FONDATION IDEA a.s.b.l.

The non-competitiveness of the European Union: the macro causes

Oporto, AEP

16 February 2016

Independent « think tank » (the most prominent in Luxembourg), created nearly 3 years ago by the Luxembourg « Chambre de Commerce ». Active especially (but not exclusively) in macroeconomics, public finances, labour markets, housing, demographics.

WHAT IS THE IDEA FOUNDATION?

Overview of the presentation

1. Helicopter view of the macro situation
2. A few « common sense » - but weak – explanations
3. The « real » causes
4. Solutions?

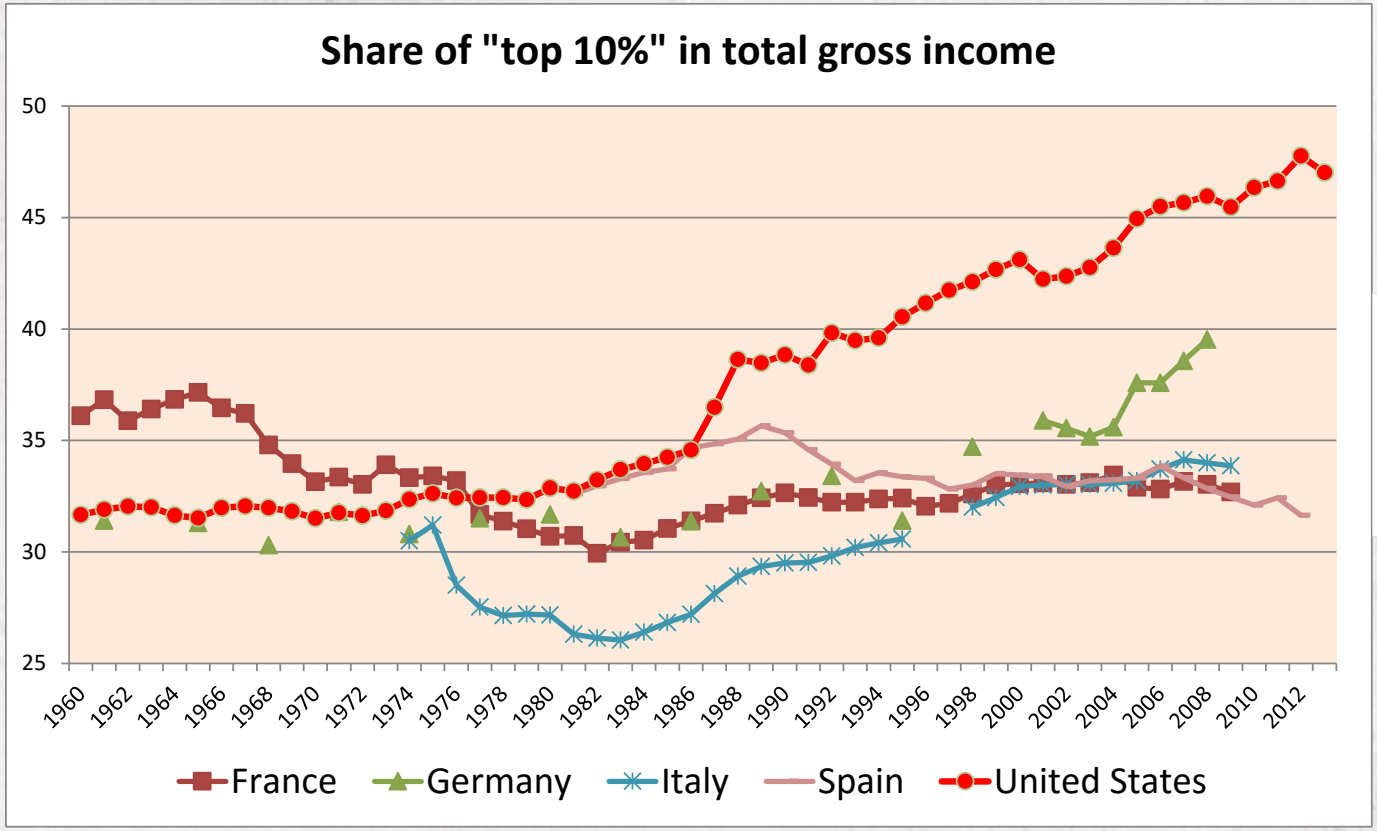
1. Helicopter view of the macro situation (1/3)

The euro area is (quasi) continuously below the U.S., in terms of real GDP, population growth, GDP per head and labour productivity:
robustness of these gaps. Causes?

DIFFERENCE: EURO AREA - USA	Average yearly changes						
	'60	'70	'80	'90	2000-2014	2000-2007	2008-2015
(1) Real GDP	0,6	0,5	-0,8	-1,1	-0,8	-0,4	-1,2
(2) Population	-0,4	-0,5	-0,7	-0,9	-0,5	-0,5	-0,5
(3) Real GDP per head	1,1	1,1	-0,2	-0,1	-0,3	0,0	-0,7
(4) Labour productivity	2,5	2,2	0,3	-0,6	-0,7	-0,6	-0,8

1. Helicopter view of the macro situation (2/3)

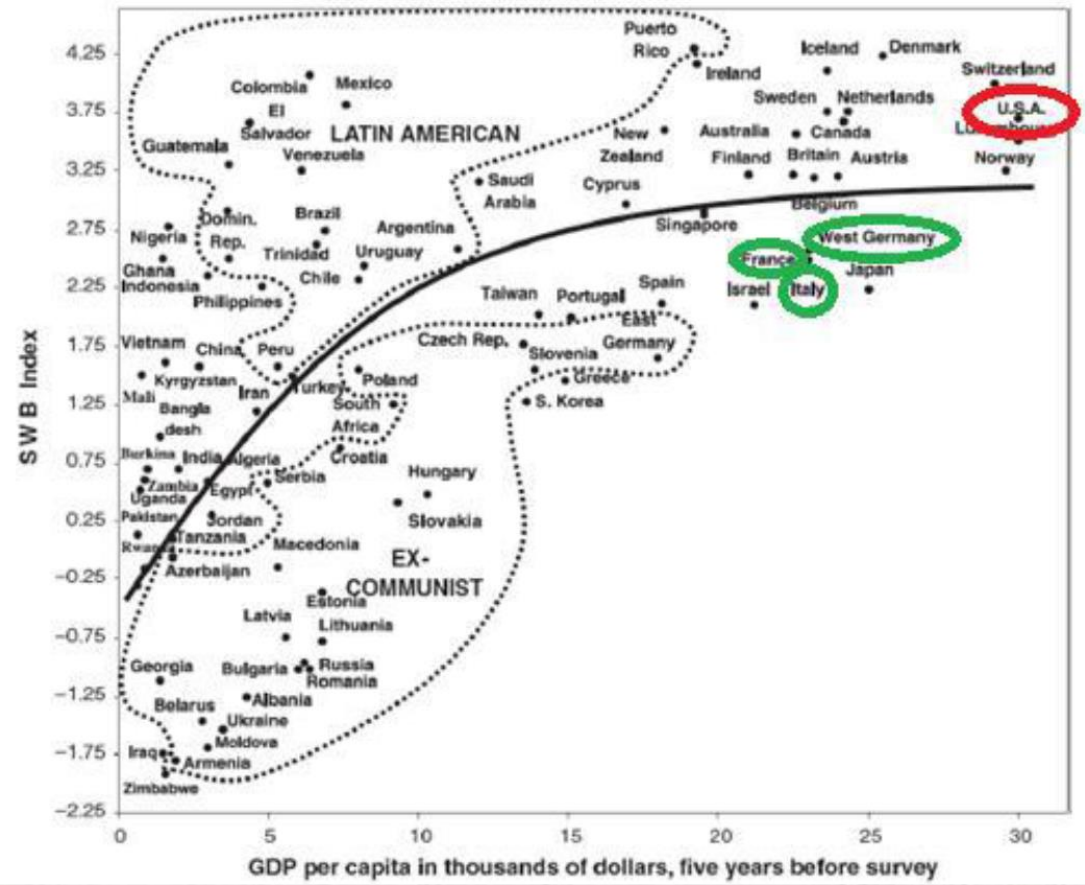
Yes, but: growing inequalities in the U.S.

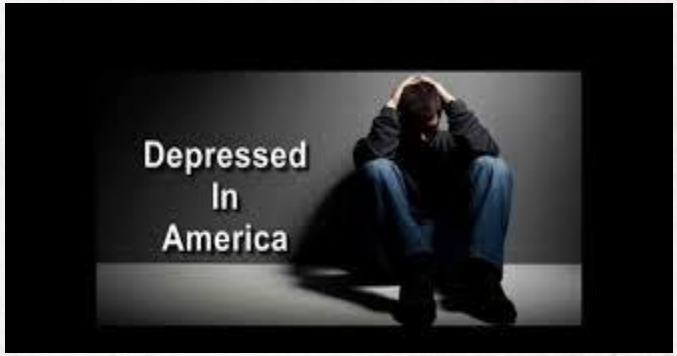


Source: World Top Incomes Database.

1. Helicopter view of the macro situation (3/3)

…and below Europe in terms of « well-being »



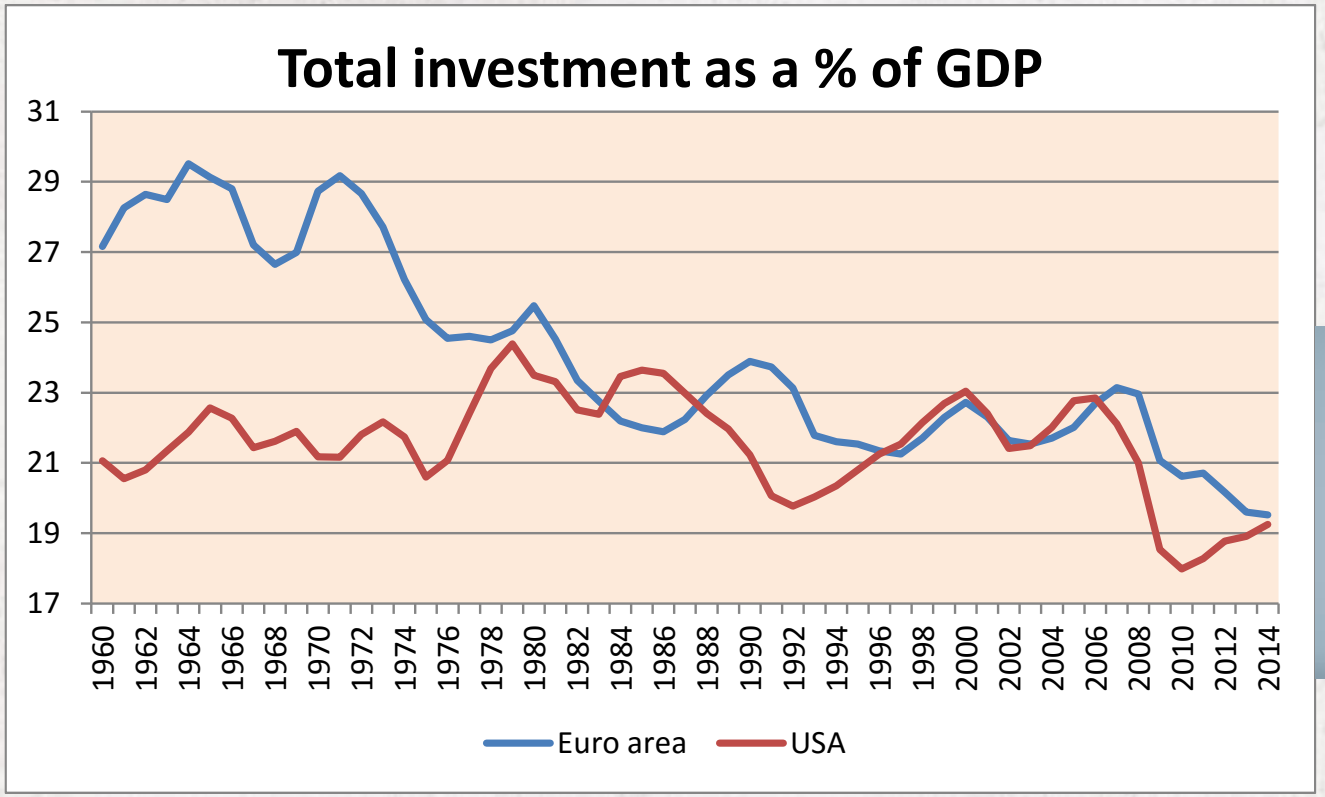


Bad well-being / GDP combination in the U.S.? No, according to this chart.

Source: Inglehart, Foa, Perterson and Welzel (2008)

2. A few « common sense » - but weak – explanations (1/6)

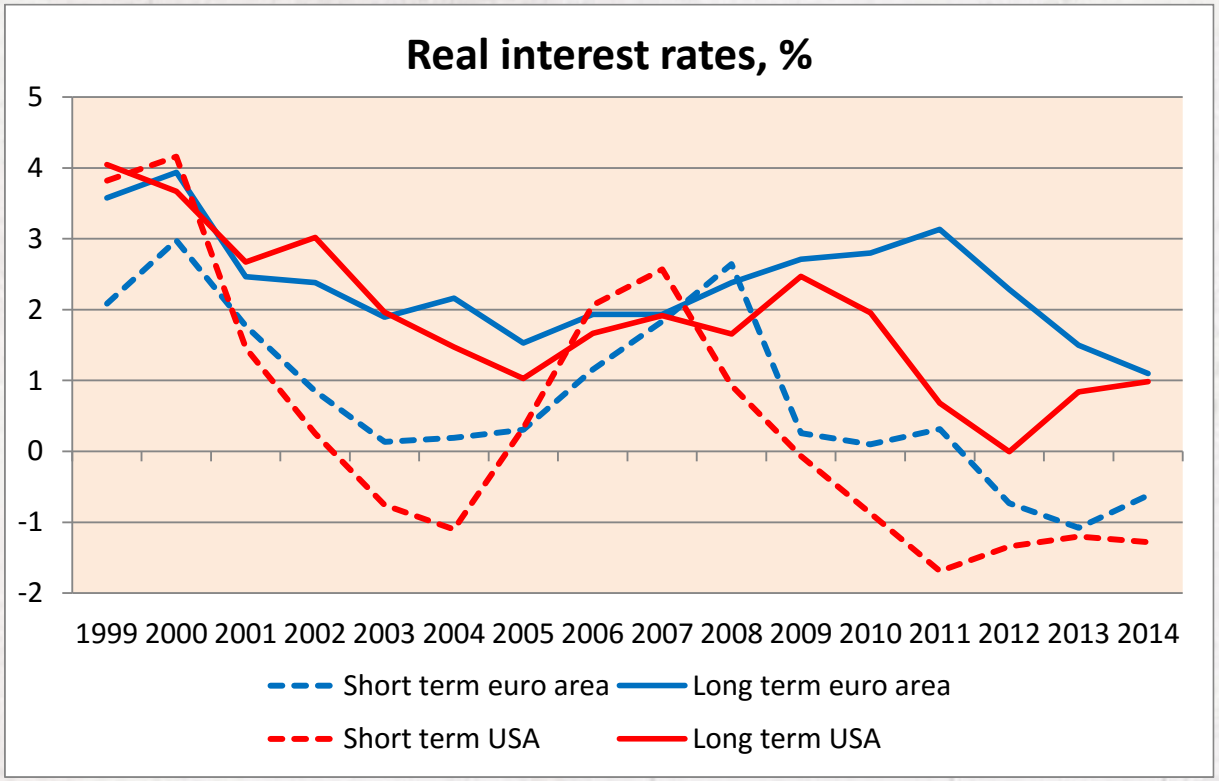
"More investments in the U.S.": **not really.**
More efficient selection in the U.S., higher technological content?



Source: European Commission, IDEA calculations

2. A few « common sense » - but weak – explanations (2/6)

"Monetary policy bubles in the U.S.": not really

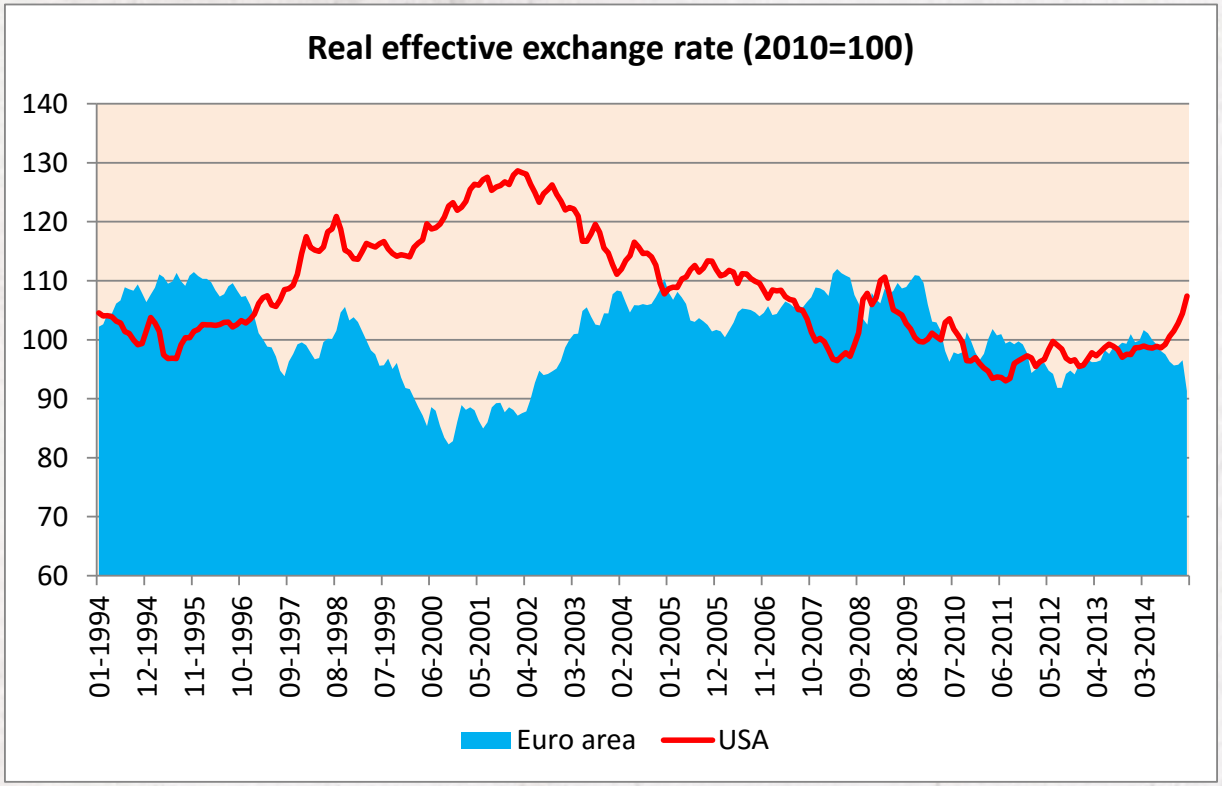


Source: European Commission, IDEA calculations

- No systematic differences in short and long term interest rates (except during sovereing debt crisis).
- Bubbles would not sustain a growth gap over a 35-year period…
- More accommodating ECB monetary policy stance at late.

2. A few « common sense » - but weak – explanations (3/6)

"U.S.: our currency, your problem" overstated

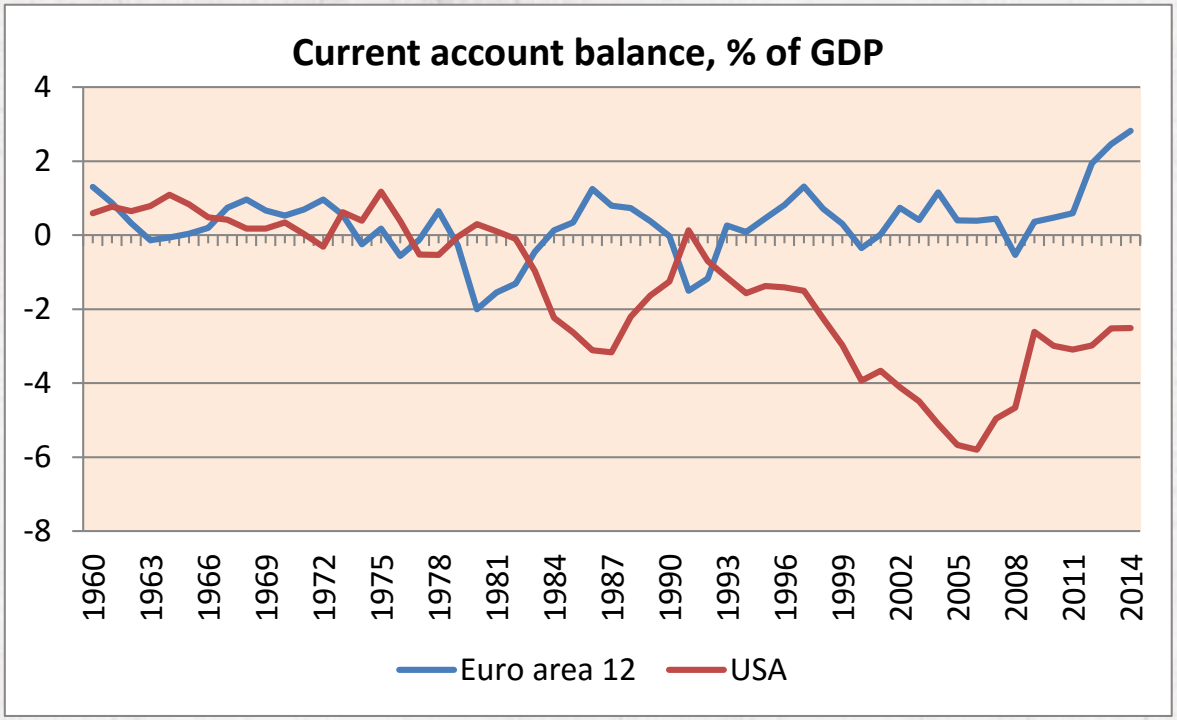


No systematic deviations in real effective exchange rates. Nominal differences tend to be neutralised by price differentials over long periods.

Source: Bank for International Settlements.

2. A few « common sense » - but weak – explanations (4/6)

"Déficit sans larmes" ("Deficits without tears"): a paradox



Source: European Commission

- Before EMU: no systematic discrepancies.
- The case during EMU. But this is a paradox: EMU means that the euro area could potentially enjoy a "déficit sans larmes".
- Deflationary bias?

2. A few « common sense » - but weak – explanations (5/6)

"Austerity..."

1) From 2011-2014 (sovereign debt crisis): **fiscal consolidation effort in the euro area** = 0.9% of GDP 2011, 1.5% 2012, 0.7% 2013 (0% 2014). Cumulated impact on GDP growth with « *common sense* » fiscal multipliers: about 4%. This accounts for most of the growth differential with the US over this period.

2) But: only a **« one shot » explanation** of the growth gap (short period).

3) Most importantly: fiscal effort as usually measured (changes in structural, primary balances) are **even higher in the U.S.** over this period…

2. A few « common sense » - but weak – explanations (6/6)

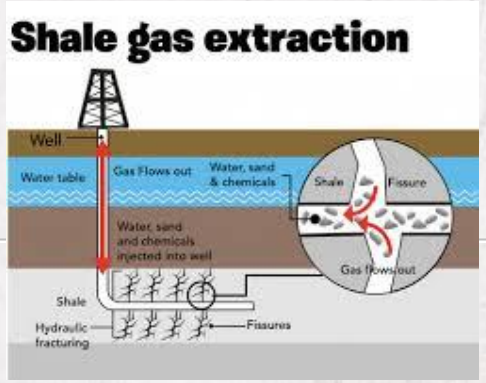
"Non conventional energies"

1) Production of energy including non conventional sources (shale gas and oil), 1980 to now: **+0.5% in the USA, +0.4% in the EA** (although very different levels: 3 to 4 times more in the U.S.). Could not account for growth differentials over a long period of time.

2) Lesser relevance since the strong decline in oil prices, from mid-2014 onwards. In spite of this, growth remained stronger in the U.S. in 2014 and 2015.

3) Studies: according to Huntington (2013) (Stanford), shale gas would have a long term impact on the GDP level equal to 0.46%.

4) Lower energy prices in the U.S. But also the impact of lower taxes.



3. The « real » causes(1/9)

Public expenditure, revenue, tax burden

Euro area	1995	2000	2005	2010	2015
Total expenditure	**53**	**46**	**47**	**50**	**48**
Investments	3	3	3	3	3
Interest	5	4	3	3	2
Others	44	39	41	44	43
Total revenue	**45**	**46**	**44**	**44**	**46**
Tax burden	39	40	38	38	40
Fiscal balance	**-7**	**0**	**-3**	**-6**	**-2**

United States	1995	2000	2005	2010	2015
Total expenditure	**37**	**34**	**36**	**43**	**38**
Investments	4	4	4	4	3
Interest	5	4	3	4	3
Others	28	26	29	35	31
Total revenue	**33**	**34**	**32**	**31**	**33**
Tax burden	27	29	26	24	27
Fiscal balance	**-4**	**1**	**-4**	**-12**	**-4**

Source: European Commission.

Total expenditure in 2015: 48% of GDP in the EA, 38% in the U.S. As a result, 40 / 27% for the total tax burden.

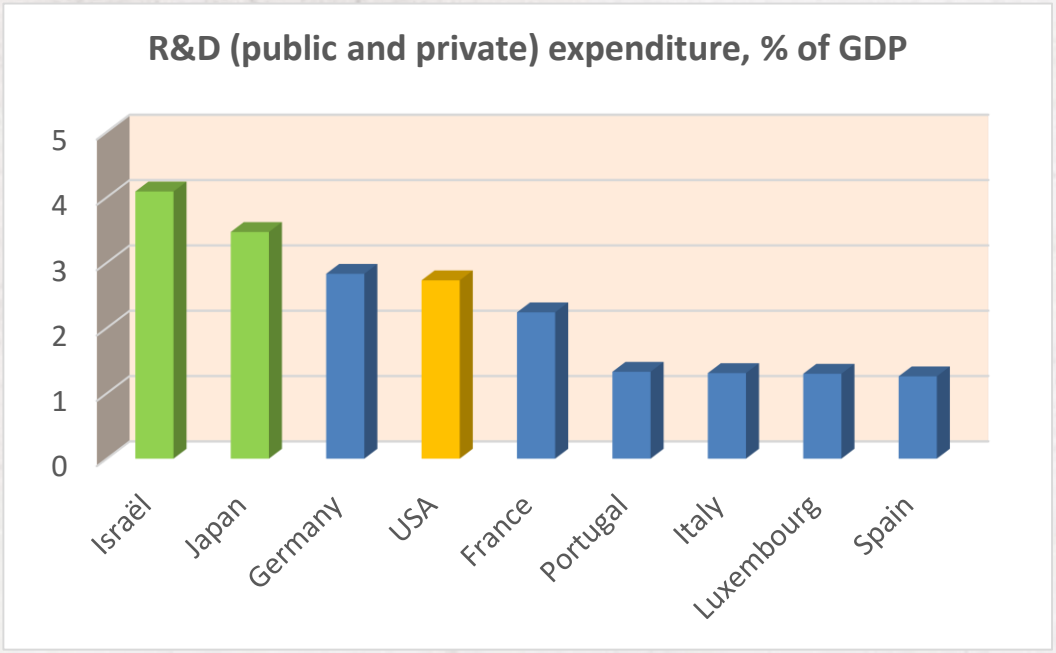
2. The « real » causes (1/9)

Universities

1	Rockefeller University
2	MIT
3	Harvard Univiversity
4	University Calif – Berkeley
5	Stanford University
6	Caltech
7	Princeton University
8	University Calif - Santa Barbara
9	University Calif - San Francisco
10	Yale University
11	Rice University
12	University Calif - Santa Cruz
13	Northwestern University
14	University Calif - San Diego
15	University Colorado - Boulder
16	University Texas - Southwestern Med Ctr
17	University Penn
18	University Chicago
19	University Cambridge
20	University Calif - Los Angeles
21	Ecole Polytech Fed Lausanne
22	Weizmann Inst Sci
23	London Sch Hyg & Trop Med
24	University Oxford
25	ETH Zurich

Ranking (Leyden): 19 U.S. universities in the TOP 20...

3. The « real » causes (3/9)
Research and development



Source: World Bank, 2013 data.

Among the big EA countries, only Germany manages to outrank (slightly) the U.S. And relative measures (high GDP per head in the U.S.). Interesting position of Israël (successful start-up place).

3. The « real » causes (4/9)

Innovation

Bloomberg 2017 Innovation Index

2017 rank	2016 rank	YoY change	Economy	Total score	R&D intensity	Manufacturing value-added	Productivity	High-tech density	Tertiary efficiency	Researcher concentration	Patent activity
1	1	0	S. Korea	**89.00**	1	1	32	4	2	4	1
2	3	+1	Sweden	**83.98**	5	11	15	7	18	5	6
3	2	-1	Germany	**83.92**	9	3	16	5	12	16	9
4	5	+1	Switzerland	**83.64**	8	6	2	11	16	14	4
5	7	+2	Finland	**83.26**	4	13	20	15	5	3	5
6	6	0	Singapore	**83.22**	14	5	12	17	1	6	12
7	4	-3	Japan	**82.64**	3	9	28	8	27	9	3
8	9	+1	Denmark	**81.93**	6	17	5	13	22	2	11
9	8	-1	U.S.	**81.44**	10	22	10	1	34	20	2
10	11	+1	Israel	**81.23**	2	30	30	3	20	1	18
11	10	-1	France	**80.99**	12	34	18	2	10	18	10
12	13	+1	Austria	**80.46**	7	7	11	23	6	10	17
13	16	+3	Belgium	**77.18**	11	21	9	10	19	19	25
14	14	0	Norway	**76.89**	19	36	3	12	25	8	15
15	18	+3	Netherlands	**75.23**	17	24	19	6	44	15	19
16	15	-1	Ireland	**74.94**	22	2	6	16	13	22	31
17	17	0	U.K.	**74.52**	20	38	21	14	7	17	14
18	20	+2	Australia	**73.33**	13	44	1	20	21	12	21

3. The « real » causes (5/9)

WEF « competitiveness » ranking

	Euro area	USA	Difference	Euro area			
				Best		Worse	
Business costs of terrorism	5,391	4,163	1,228	Finland	6,682	France	4,560
Legal rights index, 0–10 (best)	5,996	9,000	-3,004	Latvia	10,000	It., Malta, Port.	3,000
Internet access in schools	4,931	6,062	-1,131	Estonia	6,615	Italy	3,770
No. days to start a business	11,230	5,000	6,230	Portugal	2,500	Malta	39,500
Hiring and firing practices	3,052	4,856	-1,804	Estonia	4,792	Italy	2,436
Flexibility of wage determination	3,811	5,638	-1,827	Estonia	6,165	Finland	2,368
Effect of taxation on incentives to work	3,009	4,020	-1,012	Luxembourg	5,110	Italy	1,945
Pay and productivity	3,705	4,845	-1,140	Estonia	4,902	Italy	2,612
Country capacity to retain talent	3,942	5,726	-1,784	Finland	5,582	Slovak Rep.	2,403
Country capacity to attract talent	3,780	5,784	-2,004	Luxembourg	5,481	Lithuania	2,312
Efficient use of talent	4,336	5,374	-1,037	Finland	5,150	Italy	3,023
Labor market efficiency	4,202	5,305	-1,103	Estonia	5,020	Italy	3,289
Financing through local equity market	3,847	5,185	-1,339	Finland	4,532	Slovenia	2,303
Ease of access to loans	2,889	3,929	-1,040	Luxembourg	4,364	Slovenia	1,593
Venture capital availability	2,960	4,450	-1,489	Finland	4,257	Greece	1,860
Financial market development	4,338	5,347	-1,010	Finland	5,548	Slovenia	2,852
Domestic market size index	5,286	7,000	-1,714	Germany	5,816	Malta	2,083
Capacity for innovation	4,843	5,877	-1,034	Germany	5,600	Greece	3,295
University-industry collaboration in R&D	4,665	5,850	-1,185	Finland	5,968	Greece	3,061

With an "aggregate" euro area (computed by IDEA). Wide USA dominance: especially legal rights, labour market and wage determination, talents, venture capital and innovation, market size.

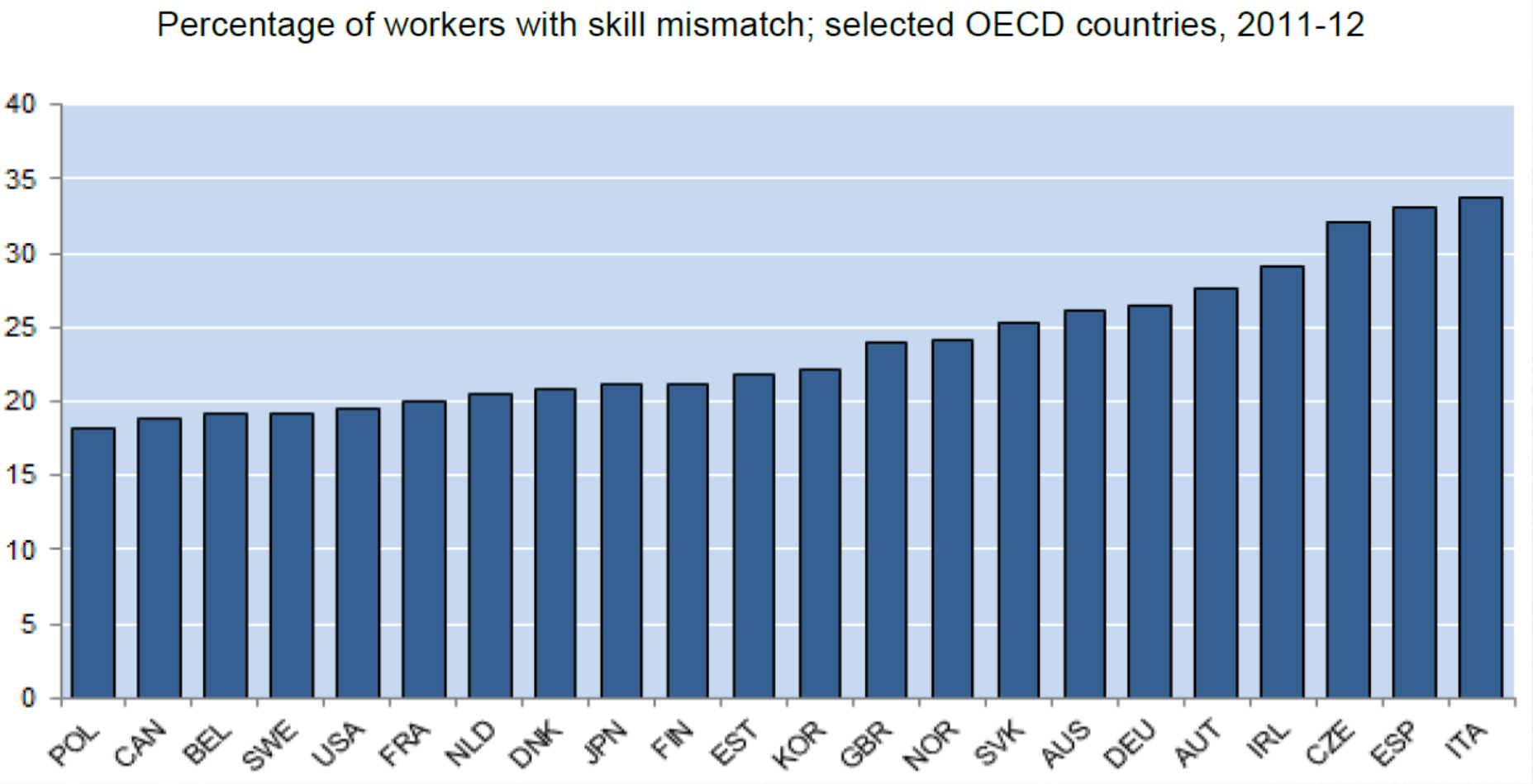
3. The « real » causes (6/9)

« Doing business » ranking

	United States	Euro area	Difference EA-USA
Starting a business	**91,22**	**88,68**	**-2,54**
Procedures (number)	6	6	0
Time(days)	5,6	9	4
Cost (% of income per capita)	1,2	6,2	5,0
Minimum capital (% of income per capita)	0,0	13,3	13,3
Dealing with construction permits	**78,87**	**75,80**	**-3,07**
Procedures (number)	15,8	9,3	-6,5
Time (days)	78,6	167	89
Cost (% of warehouse value)	1,0	3,0	2,0
Getting electricity	**79,52**	**83,32**	**3,80**
Registrating property	**82,92**	**69,26**	**-13,66**
Getting credit	**95,00**	**56,62**	**-38,38**
Protecting minority investors	**65,83**	**62,51**	**-3,32**
Paying taxes	**80,84**	**74,54**	**-6,30**
Payments (number per year)	10,6	10,0	-0,6
Time (hours per year)	175	188	13
Total tax rate (% of profit)	43,8	55,1	11,3
Enforcing contracts	**67,26**	**69,48**	**2,22**
Resolving insolvency	**90,12**	**80,32**	**-9,80**
Rank "Ease of doing business" (out of 189)	**7**	**30**	**23**
Overall score	**81,98**	**74,76**	**-7,22**

Same overall messsage with "Doing business", World Bank: USA rank 7, the "synthetic" euro zone ranks 30. Only two dimensions are better for the EA.

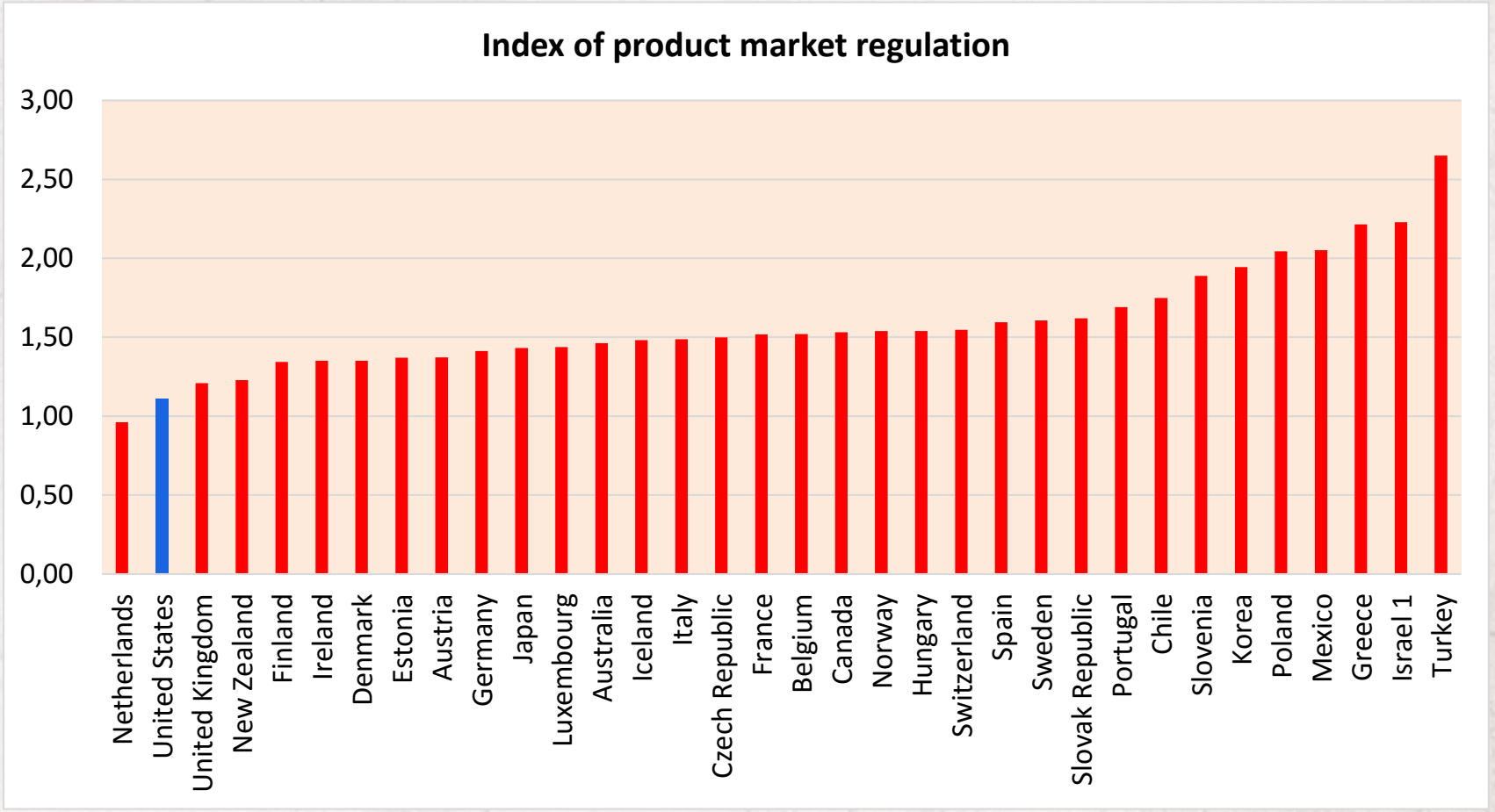
3. The « real » causes (7/9)
Labour markets?



Source: OECD.

3. The « real » causes (8/9)

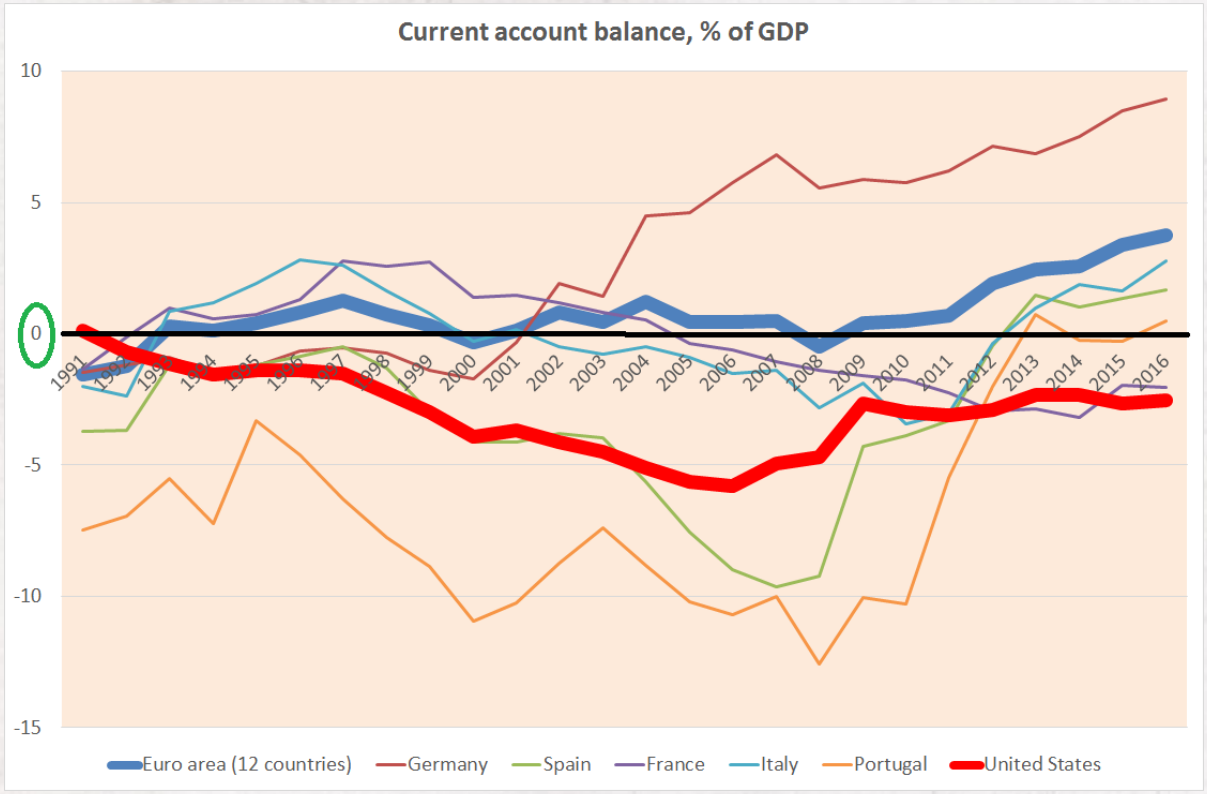
Product markets?



Source: OECD.

3. The « real » causes (9/9)

A deflationary bias?



Source: European Commission.

See the evolution of current account balances...

Could signal the asymmetric character of the European economic gouvernance framework (macroeconomic imbalance procedure, SGP?) and the need to "deepen" the euro area.

4. Solutions? (1/1)

10 areas to follow closely:

1) More coherent **immigration policy**, draw and retain talents.

2) Internal mobilty of European citizens

3) Well-targeted **public expenditure**

4) Labour markets

5) Easier access (e.g. SMEs, new companies) to **finance** (European NASDAQ?)

6) Innovation, better connections research – universities / business

7) Entrepreneurship in Europe

8) Product markets

9) Energy

10) Modernisation of **economic gouvernance**, esp. in the EA

Thank you for
your attention

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