The United States vs. Europe – which macroeconomic system is better?

Unemployment

In the 1960s, the US had a 4% unemployment while Europe had ~2% and they used to laugh at us and ridicule us. Twenty years later, the US still had unemployment around 4% but Europe had over 10%! This change had to do with regulations involving efficient and the ability to hire and fire people. European unemployment insurance also had a lot to do with it.

Difference may also be in how unemployment is measured. In Europe, it’s taken from generous insurance rolls, which every one signs up for even they aren’t looking for work (results in overestimation. In US, have to want a job and prove that you are actively looking for one to be counted (results in underestimation). For example, with a rate of 4% in the US, this means about 5 million unemployed people. But there are also 4m discouraged workers, 4m involuntary part-time, 8m independent contractors, 8m temps, 2m on-call, and 6m missing males. So what’s the real unemployment in either place – who knows? There are degrees of unemployment.

Implications of unemployment

If unemployment is too high, then you know that wages are also too high. In the US, over the past few years, the average wage has been going down while $W_{skilled}/W_{unskilled}$ has been going up. In Europe, the opposite has been true. This makes the US an much cheaper place to produce – BMW and Mercedes were able to cut their labor wages in half by moving to the US. This actually results in a productivity increase because the US is not a third-world country.

In Europe, government sector jobs have much higher wages and benefits than private companies. In US, government wages are much lower than private jobs (benefits are comparable). This causes a brain-drain in Europe to government (which is a socialism legacy) and also higher taxes.

Globalization
So in a developed country, globalization leads to higher wages in skilled jobs and lower wages in unskilled jobs. Labor supply and demand both shift outwards in both markets but the unskilled labor supply completely overwhelms the increase in unskilled demand. Globalization leads to an increase in inequality. This can be seen by the fall in wages in Mexican border states in the US.

**Skill Intensive Technology Shift**

![Skilled and Unskilled Labor Supply and Demand Graphs](image)

With a technology shift, you get an increase in demand of skilled workers and a decrease in demand of unskilled workers. Again, you get an increase in inequality. There seems to be a natural tendency to shift to inequality.

**Shift to Services**

During Clinton’s tenure, the US added 23 million jobs but of these, 20 million were in private service, 2 million in government service, and 1 million for everything else. Service in general don’t require many skills ($W_{service}/W_{manufacturing}$ is 0.67) but you get much higher inequality ($W_{skilled service}/W_{unskilled service} >> W_{skilled manufacturing}/W_{unskilled manufacturing}$).

In Europe, the government tries to keep down this inequality causing $Price_{services}/Price_{other stuff}$ to be much higher than in the US. Also, Europe exports a lot of service jobs, and many jobs have been cut (think services at public attractions like ski resorts). So Europe substitutes capital for labor wherever it can and this results in a capital to labor ratio that is much higher in Europe than in the US, and allows Europe to pay service wages that are similar to manufacturing wages. It’s no surprise then that while the US created 23m jobs, Europe created only 2m – Europe is moving to a capital intensive economy.

During the 80s and 90s, this resulted in Europe having a high productivity growth rate than the US. However, this is because during all these shifts (which Europe avoids), you need some slow productivity to absorb all the people (which is what happened to the US).

**Big Picture** (what does all this mean?)

It means that you have to change the social contract with shifts in the economy. You can’t guarantee that everyone will partake in higher wages. Europe tries to solve this problem by paying the unemployed people to do nothing. The better solution would be to reeducate the people – make more skilled workers.
High Social Charges

Theoretically, wages paid are equal to a firm’s productivity. But with high social charges (say 60% payroll tax), either wages become too high for productivity or the firm has to cut wages. Higher wages leads to unemployment. So to raise wages without unemployment, you need to cut payroll taxes. This cut must be offset by a drop in benefits or an increase in the VAT. This would almost be like a free lunch because the VAT makes exports cheaper (redeemable) and you can decrease unemployment while maintaining benefits.

Europeans don’t like this because they believe that the VAT is regressive. However, you can make it progressive by balancing it with tax credits. Consequently, many believe that the Europeans don’t really feel any sympathy for the unemployed – they just like to complain.

Hiring and Firing

Another degree of flexibility that is necessary is the ability to hire and fire people at will. In the US, you can hire and fire people easier than any other country (no notice, no pay, no reason). In Europe, getting rid of workers is horrible expensive and incredible difficult. So if you can’t fire, you are much more reluctant to hire someone. This prevents hiring during the booms and (of course) firing during the recessions, which is very inefficient.

Work Sharing

Limiting hours and sharing jobs is very popular in Europe. The problem is that with two people doing one person’s job, training costs go up, wages must go down, and management costs go up (need greater coordination between more workers). So this seems like not such a good idea. But work sharing also happens in the US – 20m of the new jobs were the result of work-sharing or part-time workers. But in the US, its been restricted to service industries which jump on work sharing because the training costs are so low (not true in manufacturing).

Minimum Wages

The minimum is much much higher in Europe. In the US it is about 5% of the average wage whereas in Europe it is almost 85%. So in the US, the minimum wage has almost no effect on the wage structure but in Europe, the minimum wage a real adverse effect – it distorts the wage distribution.
Unemployment Benefits

In Europe, for a long time, 80% of the people on employment insurance received 2/3 of their wages. Over 40% of the people finally getting jobs were unemployed for over 12 months. In the US, nobody gets 2/3 of their wages and ¼ of them get new jobs within 20 weeks. Only 5% of new hires were previously unemployed for longer than 12 months. People in the US will take a pay cut and move across the country to get a job because they have no other choice. In Europe, however, they have no reason to do this because the benefits are so high. This only works though because the people in Europe who are working are willing to pay high taxes. There is an argument for this as over the past 20 years, GDP growth has been basically equivalent between the US and Europe. However, in the US, this growth was due to skyrocketing total growth and gains in production while in Europe, they have mostly just gotten rid of people (very few immigrants and low population growth rate). Depends on your point-of-view as to which growth is better…