

Is Europe going to repeat a Japanese-style Stagnation Trap?

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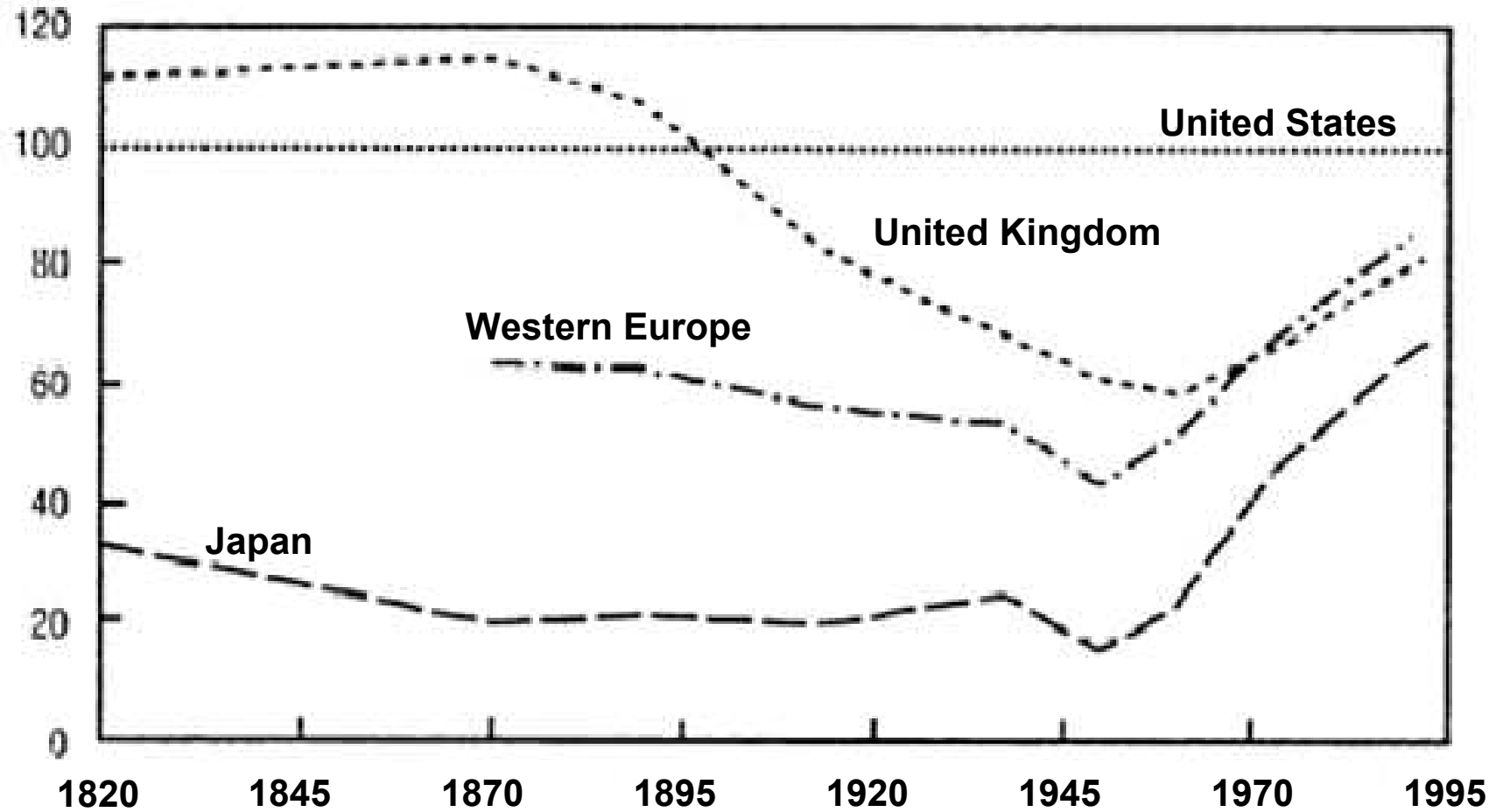
November 18, 2011

Labor Productivity (GDP per hour)

(1990 base year)

Levels, 1820-1992

b. United States = 100



Note: Western Europe in this figure excludes the United Kingdom.
Source: Maddison, Angus (1997). *Journal of Productivity Analysis*, 8, 325-359.

In the 1990s and Early-Mid 2000s

- EU's relative position weakened in
 - GDP growth
 - GDP per capita growth (less so)
 - Growth in employment
 - Growth in labor productivity (less so)
 - Living standards
- Smaller EU states have done better, on average, than larger states in productivity and employment growth

What happened in Japan?

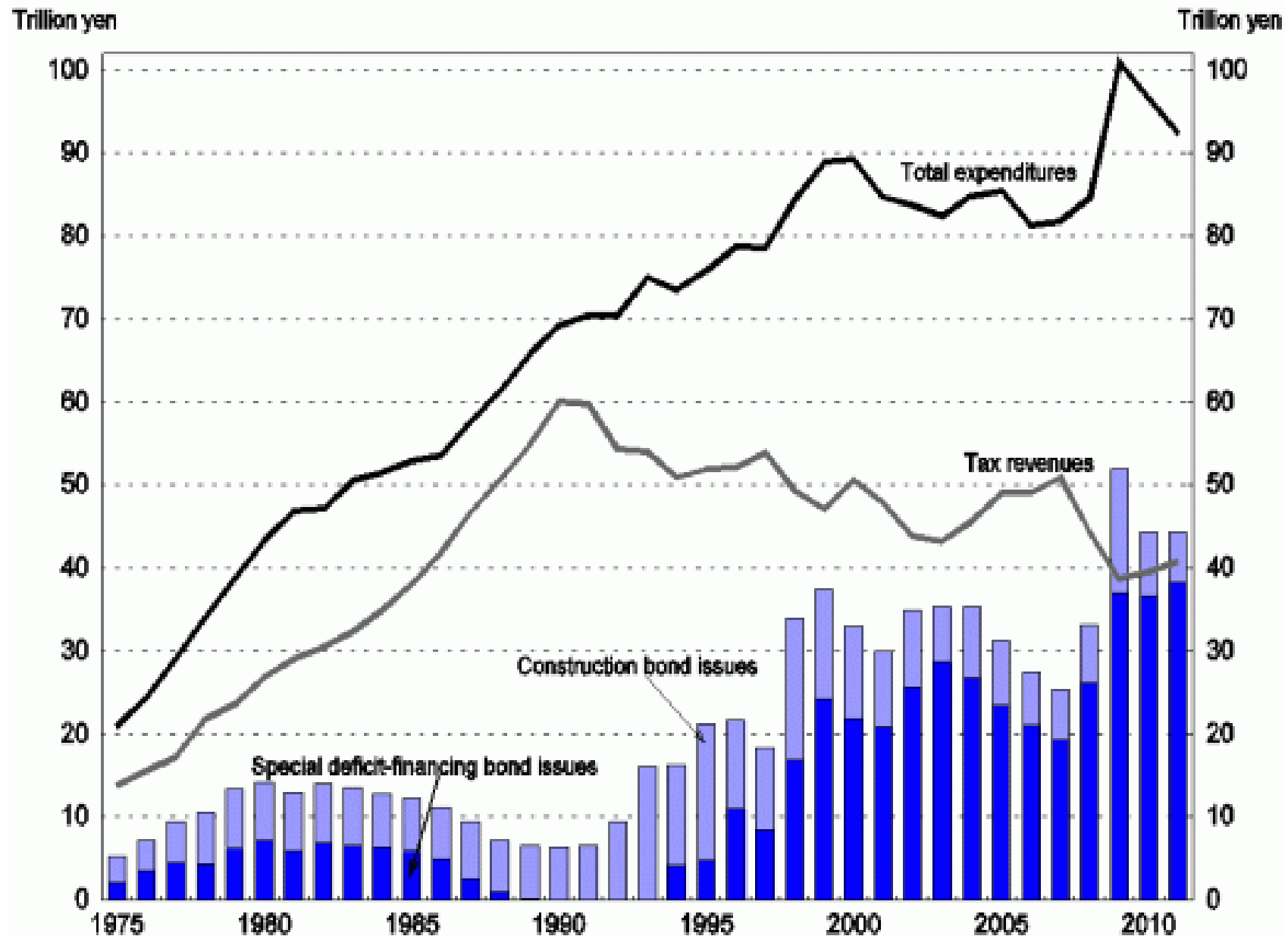
Main Explanations of Japanese Stagnation

- Demographic factors
 - Aging
 - Changing values of younger generation
- Financial markets and debt burden
 - Depressed investment (after overinvestment)
 - Problems with financial intermediation
 - Liquidity trap
 - Self-fulfilling expectations
- Inadequate fiscal policy
- Subsidizing inefficient firms resulting in low productivity growth

Debts and Growth: Empirical Facts

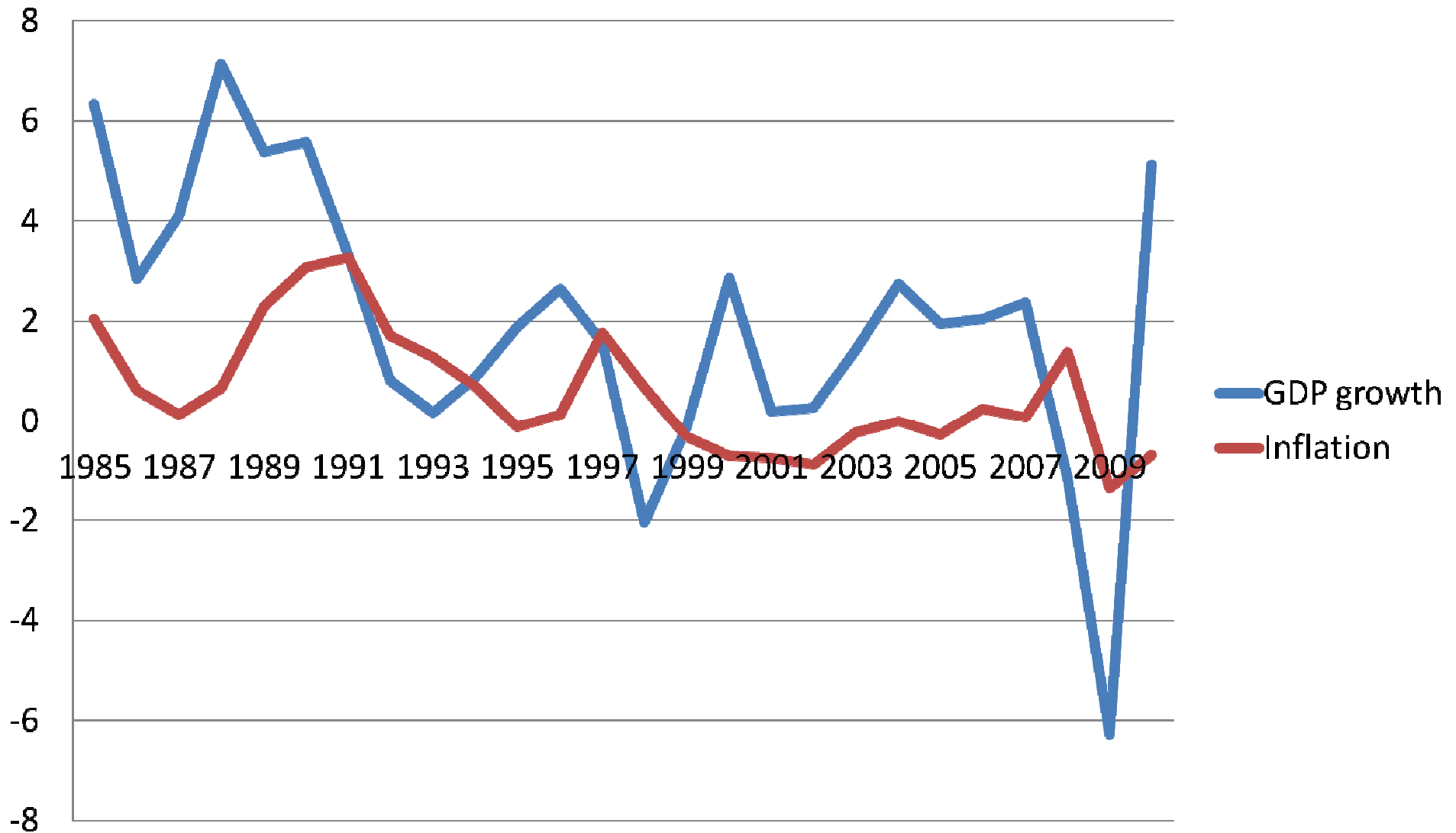
- Reinhart & Rogoff (2010):
 - "Countries which have public debt over 90% of GDP have on average several percentage points lower growth than other countries."
 - "When gross external debt reaches 60% of GDP annual growth decrease by 2 pp."
 - "When level of external debt exceed 90% of GDP growth rates are roughly cut in half."

Japan: Gap between Expenditure and Tax Revenue



Source: OECD

Japan: Real GDP Growth and Inflation (%)



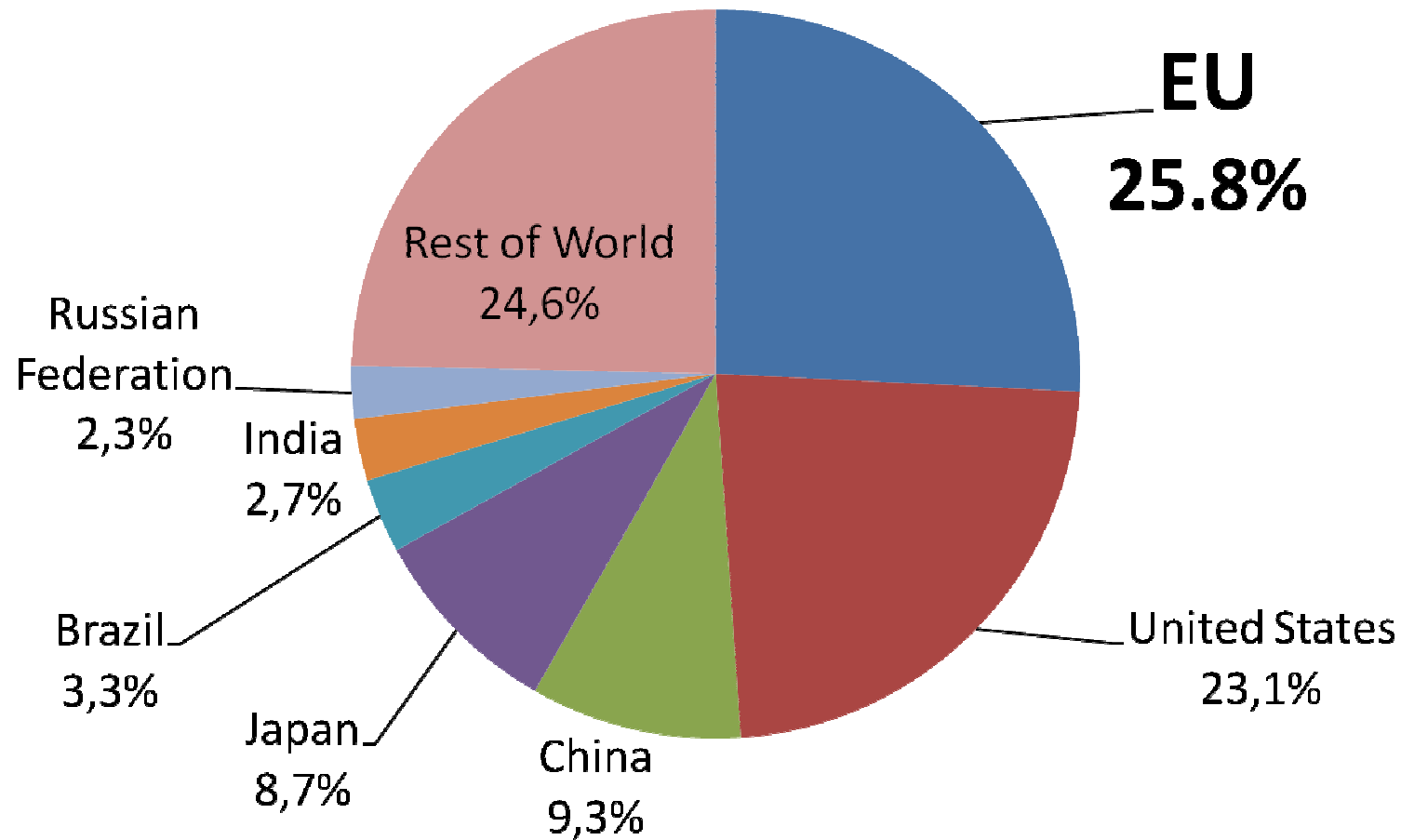
Source: WDI database

EU (Relative to the US)

- Largest economy in the world (in GDP)
 - But not the richest or most dynamic one
- Fragmented on a number of key issues
 - Fiscal policy, financial sector
- Not always seen as a real partner by other countries
 - Prefer bilateral negotiations with individual EU members
- Monetary integration (€) under pressure
 - Problems of weaker EU members
 - But countries still striving to become members of both EU and EMU
- Searching for new objectives and approaches

Shares of the World GDP in 2010 (%)

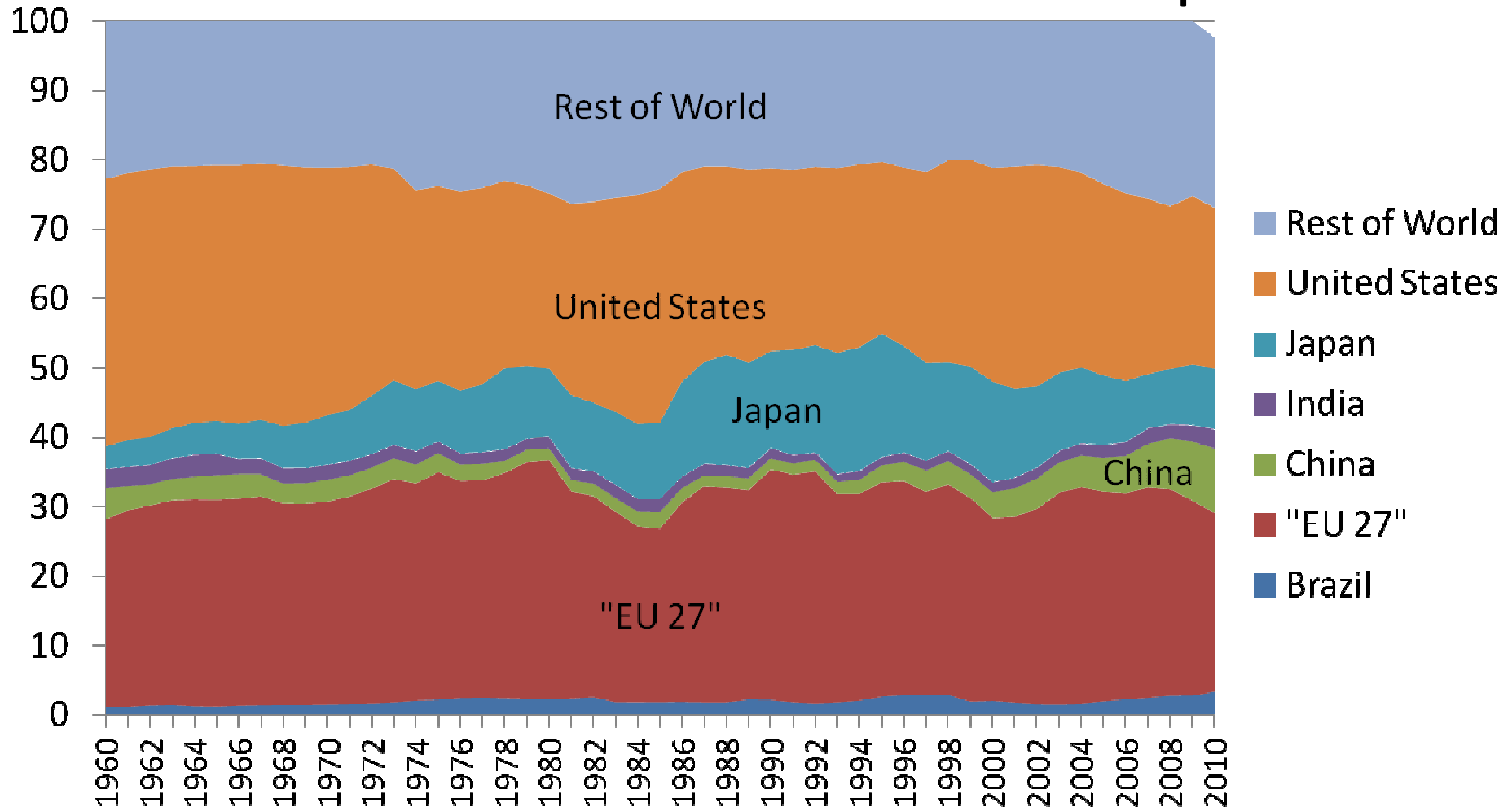
Based on GDP in USD and current prices



Source: World Development Indicators

Structure of World Economy: Long Run

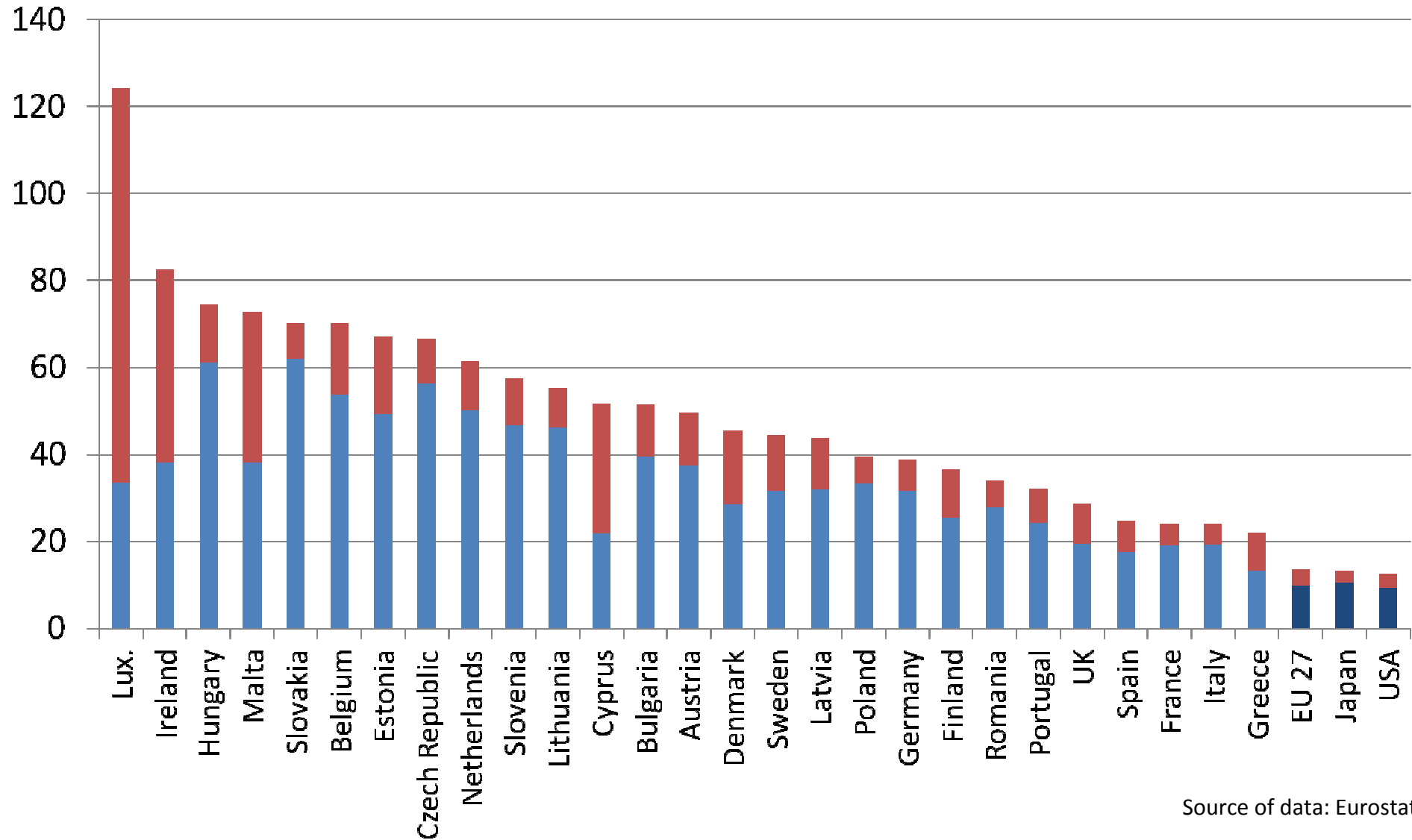
Based on GDP in USD and current prices



Source of data: WDI

Market Integration: Trade in 2009

Average value of imports and exports of goods and services in % of GDP



Source of data: Eurostat

Assessment

- Early 1990s -- the US, Europe and Japan reached similar levels of economic development
- EU and US became similar size economies
- New dimensions increasingly started to matter in a more global world
 - Entrepreneurship & availability of venture capital
 - Regulation (cost of doing business)
 - R&D
 - Human capital
 - Leadership and perception of leadership

Principal Issues in EU

- EU governance
- Common monetary policy vs. separate fiscal policies
 - Less growth-oriented institutions (ECB v. FED)
 - Possibility of disintegration?
- Knowledge-based competitiveness challenge – 2010 (2020)
 - Financial markets and government intervention
 - Labor and social institutions (education, flexibility, cost, employment)
 - Tax issues/cost of doing business – pension reforms
- Importance of quest for innovation and leadership
- Complete Integration of Central and East/South European Countries
- => Europe has tremendous unexploited possibilities (largest free trade zone in the world, (still) single currency, increasingly acts as a unified economic power)