

The Importance of Competition for Growth and Consumer Welfare

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Presented at *European Competition Day*

Dublin, April 29, 2004

Today's Topic: "Competition, Efficiency, and Productivity"

- The Easy Approach is that Competition is always Good, and anything anti-competitive is always bad
- But Competition, Efficiency, and even Productivity create Trade-offs, Political Decisions, and Compromises
- A More Subtle Concept of Competition Emerges from Considering Tradeoffs

A Second Theme: American Exceptionalism

- Can we count the ways?
 - Productivity take-off after 1995
 - Higher hours per capita
 - Higher fertility rate
 - Different attitude toward immigration
 - No trains
 - Low gasoline (petrol prices)
 - Low-density metropolitan areas
- Multiple equilibria, can this last forever?

Outline of Talk

- Defining Competition: What is the Opposite of Competition?
- Europe vs. U. S.: How Much is U. S. Welfare Exaggerated?
- Diagnosis of European problems: how much involves lack of competition?
- Do Small Countries Merit Special Treatment?
- Broader Policy Issues going beyond a narrow view of “Competition”:
 - Urban density, old-age pensions, immigration

I'm Going to Reject that Simplistic “Competition is the Goal” Approach

- The Elementary Economics Approach:
Perfect Competition
 - Zero Economic Profits
 - Free Entry
 - No government regulation or interference
 - No externalities

The Reality of Market Failure

- Perfect Competition Fails Because of
 - Monopoly and Oligopoly
 - Externalities
 - Government
 - Price ceilings and floors
 - Tariffs and trade quotas
 - Subsidies to particular industries

One Simplistic Approach to Promoting “Competition”

- Productivity Growth in the U. S. has accelerated since 1995, slowed down in Europe
- U. S. labor and product markets are competitive and flexible, while Europe is overregulated
- Therefore, Europe must “reform” to catch up with U. S. productivity growth

This Simplistic Starting Place Misses Everything Interesting

- Flexibility in U. S. Labor Markets Imposes Human Costs
- For instance, the U. S. Medical Care “non-system” not only introduces risk, inequality, and lack of care
 - It is *highly inefficient* both in its own operations and in its effects on labor markets

Ian as the 19-yr-old Interlocutor

- Ian upon reading the first draft of my Dublin presentation
 - Except for matters of fact, I disagree with everything you say
- From time to time, Ian will appear in this talk as the American voice.
 - Wimpy Gordon is too pro-European

The Best Place to Start in Demoting Competition from its Throne

- The American “Competitive” Model: Free Entry and Accommodative Government Environment
- Background: The Productivity Growth Gap
 - Computer Production vs. Use
 - Computer Use: Concentrated in Retailing, Europe vs. the U. S.
 - In U. S. productivity growth in the new establishments
 - Both Europe and U. S. use the same ICT
 - Something else must create productivity growth in the U. S.

Wal-Mart as “Midnight in the Garden of Good and Evil”

- The American productivity paradigm
 - No land use regulations, plough up the freeway interchanges without inhibition
 - Non-union, pay the workers whatever you want, with no benefits if you can manage it
- This sounds bad, but it delivers low prices to consumers, reduces the inflation rate
- A source of political debate. Inner-city Chicago. Who wins, who loses? There is plenty of land.
- Decades of discrimination means that there are **TOO FEW STORES** in many American inner-cities.

Europe Protecting Old Firms

- *Economist* on Wal-Mart in Germany: The German Government blocked price reductions
- Regulatory barriers to unlimited big-box expansion, whether in suburbs or central city
- Does inner-city shopping district disappear? America does not provide a clear story. Yes and no.
- Public transit in Europe as a special resource
- European inner-city pedestrian shopping zones as a special value, a special resource

A More Subtle Problem with the American “Competitive Paradigm”

- No measure of income per capita can properly capture the risk and uncertainty of the American environment
- Employer-based medical insurance, lose your job, lose your medical care
- Private defined benefit pension plans, lose your job, lose some or all of your retirement savings (Enron)

Ian on Wal-Mart

- “Wal-Mart vs. inner-city pedestrian shopping zones”
 - Not an issue of variety vs. homogeneity
 - It’s an issue of aristocracy vs. egalitarianism
- “To promote ancient downtowns at the cost of higher prices aids the rich and hurts the poor”
- My false dichotomy: Carrefour in France and a thriving downtown in my own Evanston

Another Dichotomy: Against Competition, Good or Bad Government Regulations?

- Unfettered advance of competition faces off against government regulation
- But there are both bad and good government regulations
 - Good: warning smokers of the dangers of smoking
 - Bad? Can we count the ways?

Government Intervention in the U. S. is off the Rails

- Farm subsidies: hurt LDCs, promote obesity
- Medical Care: Run in the interest of giant insurance and pharmaceutical corporations
- Starvation of Public Transit and Subsidization of Interstate Highways
- Local Zoning and Inequality of School Finance
- Tax Deductibility of Mortgage Interest

Ian on Farm Subsidies

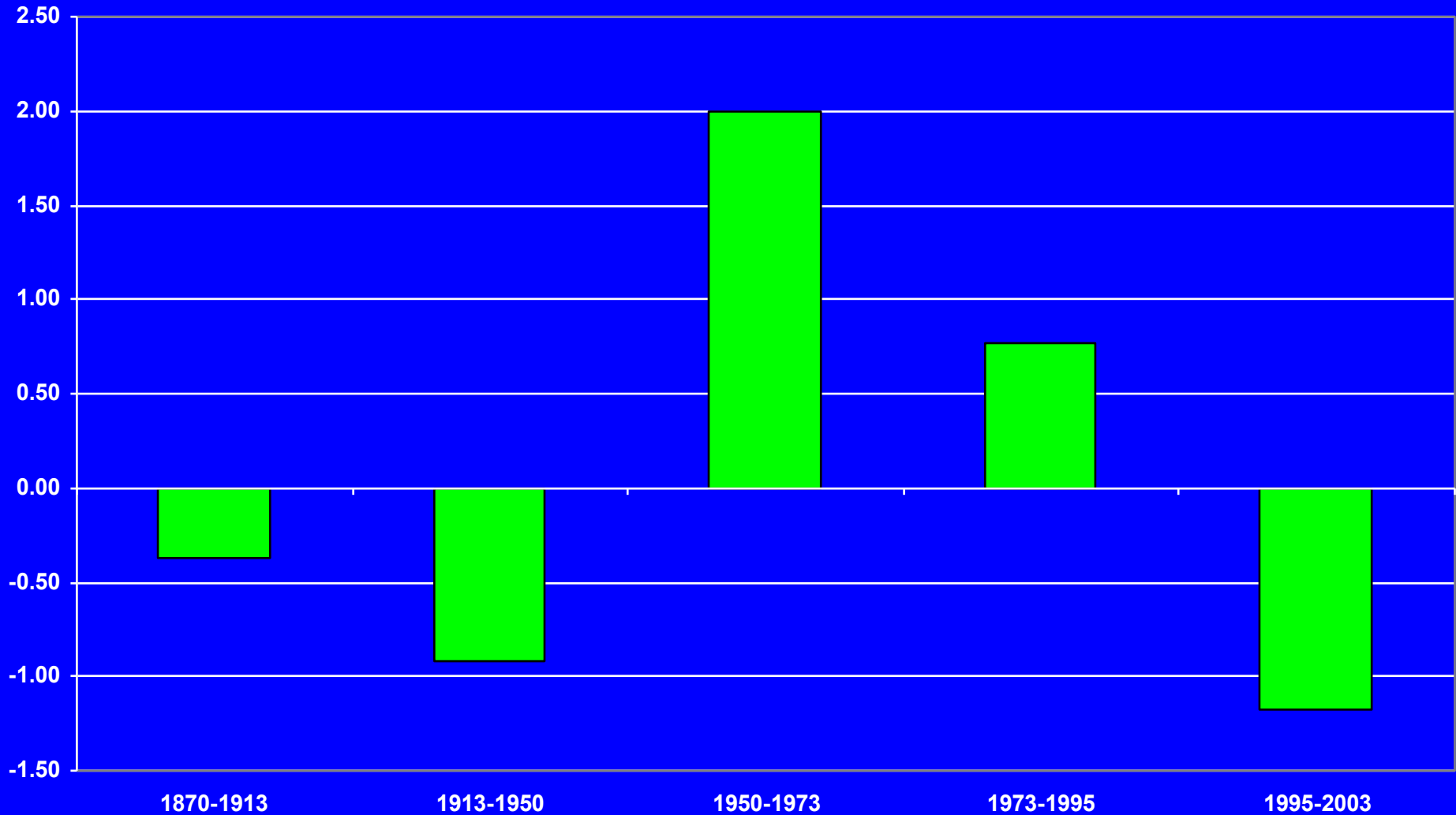
- “To complain about American subsidies seems odd considering that the average cow in Europe earns more income in subsidies than the median income of the world”
- OK, Europe and U.S. are equally guilty on farm subsidies
- The rest of my list is intact

To Understand These Issues, We Need A Welfare Measure Going Beyond GDP

- GDP does not include environmental benefits or costs, of which preservation of ancient European city centers is a benefit
- GDP does not include non-market attributes of jobs, including risk of layoff, risk of losing medical care coverage or pension benefits

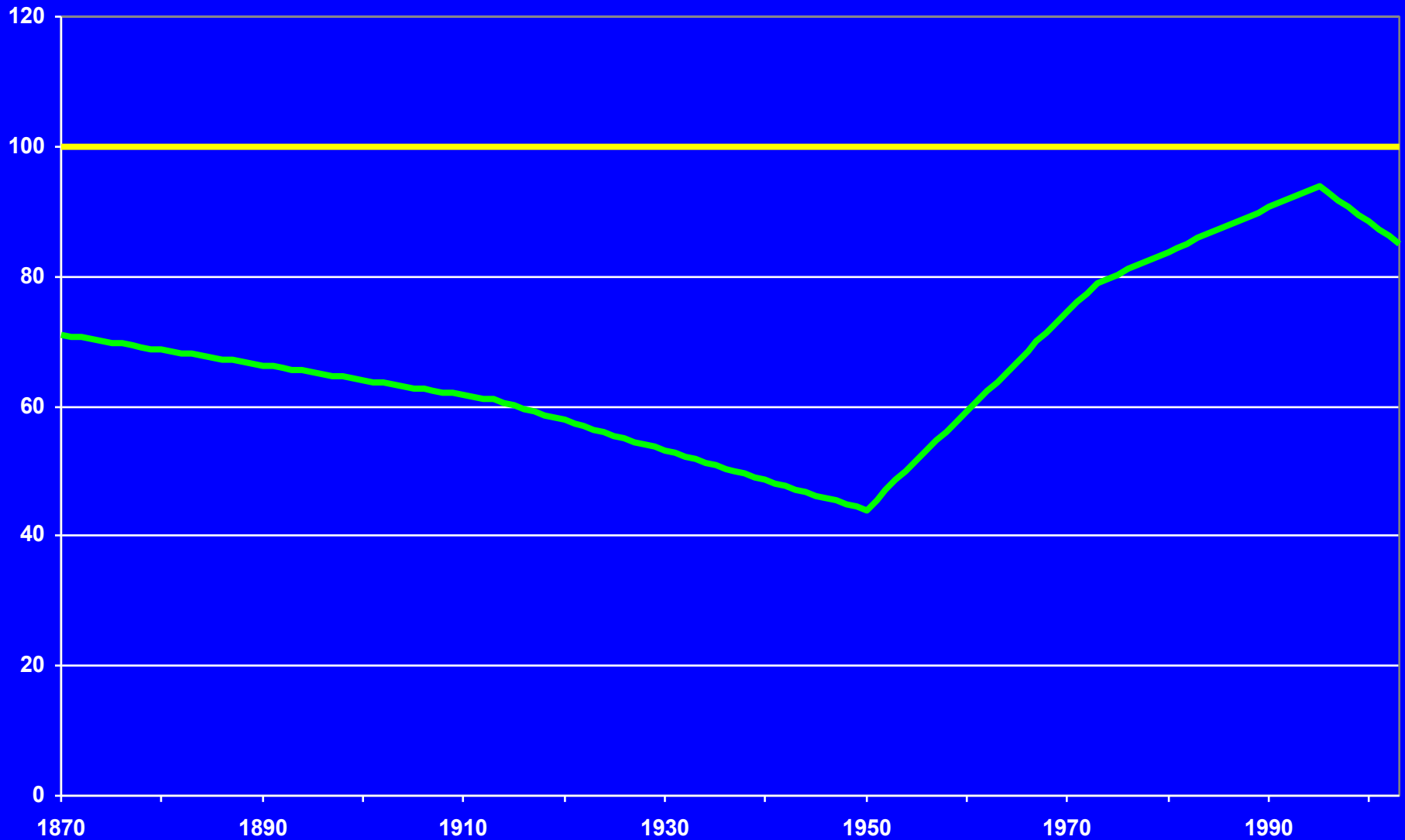
133 Years: Falling Behind, Catching Up, Now Falling Behind

Annual Growth Rate of GDP per Hour,
EU minus US, 1870-2003



The Reversal Shown in Levels

GDP per Hour, EU as a percent of US, 1870-2003



Divide Up These Time Intervals into Themes

- 1870-1913: Wright on Material-Intensive Manufacturing
- 1913-1950: U. S. Exploits the “Great Inventions” Much Faster than Europe
- 1950-95: The Great European Catch-up
- 1995-2003: What Happened?

Wright's Misinterpretation of U. S. Raw Material Advantage

- Wright, raw materials
 - part of political union, not just natural endowment
 - US has advantage in resources vs. individual nations, but vs. not all of Europe (no real difference USA vs. USE)
 - No fear of Minnesota and Indiana going to war
 - German import substitution, not necessary in U. S.
- Wright: doesn't emphasize enough agriculture, transport, trade

Post-1913: Exploiting the great inventions

- Vs. David-Wright on electricity in 1920s US mfg
- Much more emph needed on ICE and 1930-50
- Huge US lead in exploiting both electricity and ICE
 - 1929 U. S. had 90% of vehicle registrations and 80% of vehicle production
 - Solves the puzzle of the “Arsenal of Democracy”
- Alex Fields (Sept 2003 AER) on 1930s: “The Most Progressive Decade”

Post-1913: The Great Compression

- Immigration
- Trade barriers
- New deal pro-union legislation
- Implication: Unskilled labor was overpriced, incentive to capital-labor substitution, the “one-big-wave” of Productivity Growth
- Most rapid era of U. S. productivity growth was between 1928 and 1950

Post WWII: Europe Catches Up

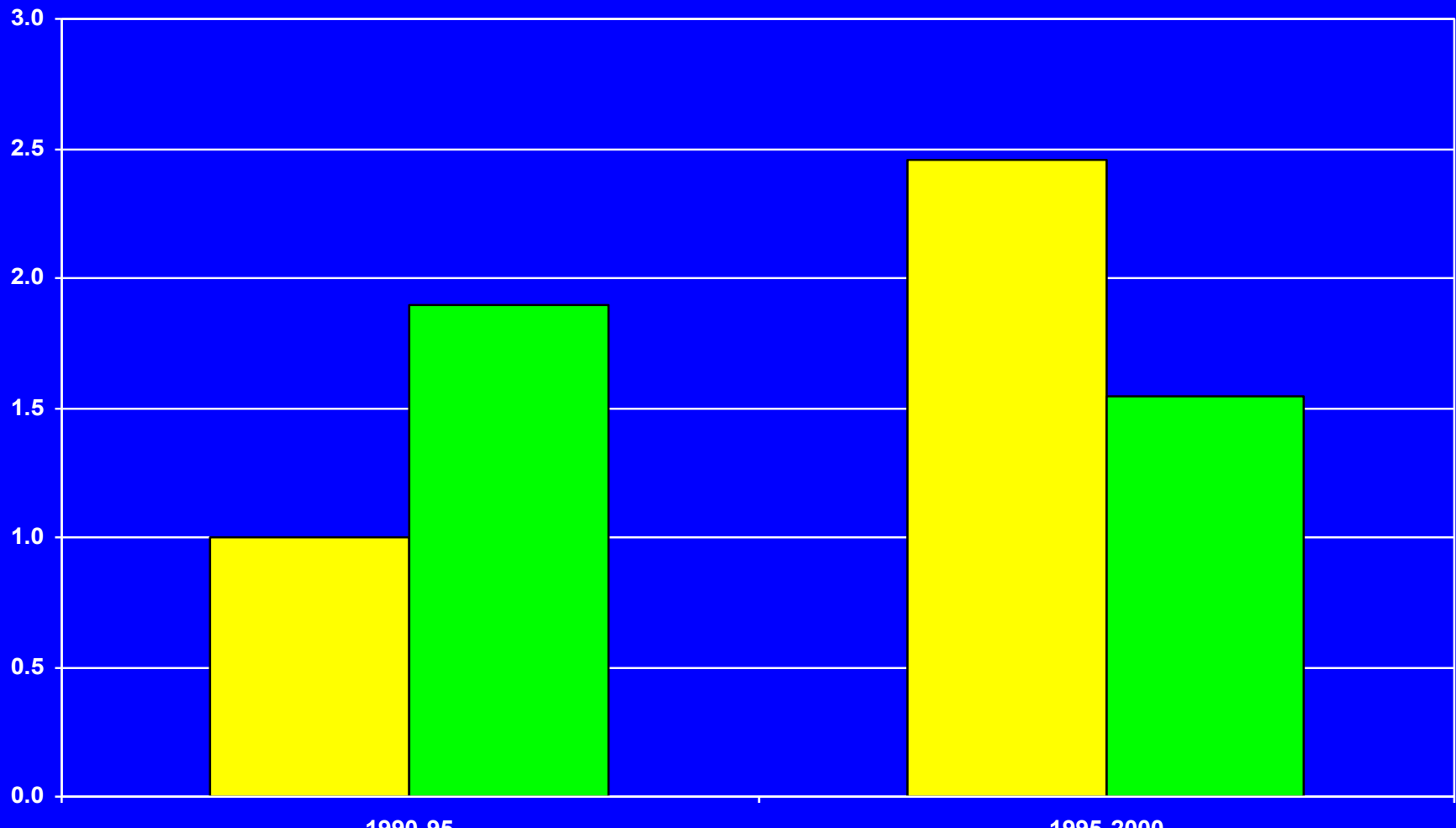
- The Low-Hanging Fruit -- France diffusion of electricity and ICE: exactly 40 years later
- Reversal of initial U. S. advantages
 - Raw materials
 - Political union
 - Newness depreciates, US stopped immigration
 - Reversal of the Great compression

The Great Paradox: Europe's catching up stops after 1995

- 1973-95 Europe, starting 40 years late, continues to exploit great inventions while U. S. has run into diminishing returns
- 1995-2003. Europe's productivity growth doesn't revive, the great European funk.
- Let's look at the last 13 years

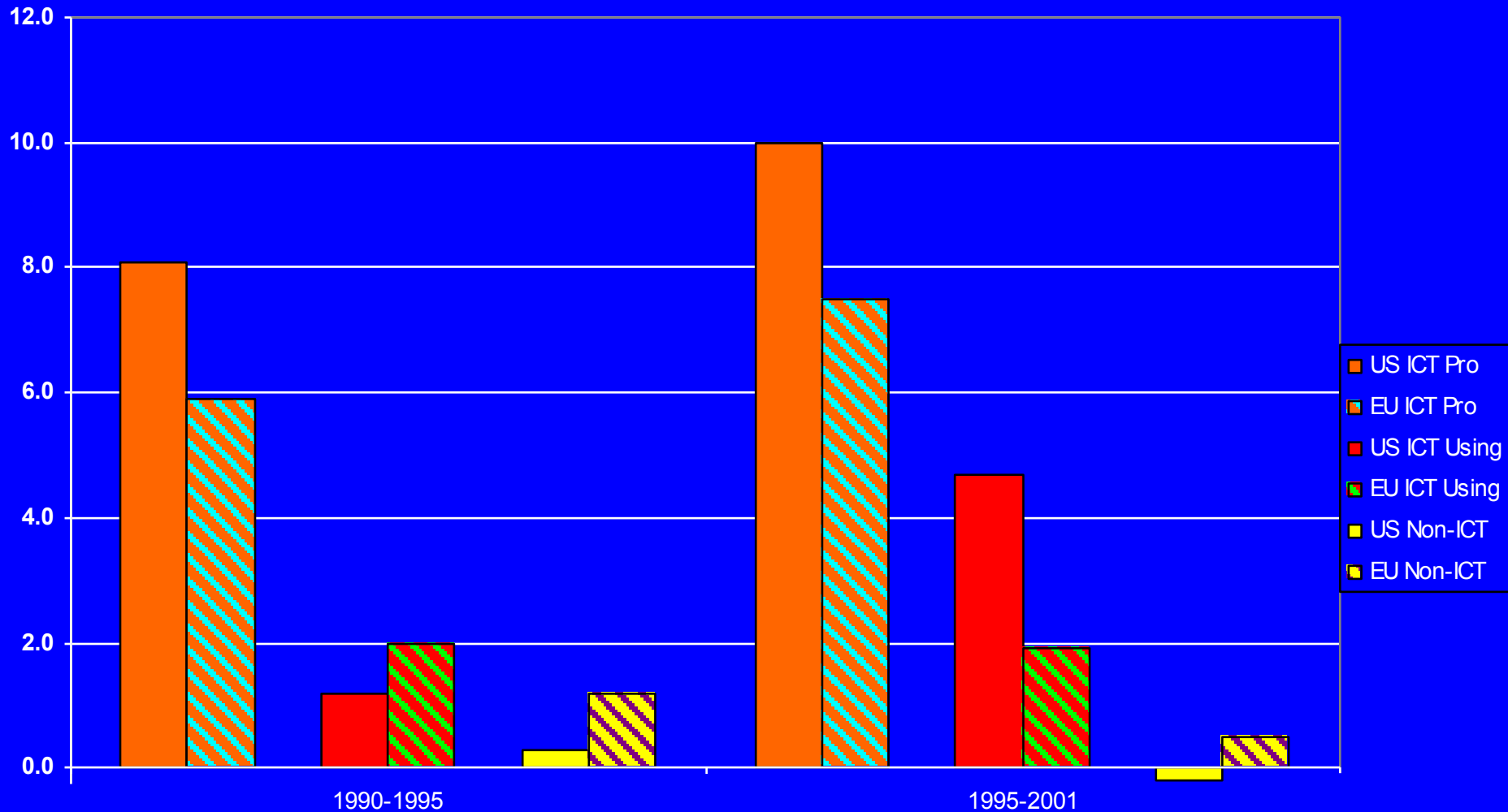
A Closer Look at the Last Decade

Annual Growth Rate of GDP per Hour, EU and US, 1990-2003



Finding the Culprit Industries

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



Where is the Difference? The Van-Ark Decomposition

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

Europe in Retailing

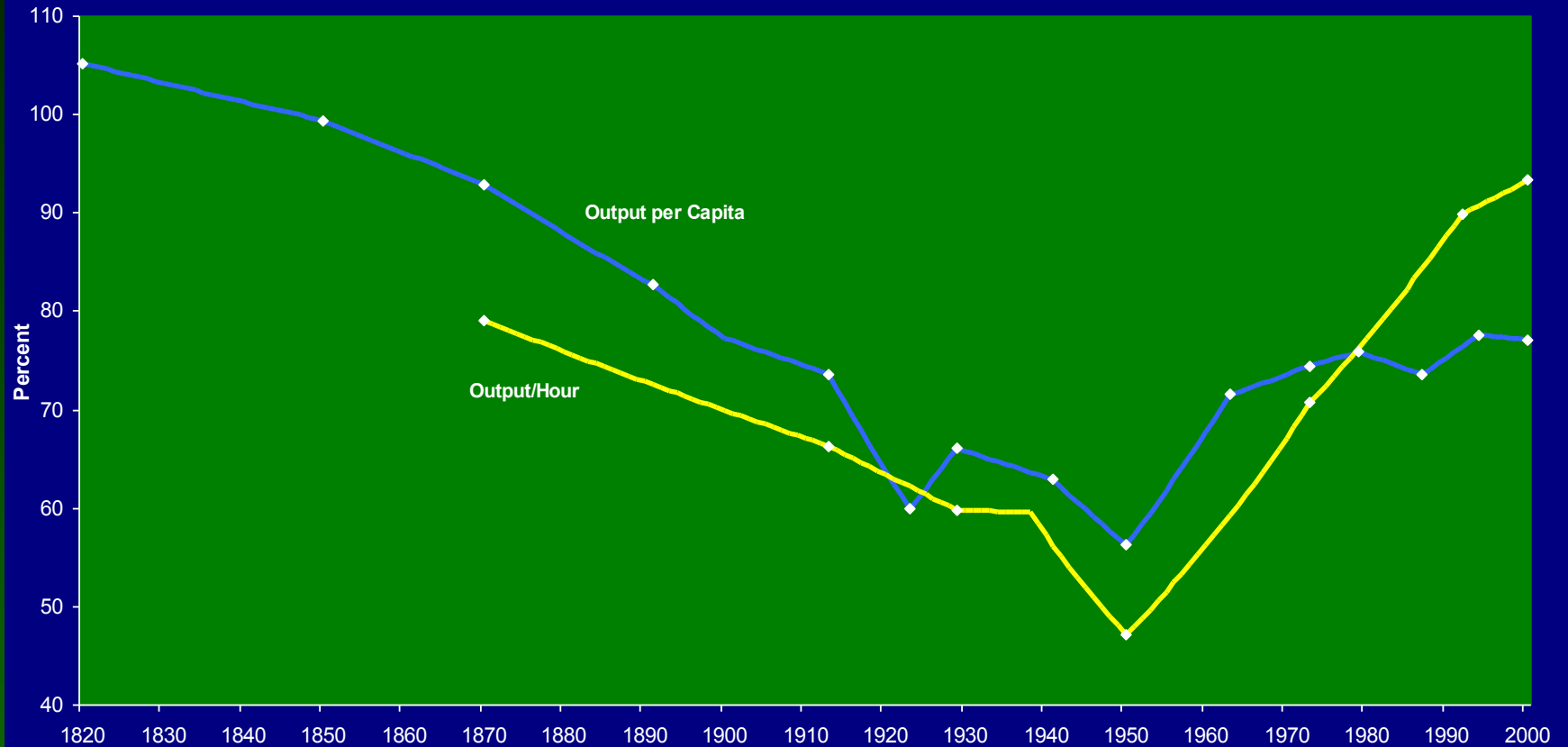
- Not uniform – Carrefour, Ikea
- U. S. “Big Boxes” (Wal-Mart, Home Depot, Best Buy, Target)
- Europe:
 - Land-use regulation, planning approval
 - Shop-closing restrictions
 - Central-city congestion, protection of central-city shopping precincts

Blanchard on the “Future of Europe”: Europe is OK

- Blanchard: Productivity has caught up to 100% and the 75% for Output per Capita reflects Voluntarily Chosen Leisure
- Let's Look at the Decomposition of YpC vs. YpH

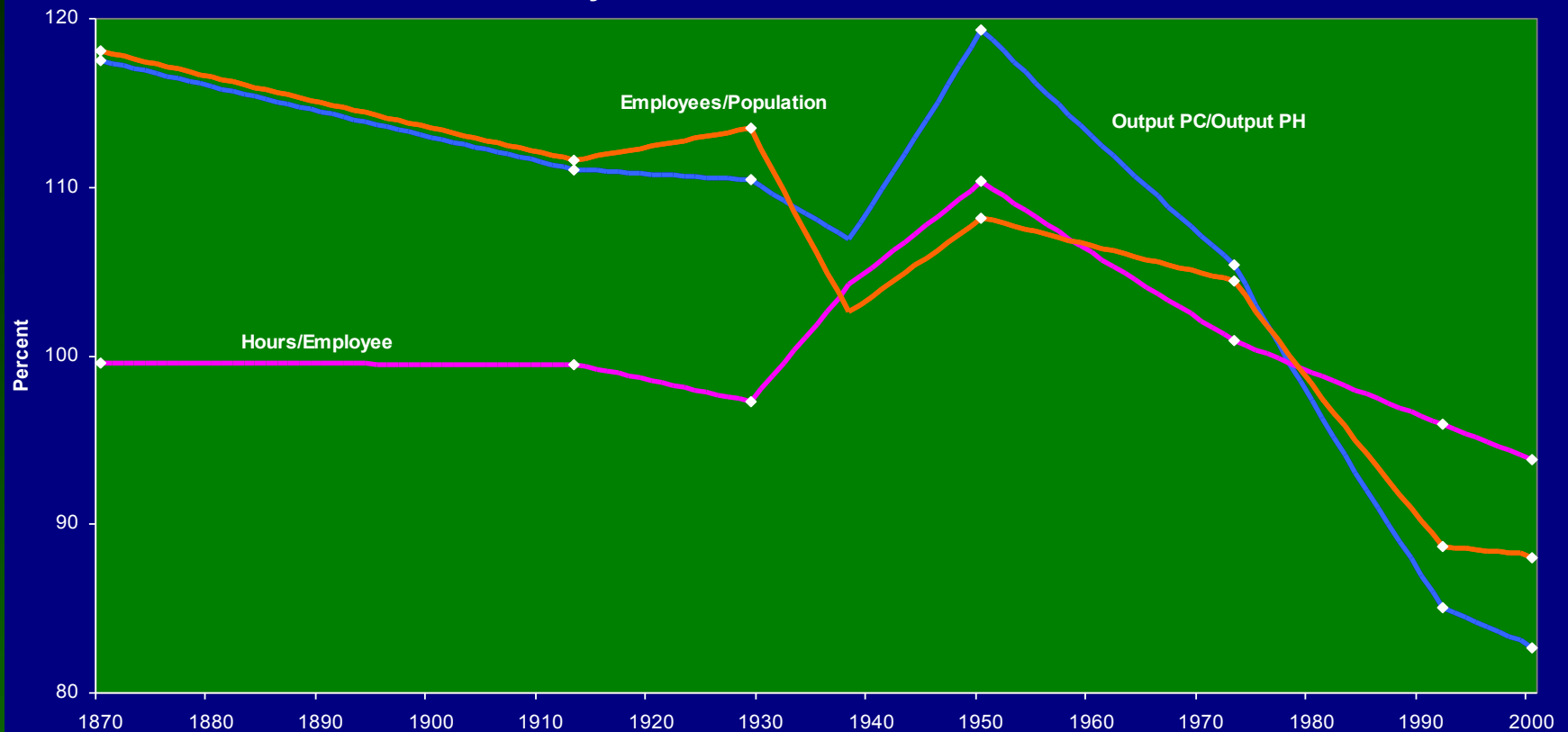
Output per Capita and Output per Hour

Ratio of Europe to the United States,
Output per Capita and Output per Hour,
selected years, 1820-2000



The Contributions of E/N and H/E

Ratio of Europe to the United States, Ratio of Output per Capita to Output per Hour, Decomposed into Hours/ Employee and Employee/Population Ratios, selected years, 1870-2000



Ian on Work Hours

- “To call long work hours in America a bad thing seems odd”
- “People here have the choice to work as long as they want”
 - “Europeans would work longer if they could”
 - “France wouldn’t need labor police if nobody wanted to work more than 35 hours”

Ian on Diminishing Returns

- “Are Europeans on a Different Point on the Average Product Curve?”
 - “Americans work more to a point of diminishing returns”
- Reminder of Ed Denison (1962) trying to correct for work effort effect
- Reminder of unemployment-productivity tradeoff

Going beyond hours per capita, does GDP exaggerate U. S. advantage?

- Harsh climate, energy use
 - Motor vehicle fuel due to long distances, dispersed metro areas
 - Harsh climate requires more energy to achieve moderate interior temperature
- Prisons

This is not black vs. white. It reflects different values

- U. S. Low-density metro areas dependent on auto, high unmeasured cost of traffic congestion, subsidies to auto transit, starvation of public transit
- Europe high-density metro areas, unmeasured time cost of public transit, subsidies to public transit
- Multiple equilibria?

Ian on Urban Density

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

A Solid Reason why the U. S. Welfare Level is Truly Higher

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

Summing up to this Point

- How does Competition Matter for Interpretation of Europe Falling Behind, 1995-2003?
 - Retailing tradeoff, land-use laws vs. protection of urban inner-city pedestrian districts
 - Wal-Mart “efficiency” also involves tradeoffs about labor standards, pension and medical benefits
- Paradox with Europe boosting productivity vs. the U. S. encouraging low-wage, low-productivity jobs
 - The raw data disguise the U. S. handicap, thus subtracting the handicap makes the U. S. productivity upsurge even more impressive

Is there an Issue for Small Countries?

- The Hosts Asked Me to Talk about This, but It's a NON-TOPIC
- Compare the core Western European countries.
 - Large: UK, France, Germany, Italy
 - Small, IR, NL, BE, NO, SD, DE, FI, CH
- There is no Significant Difference in Growth Performance over a Century!

Aggregation in U. S., Lack of Aggregation in Europe

- Puzzle is not failure in Europe, it's heterogeneity in Europe
- If you disaggregated the U. S., you'd find similar differences:
 - Silicon Valley = Ireland + Finland
 - New England = Denmark + Sweden
 - Austin Texas = Australia
 - Heartland = France or Germany
 - What's Missing in U. S. is Olive Belt (IT+PO+SP+GR)

Some Small Countries Do Better, but a Separate Story for Each

- Ireland: Congenial Reception for Foreign Investment, no such impact in a large country
- Finland: Home-grown comparative advantage, reputed to have the best school system
- NL: Combines huge multi-nationals with home-grown horticultural and network airline industries
- NO, lots of oil. SD and DK, How do they survive with such high taxes?

Small vs. Large is not the Right Metric

- Why Should Any Discussion Distinguish between NL and D?
- The Issues Facing the EU are High Y/PC vs. Low
 - Germany vs. Poland vs. Slovakia
 - UK vs. Portugal vs. Cyprus
- The Small Countries are both Rich and Poor

Back to all of Europe: Poor Labor-Market Performance

- Why is Average EU Unemployment Rate Higher than US, LFPR Lower?
- Minimum Wages, U Benefits
- Regulations on Hiring, Firing, Plant Closings, Plant Openings
- This is an old Story, still valid

Phelps' Refreshing departure from Vagueness

- Too little competition, too much corporatism
- “penalties, impediments, prohibitions, mandates” that dampen “creative destruction”
- Youth in America vs. Europe, culture of “dependency”

Spillover to Culture and Lifestyle

- Lack of Job Opportunities for Youth in Europe:
 - Late Marriage Ages
 - Late Development of Independence
 - U. S. Youths working in High School for McDonalds and Burger King
 - U. S. Youths earning part of their college tuition, taking out loans, need to work to pay them off
 - Low Fertility Rates
 - Italy: Living at Home with Mama

U. S. More Congenial to Immigration

- U. S. Welcomes Immigrants but Expects them to Assimilate
 - OK, bilingual ATMs, ballots
- Canada perhaps the Extreme in Welcoming Immigrants, esp. those with Money
 - U.K. Keeps Tight Control but Admits relatively a Lot
 - Australia formerly hostile, now hospitable
- In other parts of Europe, immigrants are kept in an inferior status
- Language is the great handicap for true European unity
 - Prevents labor mobility, undermines Euro

Conclusion: Persistence of American Exceptionalism

- America:
 - Long work hours, short vacations
 - Low-density metro areas
 - High fertility
 - Role of immigration interacts with flexible labor markets

Are Tastes Endogenous?

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

Conclusion: Where does Competition Fit In?

- Labor Markets: Let's Face it, union-created rents for high-school drop-outs are obsolete
 - Has Germany's IGMetall got the message?
- Open immigration reduces consumer service prices and revitalizes dying urban neighborhoods
- With open immigration, the educational system becomes the focus. And the U. S. system of COMPETITION between state and private universities sets the ideal model
- Exporting high-IQ services is the greatest comparative advantage of the U. S., makes a mockery of the “outsourcing” debate

Ian's Final Blast

- “Too bad some people in America have to work 2 jobs but if they want to get to the top, at least it's an option.”
- “Yes Europe has less variance in incomes, but it is far harder to move up”
- “Show me a European Richard Grasso, a man who didn't go to college and got fired for making *too much* money”