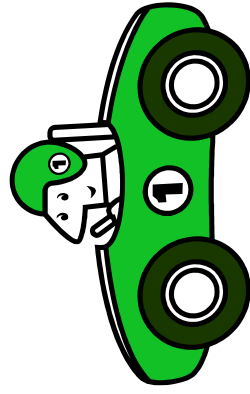
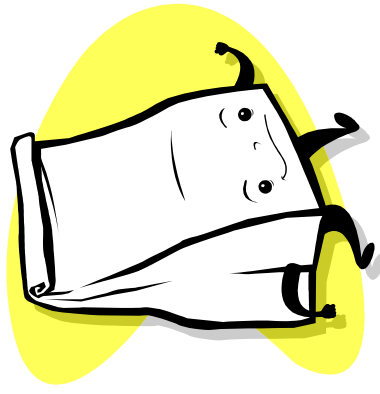
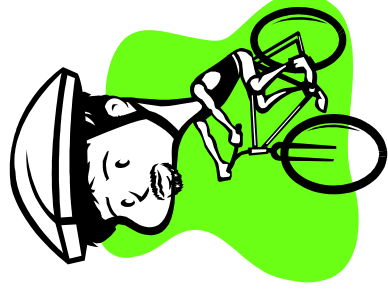


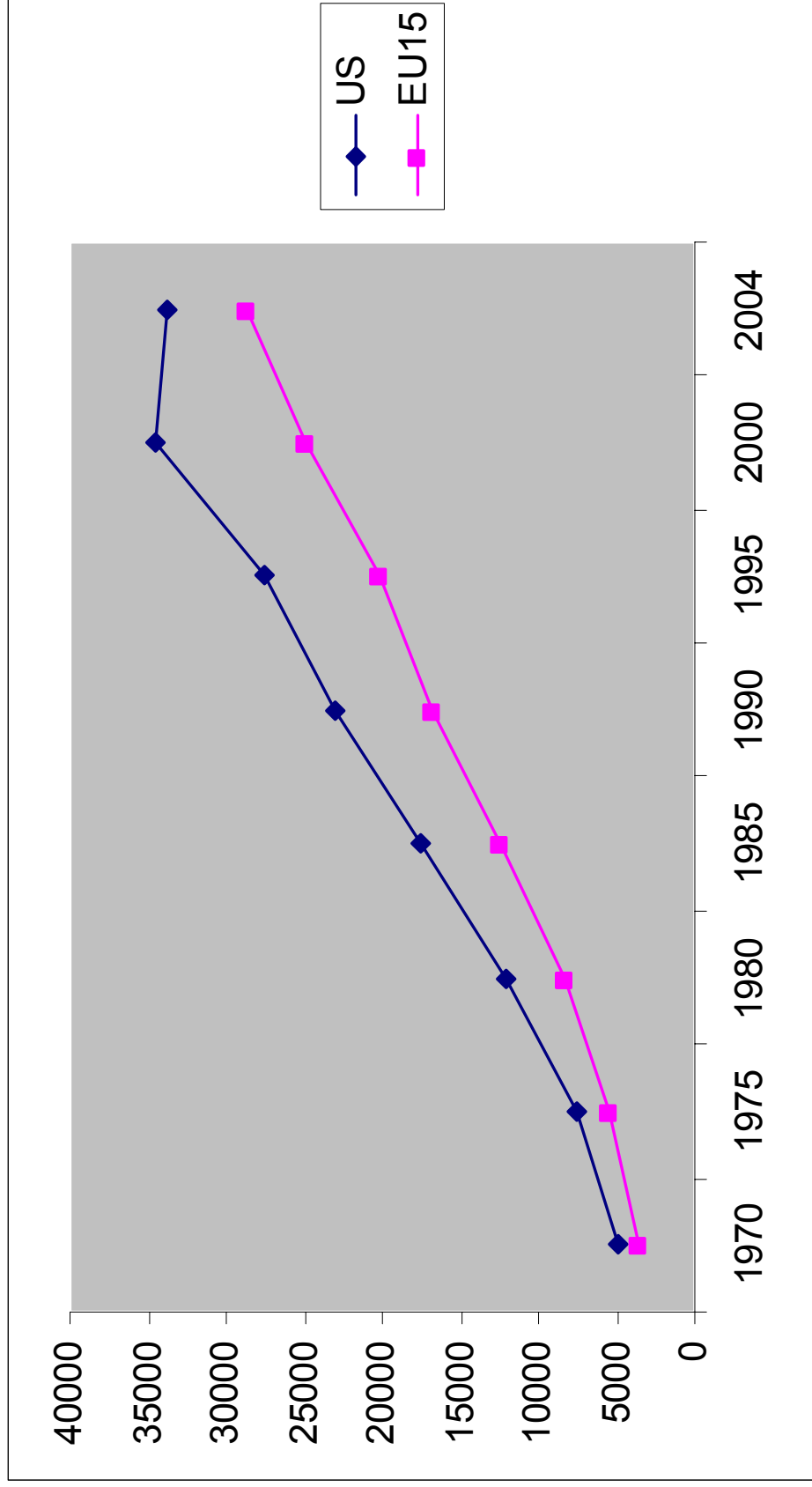
The US



Europe



GDP per capita



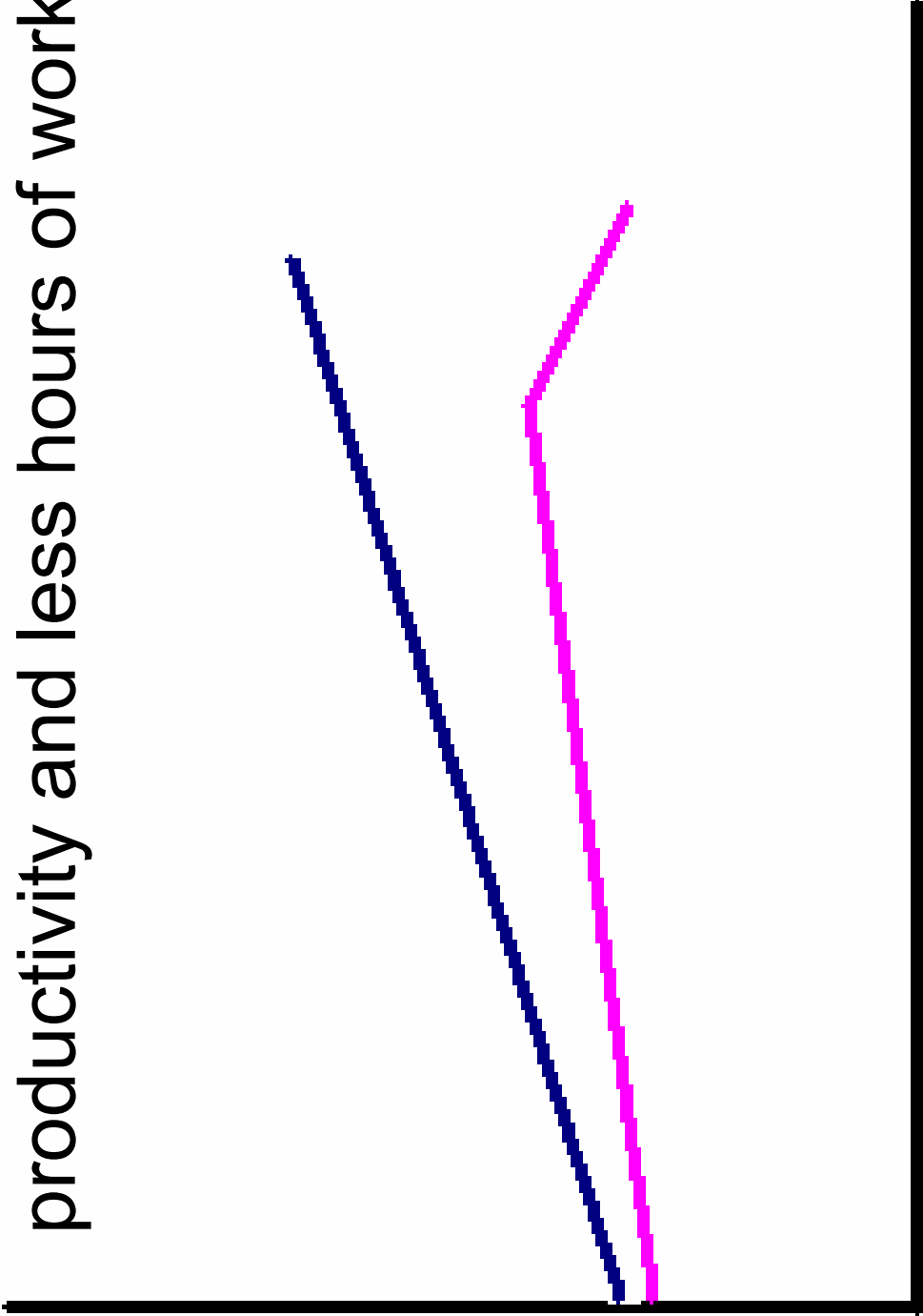
Data from OECD factbook 2006

Does America have something that Europe is missing?

- American exceptionalism vs. the
European model

- Two factors that determine GDP per capita
 - Labor productivity (output per hour worked)
Increased in Europe relative to the US between 1970 and 1995
Decreased in Europe relative to the US from 1995 and onward
 - Hours of work in the labor market
Has been decreasing since 1970

The future result of a combination of low productivity and less hours of work?



- **Part 1: What can explain the evolution of hours of work from 1970 to 1995?**
 - Prescott (2004), Rogers (2007) and Alesina, Glaeser & Sacerdote (2005)
 - **Part 2: Why has Europe lost in productivity relative to the US from 1995?**
 - Gordon (2004)
- **What does Europe have to do?**
- **Part 3: Go Europe!**
 - Blanchard (2004)

**Part 1: Possible determinants
of the decrease in number of
hours worked**

Productivity and the number of hours worked 1970 – 1995

Table 1. PPP GDP per person, PPP GDP per hour, and Hours per person, 1970 and 2000: U.S., EU-15, and France. (U.S.=100)

	GDP per person		GDP per hour		Hours per person	
	1970	2000	1970	2000	1970	2000
US	100	100	100	100	100	100
EU-15	69	70	65	91	101	77
France	73	71	73	105	99	67

Source: *EU Ameco data base.*

From Blanchard 2004, p. 4.

TABLE 3

Breakdown of 52 Weeks into Weeks Worked, Holiday and Vacation Weeks, and Other Leave

	Annual weeks worked	Holidays and vacation weeks	Full-week absences due to non holiday reasons	Part-week absences due to non holiday reasons	Absences due to sickness & maternity
Germany	40.6	7.8	1.8	0.3	1.5
Denmark	39.4	7.4	2.2	1.0	1.9
France	40.7	7.0	2.0	0.4	1.8
Italy	41.1	7.9	1.7	0.3	0.9
Sweden	36.0	6.9	3.8	1.7	3.7
United States	46.2	3.9	.94		.96

From Alesina et al (2005), p.46.

Working for vacation

- The decrease in hours of work is due to cultural factors. Europeans like vacation and Americans are workoholics.
- Labor market policies that decrease the incentives to work.
 - Taxes
 - Union policies

TAXES

- Income tax + payroll tax + consumption tax = effective marginal tax rate.
- Individual chooses between working in the labor market and leisure (encompasses non-market sector).
- The tax creates a wedge between income from labor market work and income from the non-labor market sector - distortion
- From 1970 to 2000 the tax rate in Europe increased by 10-15% in Europe compared to about 8% in the US (Blanchard 2004 p. 9).

Union Policies

- Higher wage
- Negotiate more vacation and/or shorter work week.
- Negotiation of generous pension schemes.
- Negotiation of unemployment compensation.

Prescott (2004) and European taxes

- Looks at the labor supplies in the G7 over time.
- The tax rate accounts for the whole difference in hours of work.
- Jolly good. In order to catch up Europe just have to lower the taxes.

Rogers (2007) – It is the service sector!

- An alternative view on the importance of high taxes.
- Kuznets: Agriculture → Manufacture and services → Services
- As Europe catches up with America, the employment rate across sectors expected to be roughly the same.
- In 2000, the employment in the European service sector was 70% of that in the US.
- In order to understand the difference in hours of work one must understand why Europe has not developed a market service sector similar to that of the US.

Structural transformation compared

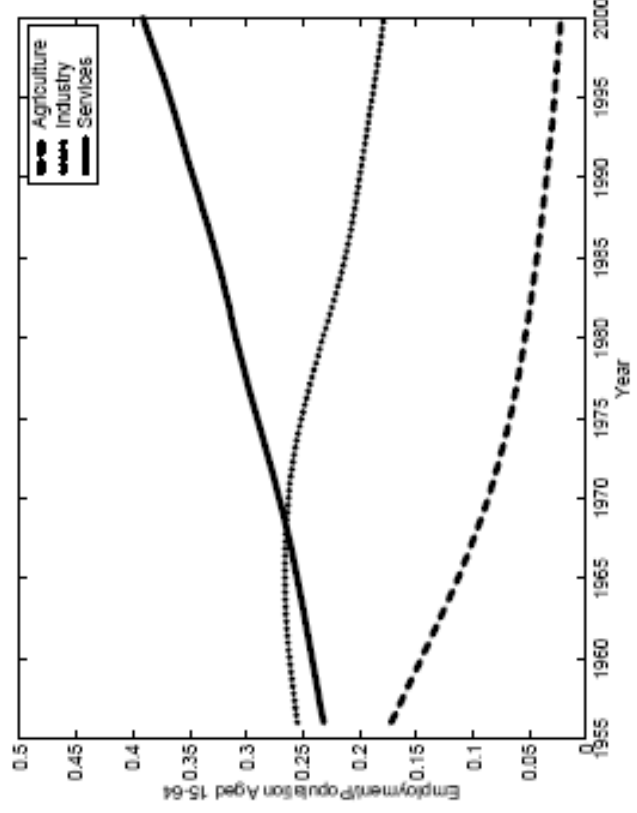


Figure 3.2: Structural Transformation in Europe

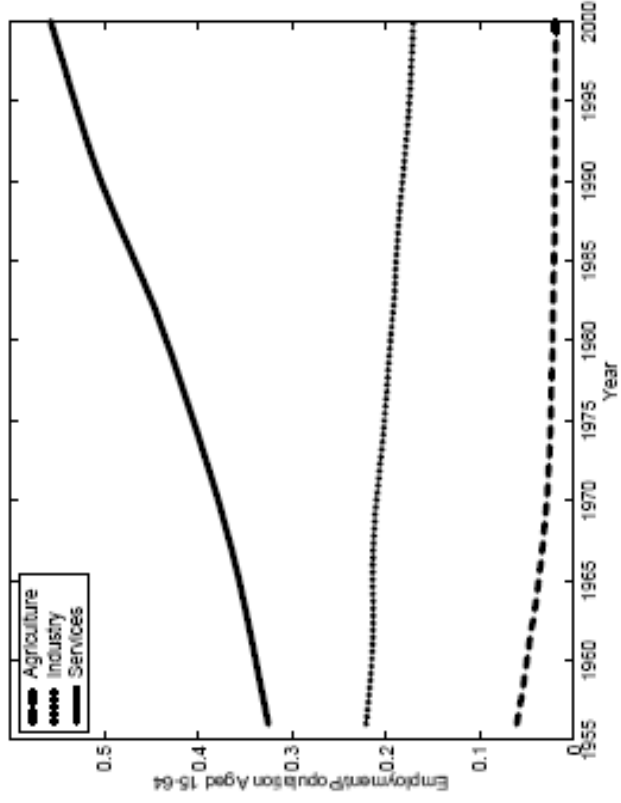


Figure 3.1: Structural Transformation in the US

The reason to Europe's non-existent market service sector

- Europe raise taxes at the same time as the development process and encourage work outside the labor market.
- Activities in market service sector have good non-market substitutes as child care, cooking, cleaning, house repairs – high elasticity.
- If the US were to adopt the same tax rates as Europe, the time allocation across sector would be similar.

So Europe can lower taxes in the service sector.

**In order to increase the hours
worked in Europe, lower the
taxes.**

... is it that simple?

Blanchard's contribution to the discussion

- Questions the assumptions about utility and elasticity
- No clear evidence of a relation between tax rate and hours of work in Europe
- Preferences: Workers chose to increase leisure as the income increased

Alesina, Glaeser, and Sacerdote

- Prescott's elasticity!

- The elasticity is too high
- Why use micro/macro elasticities?
 - Direct effects
 - Transfers → income effect
 - Substitution possibilities – market sector and non-market sector.
- No evidence that supports macro elasticities of that magnitude

Alesina, Glaeser, and Sacerdote

- Vacation contamination

- **No such thing as a "cultural" explanation**
 - In the 60s the hours per employee were about the same in Europe and in the US.
- **How to combine high elasticity and culture**
 - Positive complementarities in production, consumption, and leisure → social multiplier
- **Increase in tax → declining hours of work → reinforcement by the social multiplier**
- **But a social multiplier effect can not explain the whole difference.**
- **So what does Europe have that America is missing according to them?**

Alesina, Glaeser, and Sacerdote

- They have unions!
- Omitted variables: Unionization and labor market regulations
- In Europe, unions play an important role in:
 - Negotiation of retirement schemes
 - Negotiations of unemployment compensation
 - Solidarity wage policy
- The effect of the tax rate might be overestimated

Alesina, Glaeser, and Sacerdote

- Work less – Work all!

- The importance of the unions increased with the structural shocks of 1970-1980 (or related to the leftist surge in the late 60s).
- Lower productivity
- Faced with risk of unemployment they negotiated a decrease in work hours.
- The primary goal: Maintain their membership

“Work all, work less”

Alesina, Glaeser, and Sacerdote

-It is empirical!

- The impact of taxes disappears when they control for unionization and regulation.
- From the US: The impact of union status on vacation and hours worked seems to be as large as the impact of tax rates.
- Legally mandated holidays can explain 80% of the difference in hours worked and 30% of the difference in total labor supply.
- Conclusion: Unionization and labor market regulation might be the dominant factors when explaining the difference.

Alesina, Glaeser, and Sacerdote

- Work less – feel good!
- Suboptimality or the solution of a coordination problem?
- The importance of the social multiplier
 - People taking longer vacations seems to be happier
- ... does Europe have something that America wished it had?

Half time contemplation

Are you convinced by these
arguments?

Part 2: Factors behind Europe's lagging in productivity

- American exceptionalism after 1995

Table 2. Total factor productivity growth: U.S., EU, and France, 1980-2000. (Percent per year)

	1980s	1990s	1990-1995	1995-2000
U.S.	0.91	1.06	0.74	1.39
EU-15	1.45	1.04	1.36	0.72
France	1.90	0.68	0.89	0.38

Van Ark [2002a], Tables 19 and A7.

Potential explanations

- **Productivity slowdown in manufacturing**
 - The rate has been declining but is still at a higher level than that of the US.
- **Europe missed the IT-revolution**
 - The share of the IT producing sector is smaller in Europe than in the US, but there are large differences between countries

The largest difference is found in the IT-using service sector:

- Retail trade, wholesale trade, and securities trading.**
- Retail accounts for about 50 percent of the productivity increase.**

Why is America more successful in this sector?

Gordon: European cultural attributes

- Regulatory barriers and land-use regulation in Europe inhibit development of "big box" retailing stores (Wal-Mart).

ALSO

- Europe's corporatist structures that protect incumbent industries and inhibit new entry.
- Cultural factors that inhibit development of ambition and independence among teenagers and young adults.

American exceptionalism - US retailing

- America
 - Promote dispersed low-density urban areas without public transportation
 - Building highways
- Europe:
 - Regulatory barriers
 - Protection of green-areas
 - Different public policies relevant for metropolitan growth.

The European Model: Corporatism and spoiled youth

- Economic institutions that suppress innovation and competition
 - Licenses and permissions to set up new plants
 - Need to consult with workers before changes
 - Employment protection
- Spoiled Youths
 - Paid tuition
 - No need to work
 - Culture of dependency

Incentives for Innovation

- Development of IT, pharmaceuticals and biotech more successful in America
 - Interplay among research universities, government research grants, and private industry
 - Early development of grad school in business
 - Government research support favors young, active researchers and not non-producing professors
 - Encouraged immigration of high skilled persons

Can Europe catch up again?

- Unless the European cultural attitudes change quite fast it might be tricky.

3/4 part contemplation

- What does Europe have to do?

Possible suggestions:

- Lower taxes
- Lower taxes in the service sector
- Prohibit union activity
- Deregulate markets
- Fully adopt the American culture with highways, Wal-Mart, and no subsidies of collage education

Sacrifices for higher GDP per capita

- Vacations
 - Fun work in the home sector
 - Social security and moderately rich CEOs
 - Live close to neighbors in every aspect
 - Bus, subways, and trains
 - Green areas
 - The relatively unpolluted air
- The whole European model?

**But can you compare Europe
to the US?**

Part 3: Go Europe!

Blanchard and the European model

- The productivity growth before may have been a catching up effect.
- Europe was able to protect their industries (regulated markets), which allowed for the government to extract rents and pursue the European model with emphasis on the welfare state.
- Common argument: Now Europe must be innovative and can not escape foreign competition. The European model can no longer persist.
- The reforms in the labor market is a sign of change.

Blanchard and deregulation

Table 4. Indexes of regulation: U.S, France, Germany, the Netherlands, 1975-1998.

	BE		PO	
	1975	1990	1975	1990
U.S.	5.5	2.4	1.7	1.5
France	6.0	5.1	6.0	5.8
Germany	5.3	4.3	4.6	3.9
Netherlands	4.4	5.2	5.6	5.6

Blanchard (2004) p. 19.

- BE: Barriers to entrepreneurship
- PO: Public ownership
- Regulation has decreased in Europe
- Europe is still more regulated than the US
- There is great heterogeneity between countries

Blanchard and deregulation

- Positive outcomes can be seen in road freight, automobiles...
- There seem to be a relationship between deregulation, the degree of competition, and the level of productivity.

Deregulation of goods and labor markets

- Deregulation of goods market → Increase in competition → lower prices → lower markup
- Deregulation of the financial market (privatization, increased capital mobility) → increased elasticity of capital to the rate of return
- Implications for the labor market
 - Unions
 - Institutions

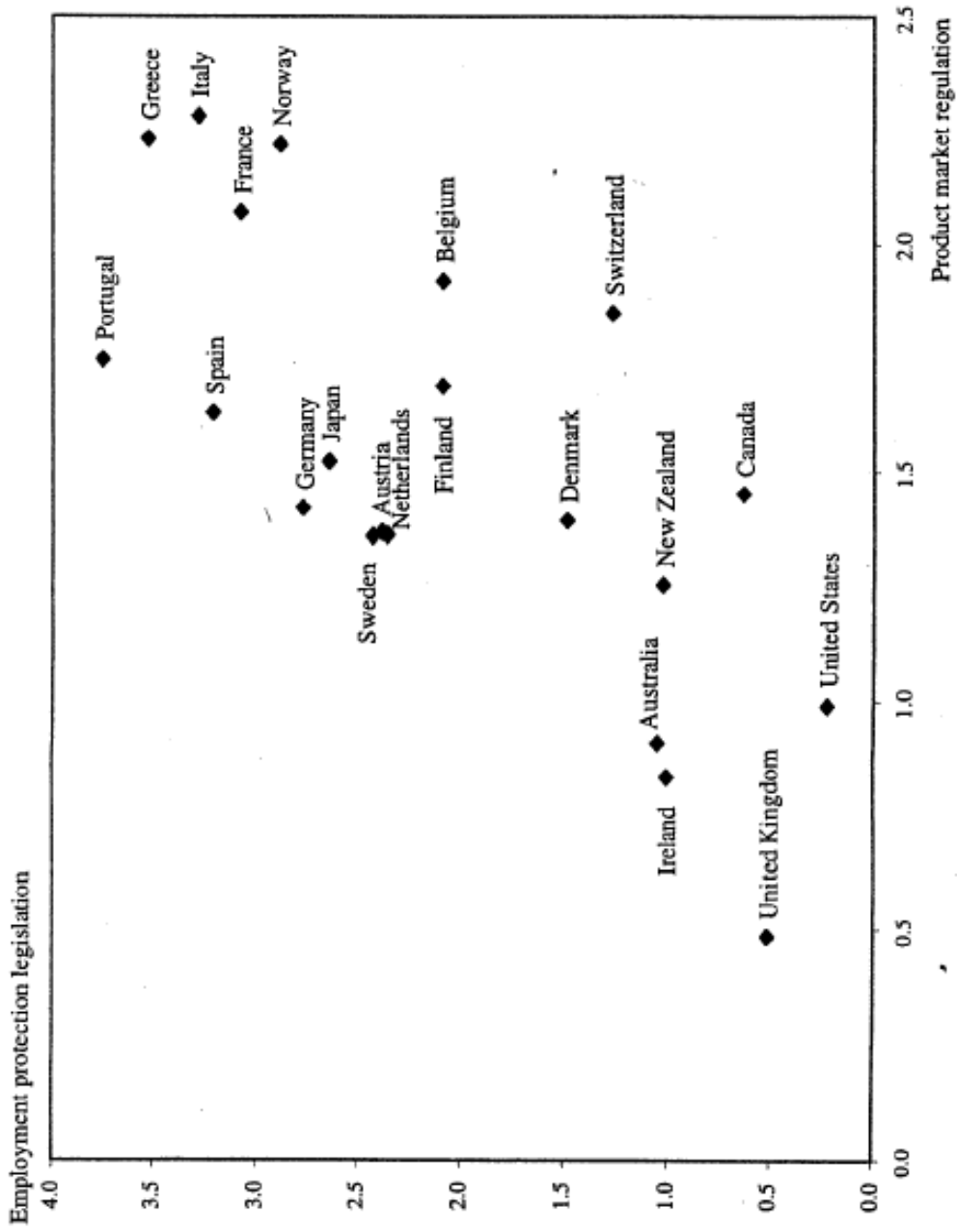


Figure 4
 Product market regulation and employment protection legislation (from Nicoletti et al, 1999)
 Blanchard (2004), p. 28.

Unions

- Smaller rents → smaller benefit of joining a union → decrease in membership → decrease in power
- The membership has declined in continental Europe

Institutions

- Another way to affect the distribution between firms and workers
 - When rents smaller, the distorting instruments to extract rents less attractive
- Provide social insurance, a trade off between economic efficiency and social insurance
 - If countries far from efficiency frontier from the beginning, deregulation might pressure them to move closer, providing about the same social insurance at lower efficiency costs.

Signs of change

- The rhetoric of unions.
 - From "class struggle" to "partnership between labor and capital".
 - Unions have become "weaker and smarter".
- Unemployment insurance systems
 - Reduced replacement rates, active reemployment policies
- Attempts to increase flexibility
 - Easier to hire and fire
- Negative income tax instead of minimum wage to achieve higher income for low-skilled workers.

A policy example: Flexicurity

It is possible to have both flexibility and security in order to achieve economic performance.

The Danish 'Golden Triangle':

- Lower degree of employment protection legislation (easier to hire and fire)
- General provision for unemployed people
- Together with active labor market policies (pressure and education)

No strong evidence of the effects, but:

- High labor mobility
 - Easier to quit a job and find a new one
- A reduction of unemployment by around 50 percent since 1993 (Flexicurity from 1998)

Does the US have something
that Europe is missing?

I don't think so

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