

Europe: a continent in decline?

by

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1. Introduction

Euro-pessimism is back. The last bout of optimism about the economic prospects of the European Union came at the beginning of 2001, following the launch of the Lisbon reform agenda (which was supposed to modernize the EU economy and make it the most dynamic and competitive in the world) and the first indications of a significant slowdown of the US economy. At that time, many European ministers expressed their belief that Europe, and in particular the EU, was poised to become the engine of growth for the world economy.

Economic performance have not been kind to such forecasts. Between 2001 and 2003 average economic growth in the EU was slightly above 1 % versus 2% percent in the US. Prospects for 2004 are not much better, with US growth according to the OECD projected at 4.2% against 1.8% in the EU. Looking backward does not offer much consolation either: between 1990 and 2000 GDP increased at an average annual rate of 3.2% and 2.1% in the US and in the EU respectively. Focusing on the performance of the Euro area rather than on the EU would only make the gap with the US larger.

Adding to the concerns of the Euro-pessimists is the steady erosion of the EU exports share in world markets. Between 1990 and 2001 Germany's export share has fallen from 12.1% to 8.1%. Italy and France have not fared better, with their share declining respectively from 5.1% and 6.1% in 1990 to 3.9% and 4.8% in 2000. Again, the contrast with the US is striking: over the same period, the US share in world export markets rose from 13.1% to 14%.

Labor productivity is also mentioned as a further, and perhaps more fundamental, indicator of Europe's long term decline. During the eighties, labor productivity rose at a faster rate in the EU compared to the US, thereby contributing to bridging the income gap between the two areas. Even in the first half of the nineties, the EU maintained its lead in productivity growth, 1.7% on an average annual basis versus 1.4% in the US. In the last 6 years however, between 1997 and 2002, the US has definitely over-performed the EU, with labor productivity growth rising to 2.2% in the former and falling to 1% in the latter.

In this paper, we take a closer look at the European performance. We take issues with the most of the indicators – GDP growth, world export share, productivity growth – that have been used to

demonstrate the facts of Europe's decline. We focus mainly on the Euro area, since this is where performance has been most disappointing and macroeconomic conditions less heterogeneous.

The paper is organized as follows. In the next section we briefly review demographic trends in Europe and the US and show that the growth gap is significantly smaller when expressed in per capita terms. We then perform two simple exercises. First, in section 3, we correct GDP growth for accounting differences and find that, while a marginal factor in explaining the gap in aggregate growth figures, such correction can significantly alter the relative trends in per capita growth. Second, in section 4, we decompose GDP per capita into its main components, namely hourly productivity, hours worked, employment rate, and demography. We find that while the composition of the income gap between the US and the Euro area has undergone a radical modification over the last thirty years. Most of the gap now is accounted by differences in the number of hours worked. Whether this is due to a greater preference for leisure in Europe or to more stringent institutional constraints in the labor market there is a key topic for future research. In section 5, we look at the behavior of export shares in world markets. The key finding there is that fluctuations in oil prices and the nominal Euro/USD exchange rate can explain most of the fall in Europe's world market shares. Interestingly enough, the recent appreciation of the Euro seems to be associated with a marked recovery of world export shares. Finally, in the concluding section, we return to the issue of the productivity slowdown in Europe and its inability, contrary to the US, to combine sustained employment growth with continuing productivity gains. We argue that this may represent, at least to some extent, a transitory phenomenon, due the large inflow of a young, educated, but largely inexperienced labor force.. Of course, even this optimistic interpretation would not free Europe's policy makers from the task of persevering on the road to labor and especially product market liberalization.

2. Demographic trend and economic performance

In 1970 Germany, France and Italy, the three largest countries in the Euro area¹, accounted respectively for 2.12%, 1.37% and 1.46% of world population. Thirty years later, their share of world population has declined to 1.36%, 0.99%, and 0.95% respectively. This is a massive decline. In percentage terms, the shares in world population dropped by almost 40% for France, 54% for Italy and 56% for Germany. In aggregate terms, the EU3 share fell by 50% against 20% for the US.

By and large, therefore, old Europe suffers first and foremost from a demographic decline. During the eighties population increased at an average annual rate of 1% in the US and only 0.3% in the Euro area. During the nineties, population growth in the US even accelerated to 1.15% and the gap with the euro area rose to more than 0.8%. Clearly, under these circumstances, comparing aggregate GDP growth is simply misleading. To control for the differences in demographic trends we must do the obvious thing, namely focus on the evolution of per capita rather than aggregate income. Doing this changes the picture, at least to some extent.

Consider table 1. Already in the eighties the US surpassed the euro area in terms of aggregate GDP growth, 2.90% against 2.40%. The gap gets significantly bigger during the nineties, rising from 0.5% to almost 1%. If we focus on per capita growth however, the picture changes considerably (table 2). First, during the eighties, growth in GDP per capita was faster in the Euro area than in the US, 2.1% versus 1.90%. This was a period therefore where the euro area was converging toward the (higher) US norm. The process however comes to halt and actually goes into reverse during the nineties. Per capita growth in the euro falls by half a percentage point, from 2.1% to 1.6%. In the US, the decline in per capita growth is much less pronounced, from 1.9% to 1.7%. As a result, per capita growth is now higher in the US than in the euro area.

These are both good and bad news from an European point of view. The good news is that the gap in GDP growth clearly understates the relative performance of the euro area economy. The bad news is that even on a per capita basis the euro area is now growing slower than the US. We have seen that the US-Euro differential in aggregate GDP growth increased by half a percentage point during the nineties compared to the previous decade. Basically, one third of the increase in the gap is due to faster population growth in the US. The rest appears to reflect the worsening of the performance of the European economy.

¹ Alone, they represent 2/3 of the Euro area population. Germany includes East Germany throughout the period.

Further insights come from decomposing the nineties into two sub periods (columns 3 and 4 of table 1). As expected, we find that US growth accelerates strongly , from 2.5% in the first part of the decade, to 3.20% between 1997 and 2002, despite a substantial slowdown in 2001. Per capita GDP also exhibits a similar acceleration from 1997 onwards (table 2). Somewhat surprisingly, however, we see that both aggregate and per capita growth in the Euro area accelerates even more, by 0.8%. As a result, in the second half of the nineties the difference in per capita growth between Euro and the US becomes virtually negligible.

Summing up so far, when corrected for population growth, Europe's performance has been better than the US in the eighties, has worsened markedly during the first half of the nineties and, in the more recent years, has been at par with that of the US. Before delving more into the determinants of such performance, we must take a small detour and check whether accounting conventions explain part of these differences.

3. Do accounting convention matter?

The harmonization of national accounts definitions has been a decisive factor in allowing meaningful cross country analyses. Yet, substantial differences persist, even among industrial countries.

The OECD department of Statistics has recently summarized the most significant accounting differences between the US and other, mainly European, industrial countries (OECD, 2003).

The first differences has to do with the treatment of military equipment. Prior to 1996, all government spending in the US was recorded as current expenditure. GDP was therefore underestimated as it excluded the depreciation component of public investment. In 1996, however, when US national accounts were duly amended, the extension of coverage of investment was more extensive than recommended by international conventions, as it included also those assets that are used exclusively for military purposes. The effect on the level of GDP may not have been sizeable, 0,6% according to the OECD. Its impact on growth may be even smaller, 0,03% over the past decade. Both effects however are likely to grow larger given the recent military build up undertaken by the current US administration.

Financial intermediation services to households are a further item that is treated differently in the US, where it is included since the late eighties, and in Europe and Japan, where contrary to international conventions it is excluded mainly for measurement difficulties. The impact on GDP level is sizeable, 2.3%; that on GDP growth is not negligible, 0.1%.

The third contentious area is the treatment of software. International conventions recommend that purchases of software, including any own-account production, should be capitalized. The key issue is how to measure software investment. Most European countries use a demand approach, relying on the way businesses record investment. An alternative approach, used in the US, is to measure the total supply of software services and then estimate the portion of such services with assets characteristics. The impact on the level of GDP is substantial. Given the disproportionate growth of software expenditure, differences in the measurement of software have also a sizeable impact on growth. According to the OECD, had the US used the European demand-based approach, growth in 1997-98 would have fallen by a substantial amount, up to 0.2%.

Last but not least, Europe and the US differ in their use of hedonic prices . This is perhaps the most notorious correction. Perhaps surprisingly, its GDP effects are not particularly sizeable. Moreover, even the sign of such correction is not unambiguous. For instance, if hedonic prices are used for intermediate imported goods, the volume of imports will grow with a corresponding reduction, *ceteris paribus*, in the volume of net output. Overall, according to the OECD, the impact on US growth is relatively small, 0,1%. More crucially, it is offset by a parallel correction in US national accounts. Following international recommended practices, the US combines the use of hedonic prices with Laspeyres, instead of Fischer indices, the latter being used instead by European statistical offices. Laspeyres indices lead to a fall in measured growth rates of approximately the same order of magnitude as the increase associate with the reliance on hedonic prices.

Overall, allowing for different accounting definitions leads to a reduction in the US growth rate of around 0.2-0.3 %. As emphasized by the OECD (2003), this results only in a fractional reduction of the aggregate growth differential, 1% during the nineties, between the US and the Euro area. However, the impact on the difference in per capita GDP growth is quite significant. Moreover, there is a further and quite crucial effect on the dynamics of the convergence process between Europe and the US. Recall that most of these accounting corrections have little or no impact on measured growth during the eighties, their main effect being to lower US growth during the nineties, particularly in the second half of that decade. This has a number of substantive implications. First, the decline during the nineties in the relative performance of the Euro area with respect to the US was less pronounced than previously thought, as it reflects to some significant extent different accounting procedures. Second, it is no longer true that the US economy grew at a faster rate than the Euro area during the first half of the nineties. Even a small reduction in US per capita growth during that period would put it at par with the euro area performance. Hence, it can no longer be taken for granted that the early nineties witnessed a stop, and even less a reversal, of the convergence process between the euro area and the US. Actually, if we are willing to make the admittedly extreme assumption that US growth should be reduced by 0.3% - the highest plausible value in the OECD study - the growth differential in the first half of the nineties would be unchanged compared to the eighties. Finally, and perhaps more crucially, in the second half of the decade US per capita growth would be again below that in the Euro area. To sum up, if the convergence process ever came to a halt in the first half of the nineties² – and even this conclusion is less than fully warranted – it was back on track during the second part of the decade.

² Recall that many European countries experienced much economic turbulence during that period.

4. A simple growth decomposition

We have seen that, once different accounting conventions are allowed for, per capita growth in the Euro area has not fallen behind the US and, most likely, has surpassed it in the most recent years. Should therefore Euro-optimism be back on the front stage? The answer is no, in spite of the fact that as far as we can see the convergence process with respect to the US is still making progress.

The problem arises from the composition of growth. Consider tables 3 and 4 that report productivity and employment growth in the US and in the euro area for both the eighties and the nineties. As before, we distinguish two sub-periods during the nineties. Three facts stand out. First, productivity has steadily accelerated in the US, from 1.1% in the eighties to 1.43% in the first half of the nineties and to 2.18% in 1997-2002. It has however decelerated in the euro area, from 1.90% in the eighties to 1.4% and 1% in the first and the second half of the nineties respectively. Second, employment continued to grow in the US, with both unemployment falling and the employment rate rising at the same time of the surge in productivity growth. The euro area shows quite a distinct pattern.

Productivity growth held up quite well between 1991 and 1996 when employment was contracting at an average annual rate of -0.18%. However, when, thanks also to wage moderation and greater labor market flexibility, employment started increasing rapidly also in the euro area, productivity growth virtually collapsed. Looking at TFP growth, a more appropriate measure of productivity, would only strengthen this conclusion. OECD research (OECD, 2003a) shows that TFP growth rose in the US, from 0.9% in the eighties to 1.3% in the second half of the nineties, but fell quite dramatically in many European countries, from 1.9% to 1.1% in France, from 1.5% to 0.8% in Germany, and from 1.5% to 0.7 in Italy.

In a nutshell, while the US economy was able to combine fast employment growth with an extraordinary productivity performance, the Euro area economy appears to be facing a difficult trade-off between fast productivity growth, and hence sustained wage growth, and rapid employment growth but stagnant real wages.

The role of productivity growth, as well as of other factors, is also apparent in a more complete decomposition of income growth. At any point of time, income per capita can be expressed as the product of hourly productivity, hours worked per employed person, the employment rate (defined as

the ratio of employment to the working age population) and demographic factors (i.e. the ratio of the working age population to total population). Formally:

$$y = Y/P = Y/H * H/L * L/WAP * WAP/P = \delta * h * l * wap \quad (1)$$

where Y is GDP, P is population, H is total hours, L is employment and WAP is the working age population (defined as the population of age 15 to 65 years). Accordingly, $y = Y/P$ is income per capita, δ is hourly productivity, $h = H/L$ is hours worked per employed person, $l = L/WAP$ is the employment rate, and $wap = WAP/P$ is the complement to 1 of the dependency ratio ('demography' henceforth). In growth terms, we have that:

$$y' = \delta' + h' + l' + wap' \quad (2)$$

where a prime indicates a proportional rate of change.

We can use equations 1 and 2 to track the evolution of the income gap between the US and the Euro area. We rely on PPP corrected data. No attempt is made however to control for different accounting conventions. Table 5 confirms that our earlier findings of section 2 carry over to a PPP corrected basis. Indeed, between 1979 and 1990, per capita GDP rose at a relatively faster rate in the Euro area than in the US, 2.1% versus 1.9%. Between 1991 and the 1996, per capita growth was faster in the US, while the reverse holds true for the most recent period.

Further insights come from decomposing per capita income growth according to eq. 2 (rows 3-10). We find that between 1979 and 2001 differences in productivity growth gave a key contribution to the reduction of the income gap between the Euro area and the US. The 1997-2001 period stands however as an exception, as the US greatly over-performed the euro area in this respect. The behavior of the employment rate is the mirror image of productivity. Over the full sample, the growth in the employment rate was substantially larger in the US than in the Euro area, with the latter however making up for some of the gap during the late nineties. The most striking fact however is the contribution to income growth of hours worked. In the US, the number of hours worked per employed person did not virtually change between 1979 and 1997. Only in the last few years it shows a (modest) decline, from 1849 to 1821 hours. In the Euro area, instead, the number of hours is a steady downward trend, from 1745 in 1979 to 1521 in 2001.

We can use eq. 1 to measure the proportional contribution of the different factors to the US - Euro area income gap (fig. 1). Productivity differential were quite important at the beginning of the period, as they accounted for 57% of the gap. Faster productivity growth in Europe meant however that this factor played a lesser role over time. Indeed, in 1997, productivity per hour was actually higher in the Euro area than in the US. More recent trends have however favored the US and, in 2001, productivity differential gave once again a positive contribution to the income gap between Euro and the US. At the same time, however, its role was much less reduced. Indeed, in 2001, the key factor in explaining the income gap between the two areas was the number of hours worked per employed person. Its contribution to the overall income gap has grown steadily. It was quite modest in 1979, 13%, but accounted for more than half, 57%, of the gap in 2001. The contribution of the employment rate also increased over time, until 1997, but following the employment surge in the euro area after 1997 is now much less significant. Finally, and perhaps surprisingly, demography has so far contributed to reduce the income gap between Euro and the US. This may be surprising in light of the ageing of the Euro area population but most likely reflects the more than proportionate reduction of the youngest cohorts, with less than 15 years. This trend however is not likely to stay, as it will be soon overwhelmed by the increasing share of the over 65 years cohort.

Figure 1 raises more questions than it provides answers. Let focus on two issues. First, we have seen how hours worked per person provides a key contribution to the income gap between the two areas. Does this mean that Europeans have a relatively higher preference for leisure? This is an area where future research would yield a large dividend. On the one hand, it is true that a larger fraction of employed person would like to work longer hours in Europe than in the US (Sapir et al. 2003). Taken at face value, this could be taken as an indication that Europe's short working time reflects more labor market rationing than a greater preference for leisure. On the other hand, this effects is relatively small, with only 2% of total employment in Europe expressing a desire for working more hours versus 1% in the US (OECD, 2003). Given that in the Euro area part time employment represents 17.1% of total employment and assuming that part timers work only half of the standard hours, we can estimate that average hours per employed person would increase by 1% if hours were no longer rationed and part time was no longer involuntary. However, worked hours per employed person would still contribute to 50% to the income gap between the Europe and the US. By and large, therefore, the preference for leisure more than labor market rationing is the main factor behind Europe's short working time and, hence, its remaining income gap with respect to the US.

The second issue is the behavior of productivity. We have seen how the Euro area was unable to combine employment and productivity growth. The key question is whether this trade off is temporary. Standard growth accounting shows that the quality of the labor force increased significantly in Europe after 1997, as the new entrants into the labor force were quite well educated. The other side of the coin is that, with constant output growth, the rate of increase in total factor productivity growth fell quite significantly. On this count, therefore, there are good reasons to be concerned that the slowdown in productivity growth reflects a fall in the rate of technological advance and bodes ill for the future growth prospects of the European economy. At the same time, though, it cannot be neglected that the new entrants into employment were mostly young and quite inexperienced. The recorded fall in TFP growth may therefore be a statistical artifact, to the extent that no (or inadequate) allowance is made for experience. Overtime, as the new entrants acquire more experience, Europe's productivity growth would rebound, softening the trade off between productivity and employment growth. This is an additional area that clearly deserves further research.

Summing up, the evidence about Europe's decline is somewhat less than fully compelling. First, much of the remaining gap is accounted by differences in hours worked. It remains to be seen whether the latter reflects a greater preference for leisure in Europe or alternatively tighter constraints in the smooth functioning of the labor market. Second, while it is undeniable that productivity growth fell in Europe and surged in the US, it is perhaps too early to tell whether the European slowdown is a temporary or a permanent phenomenon. Whatever the answer, it remains true that the opening up of the productivity gap with respect to the US offers new prospects for Europe to catch up. Whether Europe will be able to take up this opportunity will also depend on the ability to reform its economy. Finally, our analysis casts light on the role of demography. This factor is all but neglected in most empirical analyses. So far provided a positive contribution to the reduction of the income gap between the Euro area and the US. This fact however should not be taken as a reassuring indication of future trends. Over the next few decades, demography is more likely to give a negative contribution to the convergence process between the two areas.

5. Is Europe losing competitiveness?

Competitiveness, as well known, is an ill defined concept (Krugman, 1994). Yet, it is a continuing source of concern for most policy makers. In particular, the loss of market shares in world exports is often lamented as an unambiguous indication of the decline in Europe's competitiveness in the international arena.

The fact that Europe's role in world trade has been declining is difficult to deny. IMF data show that between 1990 and 2001 the euro area's share of world exports dropped from xx% to xx%. Few European countries escaped from this trend. Germany suffered the largest fall, with its share falling from 12.1% in 1990 to 8.1% in 2000. France and Italy, the two other largest countries, in the Euro area, did not fare much better. Italy's share fell from 5.1% to 3.9% between 1990 and 2000, France's from 6.1% to 4.8%. The contrast with the US is striking: during the same period, the US succeeded in expanding its part of world export markets, from 13.1% to 14.0%.

Are policy-makers concerns about the erosion of Europe's weight in world trade warranted? The answer is as usually nuanced. Obviously, for given relative prices, the loss of world exports share indicates that the elasticity of Europe's exports with respect to world demand is less than unitary. Indeed, even when measured in volume terms Europe's export share has contracted markedly. This in turn can be taken either as an indication that Europe's price competitiveness is being eroded – as Europe's prices and costs tend to increase relatively faster than in other countries, world consumers shift out of its exports – or, more fundamentally, that Europe's specialization is biased toward slowly growing sectors. In both cases, Europe would be losing competitiveness. The fact furthermore that the erosion of market share coincided with a substantial real depreciation for the euro area, a fact that by itself should have increased Europe's share in volume terms, is typically taken as further compelling evidence of Europe's decline.

By and large, these conclusions should be taken with a grain of salt. First, it is not altogether clear that a region, like the euro area, where population and hence aggregate output tend to grow at a slower pace than in the rest of the world, will be able to hold indefinitely to its share in world export markets. While it is true that small countries tend to be more open, there are no reasons to believe that the share of exports in GDP would grow sufficiently large as to offset the impact of the fall in the share of world output. Indeed, it is noteworthy that the exports per capita in Italy and Germany rose at a faster rate than in the US and in the world economy.

Secondly, and more fundamentally, how the value share in world export changes over time depends on a set of factors, many of which have little relationships with competitiveness. Consider for instance the impact of a nominal appreciation of the dollar exchange rate with respect to the Euro. The higher value of the dollar would tend to boost the value of trade outside the euro area. Conversely, the fall in the value of the Euro will depress the value of intra-European trade. This is a simple valuation effect with no implications for competitiveness, however defined. Its relevance can be seen from figures 2 and 3 where the link between the €/ \$ exchange and the share of Italy and Germany in world export markets is highlighted. We see immediately how both countries suffered a substantial loss in their market shares, during the early eighties, when the dollar was appreciating quite rapidly. Most of these losses were reversed during the period of dollar depreciation, only to resurface again in the second half of the nineties following the recovery of the US currency. Interestingly enough, over the last three years Germany's share of world exports has risen again from 8.1% to 9.4% in line with the new strength of the euro. France and Italy have also succeeded in reversing the downward trend in their world export share.

Oil price represent a further confounding factor in the analysis. Indeed, an increase in the price of oil tends to boost the value of oil trade and, *ceteris paribus*, reduces the share in world exports of oil importing countries. In an attempt to control for this factor, both figures 1 and 2 focus on non oil exports.

Further evidence can be gained from a simple econometric exercise. We run a standard regression where the share of world exports is a function of the real exchange rate, the €/ \$ nominal exchange rate, the oil price and a set of country dummies. The sample includes three countries (France, Germany, and Italy) and runs from 1980 to 2002. The data are simply pooled in a fixed effect framework. The results are presented in table 6. The notion that the nominal exchange rate strongly affects the behavior of the export share even after controlling for the real exchange rate is strongly supported by the estimation results. Similarly, oil prices have a negative and significant impact on countries share of world exports, as expected. We also test whether export behavior changed significantly after 1990 with a view to detecting a more fundamental loss of competitiveness of the major Euro area countries. The results do not support such an hypothesis. On the contrary, we find that the dummy variable for the nineties has a positive sign for Italy (not shown in the table), suggesting that during that decade Italy's export behaved relatively better than the estimated norm.

However, the same dummy variable is not significant for France and Germany or for the EU3 as a whole.

To sum up, there are no obvious indication of a structural loss in competitiveness for euro area countries. The evolution of their export share in world markets is well explained by the behavior of the nominal euro-dollar exchange rate. The recent recovery on world export share for Germany, France, and Italy also points to the paramount role of valuation effects. Finally, there is no indication that export shares suffered from a negative structural break during the nineties.

6. Conclusions

The evidence about Europe's relative economic decline is less compelling than commonly thought. First, demographic factors must be fully controlled for. Population growth has been systematically higher in the US than in the Euro area, with the gap getting larger in the nineties compared to the eighties. Accordingly, the differential in aggregate growth rates tends to provide a badly distorted picture of the relative economic performance between the two areas. Second, while it is true that since 1990 per capita income growth in the US has been somewhat higher, and certainly not lower, than in the Euro area, matters look different when allowance is made for differences in accounting conventions. When this is done, indeed, it is no longer true that the convergence process in per capita income between the Euro area and the US virtually stalled during the last 13 years. Quite interestingly, we find that, after controlling for accounting definitions, the convergence process slowed down but continued during the early nineties and is likely to have accelerated in the most recent years. Third, while the differential in the level of per capita income between the Euro area and the US is still large, around 30% in purchasing power standards, its causes have radically changed over time. In the early seventies, productivity differentials were the main factor behind such an income gap. In 2001, however, it is hours worked per person that play a predominant role. As noticed earlier, whether less working hours in Europe reflects a greater preference for leisure or institutional constraints in the labor market is a promising avenue for future research.

Finally, the fact remains that Europe has been unable to combine fast productivity growth with sustained employment creation. After 1997, European total employment has been growing quite rapidly, at the expense however of the productivity performance. This disappointing performance has much to do with inadequate spending on research and development, poor educational achievements, and inadequate regulations of labor and product markets. We have not pursued in this paper this line of research as it has been fully explored elsewhere (Visco, 2003). We suggest however that the poor productivity performance in Europe may perhaps reflect the absorption of a young educated but largely inexperienced workforce, following a number of significant changes in labor market regulations. If this is so, there are reasons to be optimistic about future productivity prospects since both wages and productivity are likely to rise in line with experience. Of course, this does not free Europe's policy makers from the task of persevering on the road reforms.

Labor and but even more product market liberalization should loom high on the agenda of European policy makers. There are good reasons to believe that labor markets reforms have strong

distributional implications and will therefore be badly resisted. While product market liberalization may also hit sectoral interests, its distributional impact may be less resented if undertaken over a broad front of sectors (Blanchard and Giavazzi, 2003). Moreover, there are good reasons to believe that labor market distortions are 'derived' distortions. Product market reforms would make the labor demand more elastic and limit the amount of rents to be grabbed through restrictive labor market regulations.

A further priority should be the strengthening of educational achievements. Lamenting the obsolete nature of the European pattern of specialization and the inadequate level of spending in research and development is of little use. Some of the proposed remedies, such as protectionist measures against foreign competition and the launching of ambitious programs to foster investment in research and development, may even worsen rather than alleviate the problem. In the end, both the pattern of specialization and the level of spending in research and development reflect the limited abundance of skills in Europe and, more broadly, its pattern of comparative advantage. Upgrading the levels of skills and promoting lifelong learning would also help in reducing unemployment and lengthening average working life. Acknowledging the nature of the problem is however the first key step.

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Table 1

GDP growth in the US and in the Euro area

	1981-90	1991-2002	1991-1996	1996-2002
United States	2.9	2.88	2.53	3.22
Euro area	2.4	1.92	1.52	1.32
Differential	0.5	0.96	1.01	0.90

Source: World Economic Outlook, International Monetary Fund

Table 2

Per capita GDP growth in the US and in the Euro area

	1981-90	1991-2002	1991-1996	1996-2002
United States	1.90	1.73	1.38	2.07
Euro area	2,10	1.60	1.20	2.0
Differential	-0.2	0.13	0.18	0.07

Source: World Economic Outlook, International Monetary Fund

Table 3

Productivity growth in the US and in the Euro area

	1981-90	1991-2002	1991-1996	1996-2002
United States	1.10	1.81	1.43	2.18
Euro area	1.90	1.34	1.70	0.98
Differential	-0.80	0.47	-0.27	1.20

Source: World Economic Outlook, International Monetary Fund

Table 4

Employment growth in the US and in the Euro area

	1981-90	1991-2002	1991-1996	1996-2002
United States	1.80	1.07	1.10	1.03
Euro area	0.50	0.58	-0.18	1.33
Differential	1.30	0.49	1.28	-0.33

Source: World Economic Outlook, International Monetary Fund

Table 5
The sources of growth
(percentage average changes)

		1979-2001	1979-1990	1991-1996	1997-2001
Per capita growth					
	US	1.81	1.88	1.86	1.99
	Euro area	1.89	2.07	1.52	2.42
Hourly productivity					
	US	1.54	1.17	1.56	2.92
	Euro area	2.09	2.36	2.65	1.09
Hours per person					
	US	-0.04	0.0	0.10	-0.38
	Euro area	-0.62	-0.65	-0.69	-0.61
Employment rate					
	US	0.30	0.72	0.27	-0.71
	Euro area	0.24	-0.08	-0.31	2.02
Demography					
	US	0.01	-0.01	-0.08	0.19
	Euro area	0.19	0.45	-0.10	-0.07

Source: OECD Economic Outlook, OECD Employment Outlook, various years.

Tabella 6**Determinants of national shares in world exports**

Var. dip.:	$\ln(X_i/X_w)$	$\ln(X_i/X_w)$
$\ln(\text{RER})$	0,08 (1,65)	0,05 (0,69)
$\ln(\$/\text{€})$	0,25 (7,72)	0,27 (7,40)
$\ln(p_{\text{oil}})$	-0,13 (7,61)	-0,14 (7,29)
D_{90}	--	0,06 (0,66)
Adj. R^2	0,98	0,98
sample	1980-2002 FRA,GER,ITA	1980-2002 FRA,GER,ITA

Legenda:

X_i : current price exports of country i (i= France, germany, Italy). Source: WTO

X_w : world exports. Source: WTO

RER: real exchange rate. Source: IMF

$\$/\text{€}$: euro/dollar nominal exchange rate. Source: IMF

P_{oil} : oil price. Source: IMF

D_{90} : dummy variable (1 during the nineties, 0 otherwise)

Note: t-statistics in parentheses

Figure 1
Decomposing the income gap between the Euro area and the US

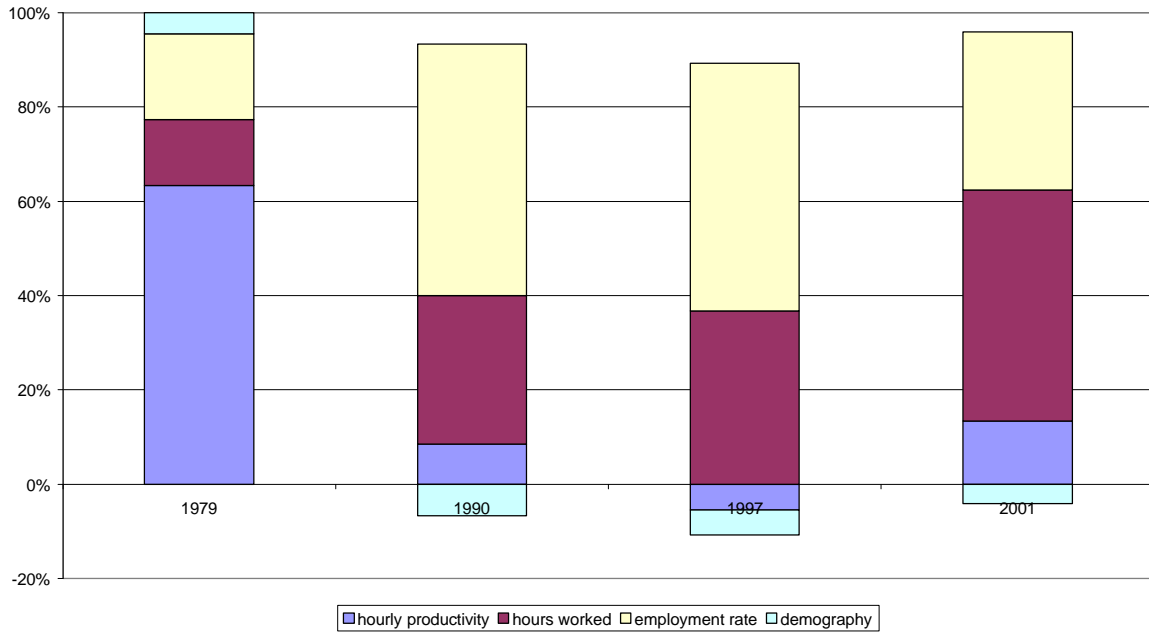


Fig.2
Italy's share of non oil world exports and the dollar/euro exchange rate

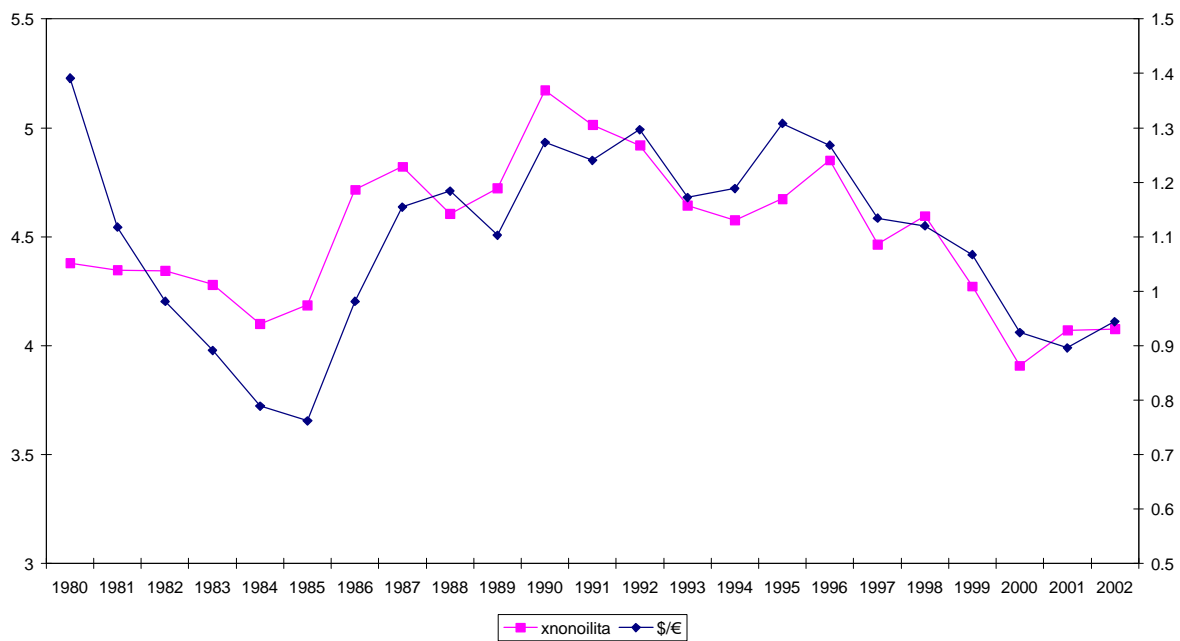


Figure 3
Germany's share of non oil world exports and the euro/dollar exchange rate

