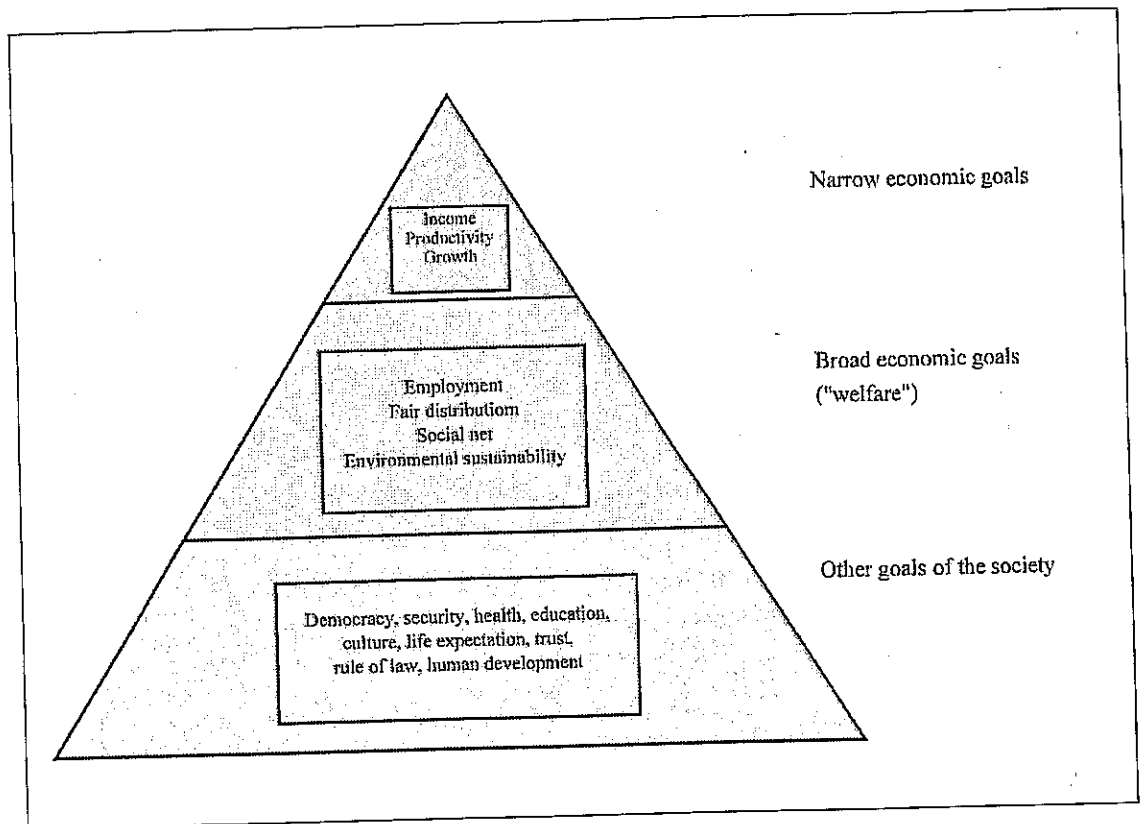
Even hard core economists acknowledge that income maximization is not the ultimate goal; a more adequate description of the ultimate objective is welfare maximization. However, what constitutes welfare is not easily defined. There is a consensus that

- people should be able to work and that unemployment is not only a waste of resources, but is in violation of a basic human need;
- incomes should be distributed fairly, inequalities should be limited, particularly those not attributable to differences in effort and qualification;
- life's greatest risks should be cushioned by solidarity: unemployment insurance and the provision of health care and old age pensions should be valued positively;
- the consumption of natural resources should be limited to the extent that existing reserves can be sustained.

These considerations imply that a more broadly defined economic concept embraces employment, unemployment, income distribution, the comprehensiveness of the social net and ecological conservation.<sup>1</sup>

When extended even farther, concepts of welfare also include life expectancy, democracy, security, cultural goals, the rule of law, and all aspects of human development. The broader the set of goals to be evaluated, the more difficult it is to measure these goals, and the more difficult it is to determine the relative weights of the individual objectives and make a general assessment.

*Figure 1: Hierarchy of economic and social goals*



This paper first evaluates the European Union and the US according to narrow economic goals, and then investigates broader aims (Sections 2 and 3 respectively). Section 4 analyses the economic dynamics of Europe and the US during the nineties, and Section 5 provides arguments as to why the US may continue exhibiting superior economic performance during the next decade. Section 6 looks at the strategies of the four most successful European economies and speculates as to whether they could represent a successful New European Model, while Section 7 summarizes our work.

## 2. PERFORMANCE ACCORDING TO INCOME, EFFICIENCY AND DYNAMICS

Income per capita in 2002 amounted to 34,000 Euro in the US and 24,400 Euro in the EU. Thus the US led Europe by 40 % – a rather high margin.<sup>2</sup> This means that a US citizen was able to buy 40 % more goods from a roughly comparable basket of goods and services. The US lead shrinks to 30 % when we calculate income per person employed (73.000 Euro in the US). The reason that the difference in productivity is smaller than the difference in per capita income is that the US employment rate is 80 %, whereas in Europe it is only 67 %. The difference narrows even more when we measure production per hour, which amounts to 38.80 Euro per hour in the US vs. 35.50 Euro in the European Union – a margin of only 9 %. Productivity per hour is sometimes considered to be the best measure of productivity proper, although it is the most difficult to estimate.<sup>3</sup> Summing up all of these facts, the US advantage is extremely large with respect to per capita income, is somewhat less when measured according to income per worker, and is even smaller, but still significant in terms of income per hour. The first indicator is most relevant to income and the potential to consume; the last is the best indicator of efficiency.<sup>4</sup>

*Table 1: Differences in income per capita, per worker and per hour*

	GDP per capita			GDP per worker			GDP per hour		
	EU	USA	US/EU	EU	USA	US/EU	EU	USA	US/EU
	1000 EURO			1000 EURO			EURO		
1980	16.30	22.31	1.37	39.84	51.16	1.28	23.00	27,93	1.21
1990	20.08	27.88	1.39	47.43	58.66	1.24	28.82	32.25	1.12
1995	21.30	29.81	1.40	52.52	62.79	1.20	32.53	34.13	1.05
2002	24.43	34.08	1.39	56.26	72.94	1.30	35.52	38.83	1.09

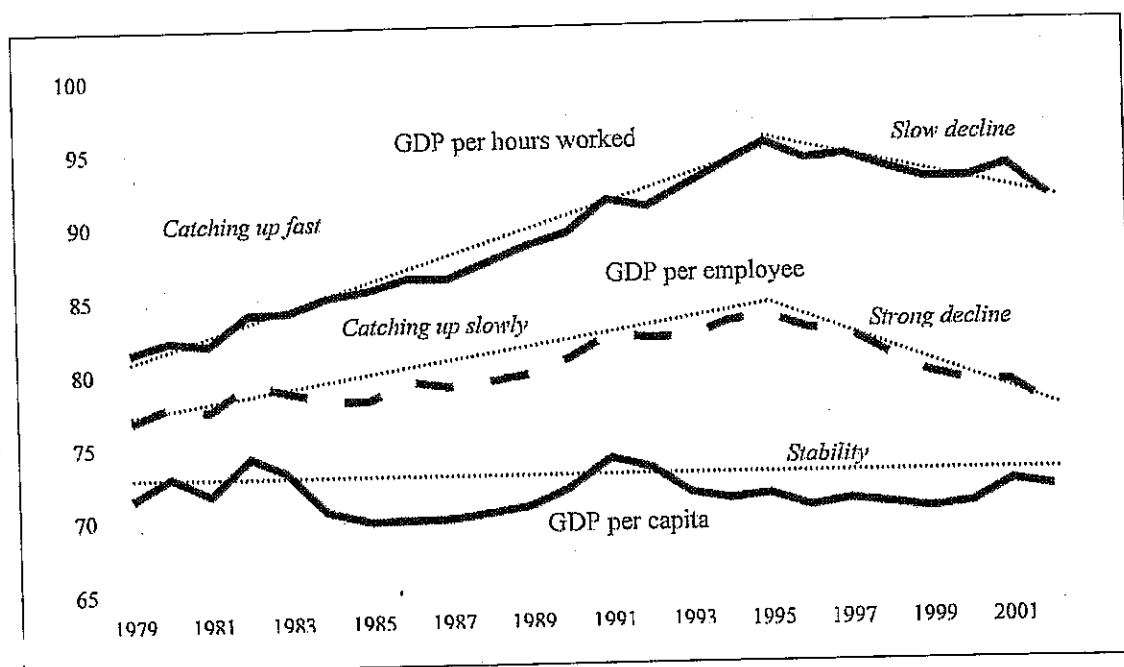
Remark: In 2002, the US lead in income per capita was 40 %, per worker 21 %, per hour 15 % as calculated according to data recently published by the European Commission (Structural Indicators).

*Source:* WIFO calculations using data from the Groningen Growth and Development Centre.

Looking at productivity dynamics, we see that over the long run, Europe has been catching up with the US in GDP per worker and per hour. The difference in the first was 28 % in 1980, narrowing to 20 % in 1995. In 1980, pro-

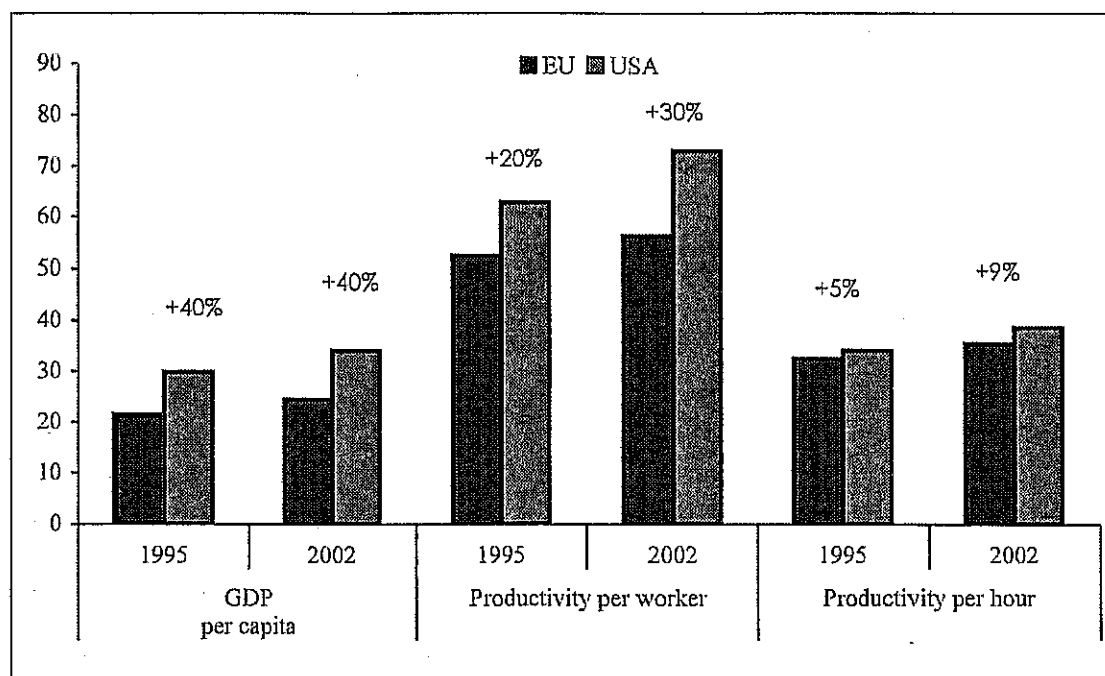
ductivity per hour was 21 % higher in Europe than in the US, but in 1995 Europe nearly matched the US (the difference declined to 5 %). Since 1995, the differences have again become wider, by about 10 points for productivity per worker and 4 points for productivity per hour. The reason why US productivity has been able to forge ahead after decades of European catching up has been widely discussed; there are at least three lines of explanation: (i) the earlier and stronger embracement of information and communication technology, (ii) insufficient European investment in research and human capital, and (iii) the rather restrictive monetary and fiscal policy in Europe. For GDP per capita the gap did not widen; the US has been leading here since the early 20<sup>th</sup> century and the difference increased only slightly between 1960 and 1990. This has been received by some researchers as good news ("at least for this indicator, Europe has not fallen farther behind during the nineties"), but the difference of 40 % is very, very large.

*Figure 2: European catching up in GDP per capita, productivity per worker and per hour (US = 100)*



Source: WIFO calculations using data from the Groningen Growth and Development Centre.

Figure 3: The US lead according to three indicators: the short run evidence



Source: WIFO calculations using data from the Groningen Growth and Development Centre.

Economic growth as measured by real GDP grew somewhat faster in Europe than in the US over a large part of the post World War 2 period, including the eighties. Since 1990, the US has been outperforming Europe: it was less effected by the crisis of 1993, achieved higher growth during the second half of the decade and was more resistant to the most recent crisis of 2001/2003. For the period 1990 to 2003, this difference amounts to 1 % per annum and 14 % cumulative.

### 3. PERFORMANCE ACCORDING TO A BROADER SET OF ECONOMIC GOALS

The employment rate is 13 percentage points higher in the US, namely 80 % versus 67 %. Up to the mid seventies, the share of employment for the working-age population was higher in Europe than in the US. In 1960, the employment rate was 70 % in Europe, as compared to 66 % in the US. The reason why the curves crossed is beyond the scope of this paper. Let it be said that more fastly growing economies need more employees. Secondly,

at the lower end of the wage spectrum, US labor became comparatively cheap. The labor intensity of US growth has been higher, and part time jobs as well as jobs which pay less than the level of income necessary for a decent living have been encouraged and accepted. The US created 78 million new jobs between 1960 and 2000, Europe 42 million. Employment creation during the most recent years has accelerated in Europe: between 1995 and 2002, Europe created 12 million jobs. Even during the three years of slow growth (2001–2003) employment has – in contrast to experiences during other periods of sluggish growth – been increasing, although many of the jobs are part-time. Unemployment is 6 % in the US and 8 % in Europe (2002), down from 10 % in Europe, and remaining nearly constant in the US.

*Table 2: Employment and unemployment*

	Employment rate			Employment in million persons			Working hours per year and per person			Unemployment rate		
	EU	USA	US/EU	EU	USA	US/EU	EU	USA	US/EU	EU	USA	US/EU
1980	64.5	71.0	1.10	145160	99303	0.68	1732.5	1831.4	1.06	5.6	7.1	1.27
1990	64.5	77.9	1.21	154249	118793	0.77	1643.8	1819.0	1.11	7.4	5.5	0.74
1995	62.7	78.6	1.25	150721	124900	0.83	1612.0	1839.9	1.14	10.1	5.6	0.55
2002	67.0	79.7	1.19	164471	134398	0.82	1581.3	1878.4	1.19	7.6	5.8	0.76

*Source:* WIFO calculations using data from the Groningen Growth and Development Centre.

The social net is considerably tighter in Europe. Net public spending on welfare is about 16 % in the US and 24 % in Europe (OECD). Most Europeans have government funded or commanded health insurance, pensions are higher, retirement can be started earlier and the share provided by the government is higher. Unemployment payments are higher in relation to income (replacement rate), they are paid for a longer period of time and the fall back payments (social assistance) are relatively high and practically unlimited in time.

Income is distributed less evenly in the US. The top 20 % earns 45 % of total income, the bottom 20 % earns 4.8 %, which results in an inequality ratio of 9.4. In Europe, the corresponding numbers (in an unweighted average of the member countries) are 38.5 % for the top 20 % and 8.3 % for the bottom 20 %, resulting in a ratio of 4.7. The lowest ratio in Europe is 3.2 for

Austria, followed closely by the Scandinavian countries and Belgium; Portugal is the only country where the inequality ratio nears that of the US. Poverty ratios can be calculated absolutely or relatively; in both cases, the US has higher rates. The uneven distribution of income is increasing in many countries, but is greatest in the US. Contrary to a common expectation – suggested by the increasing inequality of incomes – the poverty rate is not rising in the US: it dropped from 22 % in 1960 to a historic low of 11.1 % in 1973. It later increased to 15.2 % in 1983, following the shift in economic policy by the Reagan Administration and the increase in unemployment. It declined during the nineties to 11.3 % and has been increasing slightly since the most recent recession (11.7 % in 2001).<sup>5</sup> The reason for the relatively low level of poverty despite increasing income inequality is the relatively high employment rate.

*Table 3: Broad indicators of economic welfare in 2002*

	EU	USA
Employment rate	67.00	79.70
Employment generation 1990/2002	10259.40	19550.80
Unemployment rate	7.60	5.80
Net social expenditures (public and private) <sup>1</sup>	25.80	23.40
Net social expenditures (public) <sup>1</sup>	24.00	16.40
Income distribution <sup>2</sup>		
Share of top 20 %	38.50	45.20
Share of low 20 %	8.30	4.80
Relation of top 20 %/low 20 %	4.70	9.40
Energy consumption in Mtoe/GDP <sup>3</sup>	0.15	0.26
Carbondioxid in t/GDP <sup>3</sup>	0.31	0.57
Self assessment of happiness <sup>4</sup>	7.05 <sup>5</sup>	7.60
Self assessment of life satisfaction <sup>4</sup>	6.81 <sup>5</sup>	7.46
Health adjusted life expectancy (at birth) <sup>6</sup>	70.14	67.50
Persons sentenced to prison per 100000	65.00	469.00

<sup>1</sup> Adema, 2001, OECD, Society at a Glance, 2005. – <sup>2</sup> IMD, Competitive Yearbook, 1999. –

<sup>3</sup> Total Primary Energy Supply, OECD, International Energy Agency. – <sup>4</sup> Veenhoven, 1997. –

<sup>5</sup> 4 largest EU countries only (Germany, France, Italy, United Kingdom) – <sup>6</sup> OECD, Society at a Glance, 2005.



There are also other indicators which underline the greater downside risk of American society. The number of homeless, illiteracy rates, the share of population in prison<sup>6</sup>, homicides, the relative prevalence of drugs and guns, racial discrimination, and the tremendous discrepancies between living standards in slums and suburbs illustrate this point. On the other hand, the data on mobility reveal that upward mobility is greater, although the difference between the US and Europe is far less than commonly believed (Alesina et al., 2001). The number of immigrants in the US is larger than in the EU.

Europe is definitely leading the US in ecological performance. Energy consumption per GDP is 73 % higher in the US than in Europe (US 0.26 Mtoe/GDP, Europe 0.15 Mtoe/GDP), carbon dioxide is 84 % higher relative to GDP. With respect to the dynamics of emissions, Europe is at least trying to fulfil the Kyoto targets of reducing greenhouse gases, while the US is not.

Europeans have more leisure time. More specifically the share of population in work is smaller by 13 percentage points, and there are 16 % less working hours per year (more vacations, less weekly hours). It is difficult to assess the extent to which these differences are voluntary (and maybe even the ultimate goal of human development) and to which extent they are the by-products of the economic environment – such as the lack of full-time jobs or jobs for middle-aged workers, who have lost their jobs and have little chance of regaining employment. Gordon (2002, p. 10) ventures the “wild guess that about one third of the difference represents voluntary chosen leisure and the remaining two thirds represent a lack of employment opportunities”.<sup>7</sup>

How can we weight these factors? It is most likely that there is no satisfactory way, and indeed there should be no way, since an assessment of the success or failure of an economic and social system should be directly related to a specific question. One way of attaining an overall assessment by means of socio-economic research is to formulate two internationally comparable questions, namely whether a person is happy and whether he is satisfied with his life. Despite sounding a bit primitive at first, this line of research is serious. It includes many tests for cultural biases, and displays careful sampling and wording. Results indicate that people are influenced by income, but the rankings ascribed to income and subjective aspects of life are not redundant. For both subjective indicators, Americans rank higher in terms of satisfaction, namely 7.6 for happiness on a scale of ten versus 7.1 for

the 4 largest European countries (Germany, France, the United Kingdom, Italy). For life satisfaction, the US rating is 7.5, while the corresponding value for the 4 largest European countries is 6.8. Interestingly, intra-country differences within the US are smaller than in France and the United Kingdom.<sup>8</sup>

#### 4. DIFFERENCES IN DYNAMICS

European economic performance during the nineties was disappointing: growth was 2.2 % p.a. between 1990 and 2002, 1 percentage point less than in the US; labor productivity expanded by 1.6 % in Europe, compared to 2 % in the US. Employment increased by 0.6 % in Europe versus 1.1 % in the US (Table 4). What sounds small in p.a. figures amounts to a cumulative growth in GDP of 26.5 % vs. 40.7 % over the given period. Thus, output growth, productivity dynamics and the creation of employment were all higher in the US. In this section, we will analyze the reasons, discuss the weaknesses of the EU and US regimes and attempt to assess what can be expected during the next decade.

*Table 4: Europe underperforms relative to the US in growth dynamics during the nineties*

	Growth of real GDP		Productivity growth per worker		Employment growth		Productivity growth per hour	
	EU	USA	EU	USA	EU	USA	EU	USA
1991–1995	1.59	2.39	2.06	1.37	-0.46	1.01	2.45	1.14
1996–2000	2.65	4.04	1.22	2.40	1.41	1.60	1.42	1.97
2001–2002	1.29	1.27	0.41	1.58	0.87	-0.30	0.88	1.59
1996–2002	2.26	3.24	0.99	2.16	1.26	1.05	1.26	1.86
1991–2002	2.16	3.15	1.56	2.00	0.59	1.13	1.92	1.70

*Source:* WIFO calculations using data from the Groningen Growth and Development Centre.

Most international studies and specifically the OECD, the IMF and the European Commission explicitly or implicitly blame high welfare costs and low market flexibility for Europe's underperformance. While it is true that welfare costs are higher and European labor as well as product markets are more regulated, there are some doubts as to whether this is the main expla-

nation. Firstly, differences in product market as well as labor market regulation narrowed considerably during the nineties; markets in the United Kingdom are equally or even more deregulated than in the US. Secondly, there is no relation between the degree of regulatory change during the nineties and economic performance (Aiginger, 2003B). And thirdly, the European countries which performed best during the nineties were Sweden, Finland, Denmark and the Netherlands, of which at least the first three are high welfare spenders (Aiginger, 2003A).<sup>9</sup>

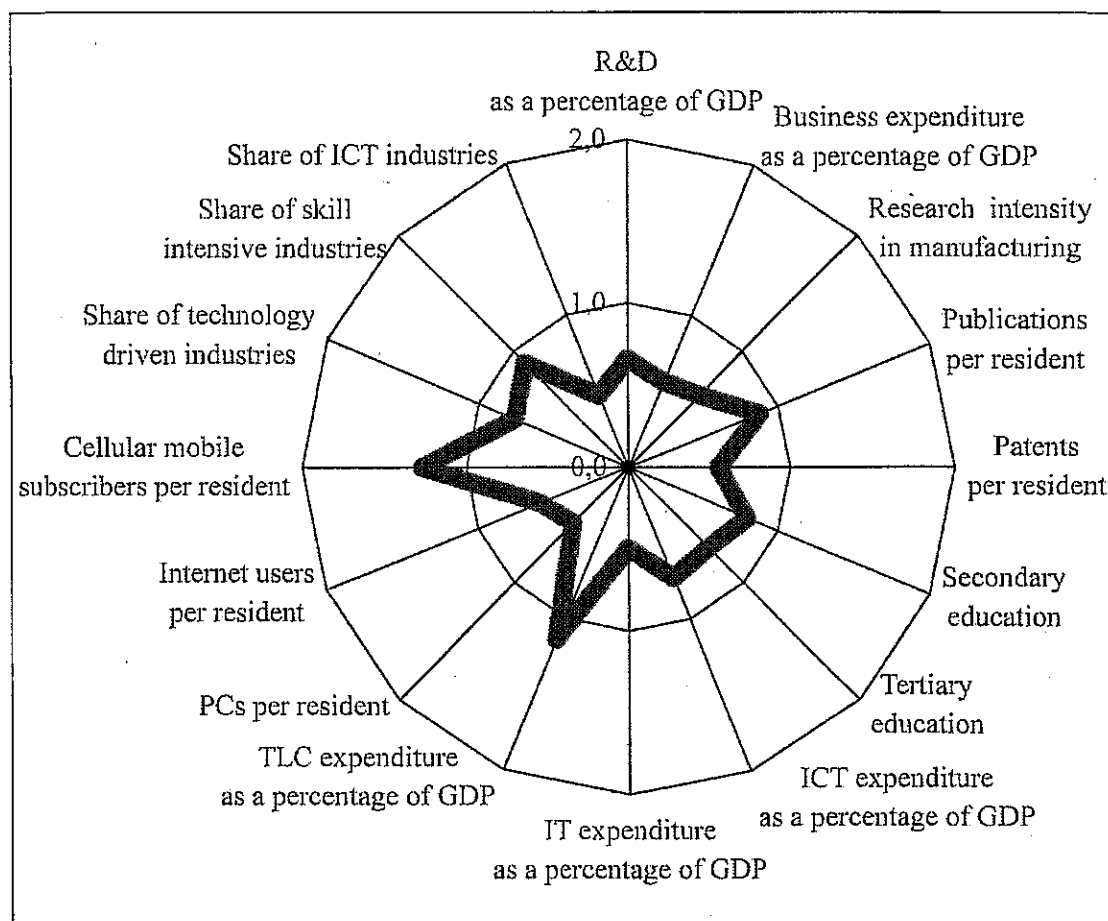
Other authors stress differences in macroeconomic policy. US monetary policy during the nineties actively fostered not only price stability, but also assumed responsibility for economic growth and output stability. The US reduced interest rates early and courageously, in order to support economic growth, reaching a rate of 1 % in mid 2003. The strategy was supported by the administration's reputation of being tough and inflation-minded, and was administered by a chairman, who enjoyed exerting his authority and actively accepted responsibility for the economic fate of his country. Interest rates are still lower in the US. The fiscal deficits during the recession of 2001/2003 were not restricted by fiscal policy rules. The government was unrestricted in its move to switch from surplus to deficit during the recession, setting into effect automatic stabilizers through discrete expenditure hikes (inter alia for security and war) and underlining its commitment to long-run growth through a generous long-term tax reduction plan. In mid-2003, the overall government deficit is estimated to be well above 4 % of GDP, while in the European Union it is 2.5 %.

My favorite explanation for the slow rate of growth in Europe during the nineties is that Europe did not invest enough in the factors responsible for long run growth. Taking a look into economic theory reveals that there are three main determinants of long run growth in high income countries: research and innovation, human capital, and the speed at which new technologies are diffused. Aiginger (2002) developed a system of 16 indicators to measure the investments of countries into those variables which theory and empirical studies have shown to be important to long run growth. The set comprises indicators of research input and research output, education expenditures and educational attainment, as well as spending on ICT in production and consumption (as a proxy for spending and the diffusion of new technologies). The astonishing result is that in 1990, the US was leading in all 16 indicators. At the end of the nineties, the US was still leading in 14 of the 16 indicators. The EU is catching up in four of the indicators, and

has surpassed the US in two; while the difference is increasing for 11 indicators. In light of this evidence, it is therefore no surprise that growth rates have been higher in the US since the nineties.<sup>10</sup> Figure 4 illustrates European performance and expenditures on determinants of future growth in comparison to the US. Each value outside of the unit circle indicates under-investment in Europe relative to the US.

While a certain degree of market flexibility is a precondition for growth, and a growth-oriented macro economic policy provides valuable support, the drivers of growth are the final determinants of the growth path.

Figure 4: Investment in future growth; EU vs. US



Remark: Values inside the unit circle show lower levels of investment in the EU; data for last year available (1999/2000/2001).  
 Source: WIFO calculations.

## 5. WILL THE NEXT DECADE ALSO BE CHARACTERIZED BY THE SAME US LEAD?

We should remain modest in our efforts to predict the course of the next decade. Economists did not predict the acceleration in productivity during the nineties. Solow even proclaimed that computers were evident everywhere but in the productivity statistics, and the US feared that it had lost its lead in manufacturing to Japan. Therefore, we will simply list the factors most likely to determine the relative positions of Europe and the USA, examining which factors have changed since the nineties and which have persevered. Finally, we will address certain problems typical of the US, which may gain relevance during the next decade.

### Arguments favoring the catching up of Europe

The restrictive effects of fiscal policy will decline: several European countries have balanced their budgets, at least from a structural, if not from a cyclical standpoint (in the trough of 2001/2). Although this is not the case for Germany, France, Italy, and Portugal, even these countries have enacted structural reforms and budget cuts on the one hand, and will go to the limits of the stability pact or beyond, which should lead to a less restrictive fiscal policy than that of the nineties.

The restrictive effects of monetary policy will also decline: the EZB favors a prudent monetary policy, which places high priority on controlling inflation. During the starting phase, the EZB built up its tough reputation; since then it has been less restrictive than the Deutsche Bundesbank was during the nineties. And the non-inflationary increase of unemployment could be smaller due to reforms in the labor market, allowing a less restrictive policy for a given amount of output growth.

Europe is reforming its welfare systems and cost consciousness has risen: several countries have started to tackle the pension problem, welfare costs have been reduced – without dismantling the core elements of the welfare states – and unfavorable incentive structures have been changed. The awareness that permissive policies cannot be corrected later via depreciation has increased cost consciousness.

Europe still has an advantage in the diffusion phase: the European system of innovation, with its reliance on skilled labor and small scale innova-

tion, seems to be more competitive during the diffusion phase of a new technology, and improving quality step by step is one of Europe's core capabilities

European enlargement, the shaping of the new institutions, liberalization and the consequences of the Single Market will favor growth and competitiveness over the long run. Some of these policies may have resulted in the short run costs of structural change and decreasing employment. Nevertheless, the growth effect of European integration should eventually become evident, and will then accelerate as a result of rapid growth in the accession countries.

### Arguments in favor of a continued US lead

Higher levels of research and efficiency persist: even if certain European countries are catching up and differences in some of the growth drivers are diminishing, differences in the levels of most of these determinants continue to persist; they reflect differences in quantitative inputs as well as in efficiency.

The new lead in biotech: while the US lead in biotech may not be all that large, and while this technology may not spread into too many industries during the diffusion phase, the US will strengthen its lead in General Purpose Technology, GPT.

Industry structure will remain more favorable in the USA, where the share of technology intensive industries as well as that of ICT industries is higher. The share of labor intensive industries is declining, but is still higher in Europe. However, the European advantage in medium skilled industries and in upgrading quality in existing structures will persist (Aiginger, 2000).

Taxes, welfare, and the burden of regulation are lower in the US. The creation of new firms is easier, venture capital is more abundant, and cheap labor is more available, due to the open labor market (and high rates of legal and illegal immigration).

### Three major problems unsolved in the USA

The twin deficit has returned. The US current account deficit has again hit the 5 % mark: although successfully closed in the early nineties, the current

account deficit has again exploded, raising the question of its sustainability (Mann, 2000, IMF, 2002). While economists believe in principle that such a large inequality cannot be sustained, it will continue proving otherwise, as long as foreign investors are content to engage in direct investment or to buy long term bonds and stocks. Up to now, a growing share of international investment has been flowing into the US, yielding the current account deficit irrelevant. The budget deficit has soared to 4.5 % of GDP, influenced in part by automatic stabilizers and by tax reforms, and partly due to the costs of security and war.

Superiority in corporate governance seems to have been lost: it was once "common knowledge" that the US accounting system, the monitoring forces of investment bankers, abundant research analysis, the SEC as a watchdog, and a large community of critical investors together contributed to a superior system of corporate governance with sound incentive structures. However naïve this opinion appears to have been, to which degree the aftermath reforms of 2002 have solved the problem, and however small the number of fraudulent firms really was, the idea of US superiority will never be considered "common knowledge" again. On the other hand, up to now European stock markets have not been able to profit from the situation, and during 2002 investment flows continued to balance the current account deficit.

The US savings rate is approaching zero: the US savings rate is at a level so low that it is thought by many economists to be unsustainable. If people should decide that capital gains are not a reliable form of saving and therefore increase the amount they save from current income, consumption will fall. Investments can only be financed through the inflow of foreign capital or government saving. The latter is no longer a very probable source of savings. Again, the whole triangle of current account deficit, low savings rate, and the influx of foreign capital has worked for a comparatively long time and may be sustainable if profits and (risk adjusted) stock returns are always a little bit higher than in other countries. Nevertheless, the low savings rate remains an element of instability, and regime changes seldom work gradually (simultaneously increasing exports, increasing the savings rate, and re-allocating foreign capital).

A fourth factor whose effect and extent cannot be judged easily is increased expenditures on security. Direct expenditures have remained low in relation to GDP (one or several tenths of a percentage point), but security could assume the role that the preoccupation with unemployment and restructuring in Eastern Germany played in Europe during the nineties: dis-

tracting public and private attention (policy makers and firms) away from the truly important drivers of economic growth.

If, despite of the impossibility correctly weighting and summing up all these different factors, we try to make a forecast, my opinion is that the USA will most likely again succeed at increasing output and productivity faster than Europe. The difference between US and European rates of growth may decline, since some of the reasons behind the superior US performance are changing. And in light of the risks, nobody can predict whether the changes will take place gradually or cumulatively, and whether they will effect the country in which they originate more than the countries towards which the turmoil may extend via world trade and investment.

## 6. DIFFERENCES ACROSS EUROPEAN COUNTRIES

Before closing our comparison of the USA and Europe, we need to highlight differences within Europe. We have already mentioned that economic performance during the nineties (including the current period of recession) was better in Sweden, Finland, Denmark and – with some reservations – in the Netherlands. These countries are welfare states of the Nordic type; this means they are characterized by a high re-distributive goal and high government involvement. These countries followed a three-tiered strategy during the nineties.<sup>11</sup> First, they contained private and public costs, in order to regain profitability and fiscal prudence. Secondly, they fine-tuned their welfare systems and liberalized part time work as well as product markets, in order to improve incentives (Aiginger, 2003A). And thirdly, investment in future growth was increased significantly, surpassing that of the large European economies in research input and output, in education expenditures and quality, and in information technology. In contrast, the large economies (Germany, France, Italy and – with important reservations – the United Kingdom) underperformed in terms of investments in growth drivers.

The structures and policies of the most successful European countries are very different from the US system as far as welfare and government involvement is concerned, as well as in their commitment to training and re-distribution as goals of labor market policy. They are much nearer to the US insofar as they attach a very high value to new technologies, the efficiency of production and the competitiveness of firms. A discussion has started as to whether this combination of welfare and efficiency constitutes a model of



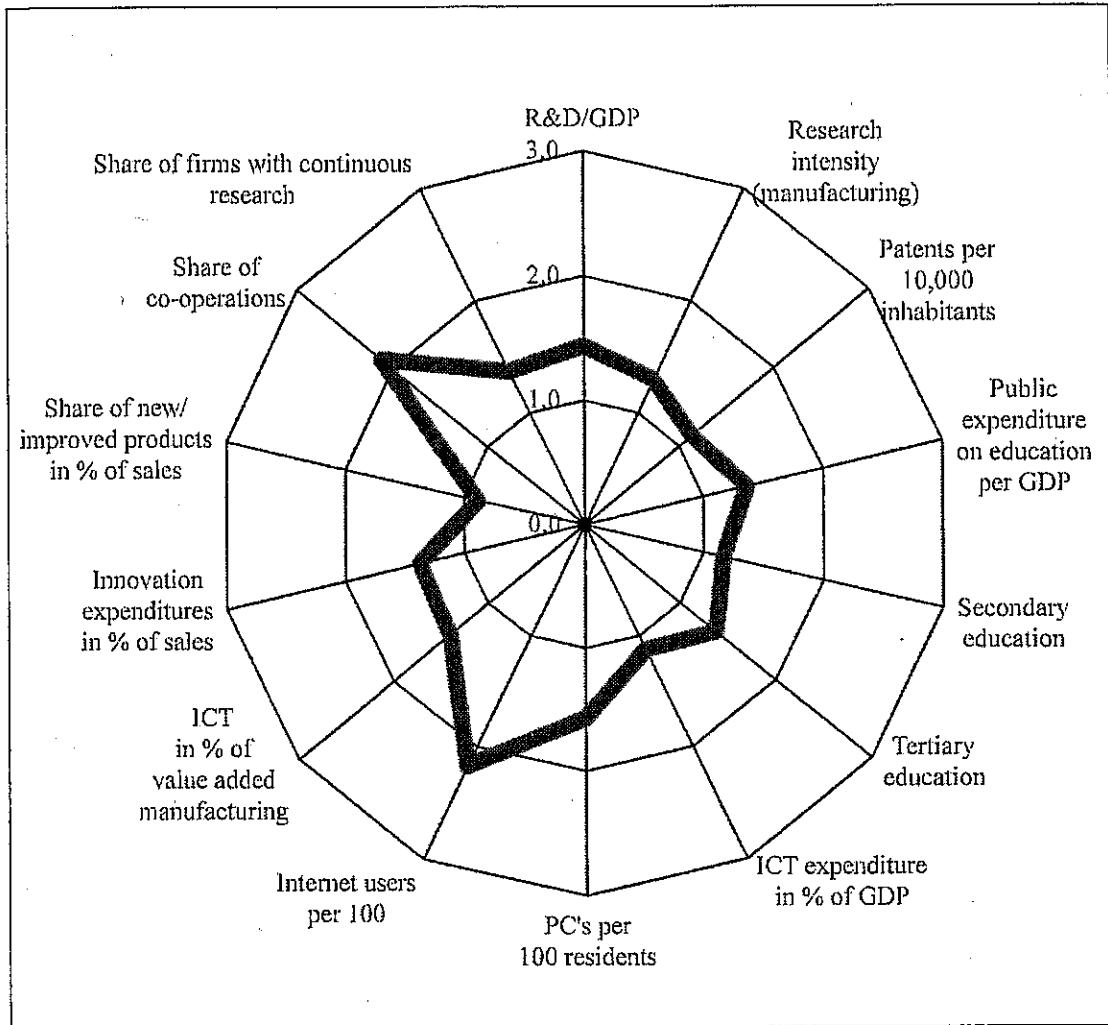
a new, reformed Welfare State (Aiginger 2002, Aiginger, Landesmann, 2002).

*Table 5: Performance of top countries relative to the EU and the US*

	Top 4 EU countries	Large 4 EU countries	EU	USA
Real growth of GDP				
Growth 1993/2002	2.8	1.9	2.1	3.2
Acceleration <sup>1</sup>	0.8	-0.7	-0.5	-0.2
Macro productivity growth				
Growth 1993/2002	2.0	1.4	1.4	1.6
Acceleration <sup>1</sup>	0.2	-0.6	-0.6	0.0
Employment rate				
Average 1993-2002	71.0	65.1	64.4	79.7
Absolute change 1993-2002	3.4	2.5	3.0	3.7
Unemployment rate				
Average 1993-2002	7.7	9.2	9.2	5.2
Absolute change 1993/2002	-2.5	-1.0	-1.0	-1.6
Inflation rate				
Average 1993-2002	2.0	2.2	2.4	2.5
Absolute change 1993/2002	-0.2	-2.0	-2.1	-1.4
Budget deficit in % of GDP <sup>2</sup>				
2002	-1.4	2.6	2.0	3.2
Absolute change 1993/2002	-4.5	-3.6	-3.9	-2.7
Public debt in % of GDP				
2002	48.2	66.4	62.7	61.0
Absolute change 1993/2002	-13.7	9.0	3.7	-13.8
Taxes in % of GDP				
2002	53.9	45.1	45.5	31.6
Absolute change 1993/2002	-4.7	0.5	-0.1	0.6
GDP per capita at PPP 2002				
1000 EURO	25.7	24.6	23.9	33.5

<sup>1</sup> Acceleration: growth p.a. 1993/2002 minus growth p.a. 1983/1992. — <sup>2</sup> Budget deficit: negative value = surplus. — Top 4 countries: Denmark, Finland, Sweden, the Netherlands. — Largest 4 countries: Germany, France, Italy, the United Kingdom.  
Source: WIFO calculations using AMECO.

Figure 5: Investment in future growth; top 4 vs. largest 4



Remark: Values outside the unit circle indicate greater investment by the top 4 countries (in the last year that the indicator was available; usually 1999).

## 7. SUMMARY

1. From the point of view that defines economic performance narrowly in terms of income, productivity, and growth, the US system is the more efficient. Income per capita in the USA is 40 % higher than in Europe and is not about to converge; productivity is 30 % higher in the EU. Europe has been catching up in productivity per worker over the long run, but at a disappointing rate and the US lead has increased during the past 10 years. Income per hour is the most favorable indicator of European per-

formance, revealing a gap of less than 10 %, but again the difference is increasing. Furthermore, this indicator will probably be the most difficult to measure in the upcoming service and knowledge based society, since it requires an exact measurement of working hours.

2. Taking a broader view of economic performance, employment figures underline the high performance of the US system. The USA created 78 million jobs between 1990 and 2003, Europe 42 million. The employment rate, which up to the seventies was higher in Europe, is now 13 percentage points lower in Europe (the gap has recently narrowed a little bit). Employment generation is higher in the US at both ends of the quality spectrum, Europe has lately boosted employment through part-time work, also). Unemployment is higher in Europe, even after a significant number of people were sent into disability or early retirement schemes in order to decrease open unemployment.
3. Europe is leading the US in the comprehensiveness of insurance against social risks (health, age, unemployment), in ecological conservation, in the fair distribution of income and in leisure time. How important these issues are to an assessment of welfare and whether these advantages can outweigh differences in income, cannot be measured objectively. It is very likely that higher incomes and less insurance in the US (and the opposite case in Europe), mirrors differences in preferences. Americans – if such a generalization can be ventured – believe more strongly that risks should be taken by individuals, that space and resources are abundant, that income differences can be closed through upward mobility and individual effort. Whether or not in reality the systems reflect the degree of differences in preferences, or whether outcomes differ more or less than preferences cannot be easily judged, just as it cannot be judged objectively for Europe, whether achievements in the social net, environmental conservation, and the amount of leisure are above or below the “preferred” position of society or the average voter.
4. One (not universally accepted) way of assessing to what extent a system provides citizens with a higher or lower degree of welfare is an internationally comparable survey. When asked about their degree of happiness and life satisfaction, US respondents ranked themselves as somewhat more happy and satisfied than Europeans. However, even the most careful wording and sampling in this line of research will not be able to eliminate all cultural and statistical biases.
5. In comparisons at the border (or outside) of the economic realm, the

downside risks in American society are larger. This can be documented by the following indicators: the number of homeless and uninsured, the share of the population in prison, the number of homicides, guns and drugs in schools, vast differences between slums and suburbs, the death penalty, racial and financial biases in legal procedures, low and socially biased voter turnout in elections. We have not been able to address these issues, but we must keep in mind that they might outweigh any economic assessment.

6. The US economy has been considerably more dynamic over the past decade and during the current recession. We predict that this is also very likely to be the case for the next decade: the USA seems to be on a growth path of perhaps 3 % p.a. compared to 2 % growth in potential output in Europe. There are negative risks for the USA in the budget and the current account – the twin deficits and the costs of security and war – just as there are hopes for Europe: the dynamics of the accession countries and a better system of innovation during the phase of technological diffusion. Some European countries are trying to combine welfare with higher efficiency, perhaps developing a Reformed European Model, which can compete with the US in terms of economic efficiency while maintaining and fine tuning social institutions and incentives, thereby combining security for their citizens with efficiency and flexibility for firms.

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#### NOTES

- 1 We are not overlooking the fact that there are certain economic variables which are also heavily monitored, such as inflation, budgetary stability, and the trade balance. However, these are not goals, but rather instruments or constraints, which have the potential to become important obstacles, if they are out of balance. If inflation is in the two digit range, it will sooner or later dampen economic growth and endanger employment. However, a zero rate of inflation is not an economic end (the less so for negative rates). Trade deficits are unimportant if they are compensated by investment flows; they may signal the loss of competitiveness if they are increasing and there is no compensation. Budget deficits may help to stabilize income and employment in the short run (anti-cyclical spending) or over the long run (if they boost research and infrastructure). On the other hand, they may endanger growth if they are the result of extensive spending that does not work to improve production potential.
- 2 To a certain extent, the comparison is influenced by short run currency fluctuations, although ideally these effects are minor, since the values are calculated at purchasing power parity.
- 3 For instance, up to January 2005, the European Commission published in its homepage figures according to which productivity per hour was higher in Europe than in the US. Following criticism of the employment data used, the Commission based its figures on other data, which now indicate that the US has a lead of 15 %.
- 4 The large difference in income versus the relatively low difference in production per hour led Gordon (2002, p. 2) to raise the provocative question "How could Europe be so productive yet so poor?"
- 5 *Economic Report of the President 2005*, Washington, 2005.
- 6 469 persons per 100,000 inhabitants are in prison in the US vs. 65 in Europe.
- 7 Europeans worked longer hours than Americans during the 1945–1975 era of post-war reconstruction. "So passion for long vacations and short weekly hours of work is a recently acquired taste" while "Americans seem happy to be bribed to work long hours for premium

overtime pay ... everyone wants his fair share of compulsory overtime" (all citations Gordon, 2002, p. 9).

- 8 The research is centred at the Erasmus University in the Netherlands. (Veenhoven provides a homepage on this subject: <http://www.eur.nl/fsw/research/happiness>). Differences are less relative to Scandinavian countries. This correlates to the fact that uncertainty is less in these countries. Happiness may therefore be a consequence of institutions not of economic performance (see Tichy, 2003).
- 9 We must acknowledge that while maintaining the comprehensiveness of their welfare systems, these countries did a lot of fine-tuning to improve the effects of incentives and to make markets more flexible: deregulating part time work, combining obligations to the unemployed with training offers, shifting the responsibility for the first days of sick leave away from health insurance to firms and allowing workers to retain part of the benefits when they accept low paying jobs. These reforms were specifically enforced in welfare states and are summarized as flexicurity, welfare to work, and flexijobs.
- 10 Some of the advantages of investment into future components of growth were already evident during previous decades, when Europe did grow faster than the US. Two explanations are available as to why insufficient investments in Europe did not hamper growth earlier: first of all, per capita GDP as well as productivity were initially much lower in Europe, so that the higher levels of European growth include an element of catching up; secondly, it is argued that the European system of innovation may have been very apt during periods of imitation and diffusion, while the US system of innovation is better adapted to periods marked by the emergence of new general purpose technologies such as ICT (Aiginger, Landesmann, 2002).
- 11 See Aiginger (2005B).