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COWBOY CAPITALISM:
EUROPEAN MYTHS, AMERICAN REALITY

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The big world story of the last two decades of the twentieth century was the demise of communism as an economic system and power bloc, and with it the end of the cold war between East and West.

At the same time, another story has been unfolding, not as dramatic as the ending of an entire political and economic system but still of great long-term significance. That story is about the pre-eminent success of the Anglo-American economies (which include not just the United States but also Canada, Australia, New Zealand, Ireland and the United Kingdom) and the relative failure of the various versions of the so-called social market economy or managed capitalism in Continental Europe and Japan.

In the last dozen years or so, economies based on free trade, private ownership, light regulation and moderate taxation have opened up what looks increasingly like a decisive lead over economies characterised by active state partnership with business and trade unions in steering the economy, high levels of taxation and social spending, a greater role for banks than for stock markets in corporate ownership and control, and intrusive regulation of business.

As this gap has opened, the terms of the debate about the two rival models of capitalism have changed. In the deep recession of the early 1990s, criticism of the alleged 'short-termism' of open market economies and stock markets won a hearing, as did the alleged virtues of Japan's interventionist Ministry of International Trade and Industry (MITI) in the previous decade. After that recession ended, the world economy entered a period of prolonged macroeconomic stability, including low inflation, that continues to this day. But whereas the Anglo-American economies have returned to steady growth and something like full employment, the managed economies have to varying degrees stagnated and experienced rising unemployment. We hear little today about 'short-termism' or MITI. But that doesn't mean that the managed economies have conceded defeat or that criticism of the Anglo-American model has ended.

Instead, the American economy in particular is subject to a range of criticisms that have acquired something approaching the status of conventional wisdom and are current to some extent even in Anglo-American countries themselves. You will be familiar with many of them: that American prosperity is built on unsustainable levels of debt; that everyone has to work unconscionably long hours; that the jobs are low-paid and demeaning ones like 'flipping burgers'; that unemployment is kept artificially low by the huge and growing prison population; that the health system is inaccessible to all but the rich; and – as always – that the gap between rich and poor is widening. And so on. By contrast, the social market or managed economies are held to provide a superior lifestyle, with a better balance between work and leisure, greater protection for those at the bottom of the income scale, and a greater degree of social and employment security for everyone.

You may think that the standard criticisms of America have a defensive, anecdotal, and unreliable feel to them. And well you may: Olaf Gersemann, author of *Cowboy Capitalism: European Myths, American Reality*, published in 2004, shows that they are nearly all wrong.[1]

Gersemann is a German business journalist who has lived in Washington DC since 1999. Having vaguely accepted the standard criticisms of America's economy, he found on moving to the United States that they were largely myths, as were Europe's alleged advantages over the American model. *Cowboy Capitalism* is a well-researched and well-argued challenge to the conventional wisdom and an education in how the Anglo-American and managed capitalist models deliver their respective benefits.

It's important to state at the outset that Gersemann isn't saying that all countries should consciously try to become clones of America. It is evident that factors like demographics and public pension liabilities will force the most stagnant European economies to change their policies in an Anglo-American direction, even if the present generation of leaders is graciously

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1 Olaf Gersemann (2004) *Cowboy Capitalism: European Myths, American Reality*, Cato Institute, Washington DC.

leaving that task to its successors. But Europeans can choose whether or not to abandon other features of their national ways of life. I'll come back to this point later on.

Gersemann starts by analysing the growing gap between the United States on the one hand and the three representative European economies that form the basis of comparison throughout the book – namely, France, Germany and Italy – on the other.

After the Second World War, Europe recovered and gross domestic product (GDP) began to catch up with American living standards: by the early 1980s Europe's per capita (GDP) was about 80 percent of America's, West Germany's was about 90 percent. Thereafter convergence ceased and has since gone into reverse: in 2002 per capita GDP in the three European countries was 70-75 percent of the American level, and trending downwards. Moreover, in the same year – one of mild recession following 9/11 – unemployment rose to 6 percent in America but to nearly 10 percent in Europe, where it has since continued to rise as it has fallen back in America.

To explain the gap Gersemann cites figures on employment, hours worked, and productivity. Employment ratios – that is, employed persons between 15 and 64 years old as a share of the working-age population – in 2002 in Europe (meaning here France, Italy and Germany) were 55-65 percent; in the United States the ratio was about 72 percent. The numbers of hours worked annually by each employed person over the last 35 years have generally fallen. In 1970 in all countries studied the number of hours worked stood at around 1,900; but whereas that figure had fallen by 2002 to just over 1,800 in the United States, it had fallen to around 1,500 in Europe. Unlike Americans, Europeans have made a major move away from work and towards leisure over the last 35 years.

Of course, had Europe undergone a productivity miracle as its employment ratio and hours of work fell, it could have continued to converge on American levels of per capita income. In fact, over the last 30 years productivity growth in Europe has declined from a higher base, while in the United States it has risen from a lower base. In 1997 annual productivity growth in the United States really took off. In that year it stood at about 1.35 percent; by 2003 it had reached 3.5 percent and is still rising. Meanwhile, in Germany annual productivity growth has been falling since 1993, when it was over 3 percent; in 2003 it was 1.5 percent and going down. Gersemann believes that this difference in productivity growth reflects in particular different levels of investment in advanced information and communication technology (ICT). In the United States between 1980 and 2001 such investment grew from under 15 percent of total investment to more than 25 percent. In Europe it expanded far less, *up to* around 15 percent, where the United States was 21 years before.

Gersemann is quite sure that the growing divergence between the United States and Europe is ultimately explained by the slackening of policy reforms to expand economic freedom in Europe since around 1990, while the United States has pressed ahead on that front. The *Economic Freedom of the World: 2003 Annual Report*, published by the Fraser Institute, shows the United States to be consistently within the top ten countries for economic freedom over the last 35 years, and in the top five since 1990. Continental Europe, meanwhile, has slipped a long way down the league.

So whereas the United States has made the transition from a lower-value manufacturing to a higher-value service economy, Continental western European countries still have sizeable manufacturing sectors that are being severely squeezed by competition from eastern Europe and Asia. The figures Gersemann cites show that other economies that have made similar transitions to services, including the United Kingdom, Australia, and the Netherlands, generally rank high on economic freedom; they are also steadily growing economies, unlike the big three Continental European ones. In 2003, the value of American production in high-value, knowledge-intensive service industries (like ICT, business services, finance, health and education) was nearly twice as large as that of Germany, France and Italy combined, and growing faster.

Those are the basic facts of the case. European economic convergence on the United States has stopped and is going backwards. But how should we evaluate this outcome? No country is obliged to maximise its economic growth, and a choice to promote values other than economic ones is perfectly legitimate. If the conventional wisdom in Europe and elsewhere to the effect that Americans' quality of life is poor and that they can't really enjoy their economic wealth were true, it might even be sensible to avoid maximising economic growth. But the central aim *of Cowboy Capitalism* is to expose that conventional wisdom as nonsense.

To avoid overburdening you with too many facts and figures I will try to summarise the counterclaims about eight current myths as succinctly as possible.

The first myth is that *'living standards are declining'* in America. The basis for this claim is that hourly wages have stagnated or even fallen over the last 35 years. But as the employment ratio has risen, *household* labour incomes have increased. As well, the tax burden has fallen; health insurance and other non-wage payments by employers are increasingly important; the spread of share ownership has increased people's income from capital; deregulation has lowered energy prices; and the real prices of many consumer durables are falling. The United Nations Human Development Index, which takes into account non-income as well as income indicators of quality of life, awarded the United States the seventh highest quality of life worldwide in 2003; France was 17th, Germany 18th, and Italy 21st.

The second myth is summarised in the advertising slogan *'For everything else, there's MasterCard'*. Americans are said to have stopped saving and to be living on a growing mountain of debt. But officially savings don't include capital gains; if they did, in 1999 the American saving rate would have been 7 percentage points higher than the official figure. Much of the rising indebtedness reflects spreading home ownership, which expands household wealth. The number of households going bankrupt has increased, but partly because bankruptcy has become easier; even so, defaults on instalment debts haven't increased, and defaults on home mortgages have fallen. So while debt has increased, it's not built on sand, but is more a reflection of the financial flexibility made possible by growing wealth.

The third myth holds that '*Poverty is on the rise'*. Europeans like to measure poverty in relative terms, using a poverty line of half the median income. On that basis poverty in America, at 17 percent of all households, would be much greater than in Germany (where it is 7.5 percent). However, incomes are so much higher in the United States that such comparisons say little about deprivation – for example, a family on the median income in Portugal would be close to the poverty line in the United States. For 40 years the United States has applied an absolute measure of poverty: "a family is considered poor when it does not earn more than three times the amount that a typical household of its kind spends on food" (p 100). On that basis, for the last 35 years poverty hasn't fallen consistently; it has fluctuated within the low teens, falling to nearly 10 percent in the late 1990s but rising again since then.

On the face of it, that's not a very impressive outcome. But the great majority of people who experience poverty in the United States do so for only short periods of time. Partly that reflects the high levels of immigration to America, which has remained a magnet for the world's poor. For example, between 1973 and 2002, the number of Latin American migrants to the United States grew from 10 million to 40 million and went from 10 to 25 percent of the poor. Would those immigrants have been better off if the United States had closed its borders?

Furthermore, in the United States cash transfers like unemployment benefits are welfare payments that are included in income measures but benefits in kind are not, so food stamps and Medicaid (the free health care programme for the poor) are excluded. Most important, the Earned Income Tax Credit – a form of negative income tax – is excluded, even though it is larger than welfare and can boost incomes by up to 40 percent. Finally, welfare programmes may have contributed to the disintegration of the family, one of the main reasons for continuing poverty in the United States. The switch to workfare for unmarried mothers in 1996 does seem to have reduced the number of births to unmarried teenage girls, which is promising. So although poverty persists in America, Gersemann thinks that it's far-fetched to blame it on the allegedly 'cowboy' style of American capitalism.

The fourth myth – that the booming service sector of the US economy provides '*Just a bunch of McJobs*' – sounds pretty rich coming from politicians in Europe, where many millions of citizens have no jobs at all. As the US economist Joseph Stiglitz is quoted as saying,

> You Europeans have a funny way of complaining. This is like saying: 'You Americans *did* create a lot of jobs. But they are lousy jobs. We Europeans didn't create any jobs, but if we had, they would have been good jobs' (p 111).

Nor does America create mostly 'lousy jobs'. Between 1989 and 2000, a net 17.3 million new jobs were created, but 60 percent of them were in the top third of the income distribution. As for the so-called working poor, in 2002 only 6 percent of people in work were officially poor, and people working for the minimum wage were much more likely to be high school or college students than single mothers or immigrants.

Myth number five is summed up in the complaint that in the United States '*Moms need to work, too*'. The idea is that the middle classes can only survive on two incomes per household rather than just one, which was normal 30 years ago. Since 1982, the share of American women working has risen from just over 60 percent to well over 70 percent; in Europe the figures are not only lower, but rising at a slower rate, although in France and Germany well over 50 percent of women have been in the workforce for well over 20 years.

There is a grain of truth in the claim that the middle classes are shrinking. The share of the population with medium incomes has declined a little, though mostly because the share with high incomes has been rising. But according to Gersemann it doesn't follow from this that middle class women have been driven into the workforce to make ends meet. On the contrary, the entry of women into the workforce reflects a free choice in response to expanding opportunities.

Indeed, if you believe in the feminist goal of equality in the workplace, the United States seems to have done a better job than Europe in meeting it. Women are much more prominent in management in the United States than in Europe, and whereas several prominent American companies have women CEOs they remain very rare in Europe. That this trend is likely to continue is suggested by college enrolment figures: since 1978 more women than men in the United States have obtained a higher education. Hourly wages for women are fast catching up with those for men. Indeed, one economic study has found that the increase in women going to work is mostly a case of wives of high-earning men choosing to work. In the bottom fifth of the income distribution, meanwhile, the growth of labour-market participation by women actually slowed down. So there's little evidence of women being pushed into work by economic necessity.

The sixth myth – '*Three jobs needed to survive*' – doesn't even contain a grain of truth. That doesn't stop many Europeans believing that, as a German trade union leader recently put it, in the United States "employees need three or four jobs to feed themselves" (p 123). But in fact in 2003 a mere 5.3 percent of the workforce had more than one job. What's more, that figure has been falling since the mid-1990s and is now slightly above the level common in the 1970s.

How does Europe compare? In Germany in 2003, 2.4 percent of workers were officially recorded as having multiple jobs. But the unofficial figure is almost certainly higher than that, because Europe's black economy is at least twice as big as America's, and that is largely because marginal income tax rates there are so much higher. Moreover, a study from 2001 found that having multiple jobs in the United States was mostly not a matter of economic necessity: people with a higher education were more likely than those without it to have multiple jobs. Again, it's a case of people responding to opportunities.

The seventh myth – '*Unemployed behind bars*' – is sustained by the relatively large number of people in American prisons. In late 2002 there were 2.2 million, four times as many as in 1980. The rate of 700 per 100,000 people was higher than anywhere else in the world. The reason for this is not so much that the crime rate is high – it has been falling for years, and in some areas is much lower than in Europe – but that the punishment is severe. However, the link with America's relatively low unemployment rate is marginal, for two main reasons.

First, people who have spent long spells in prison have a hard time finding employment when they come out. Especially at a time of rapid technological change, people who leave the workforce become rapidly less employable. Second, at the time of their arrest only about a third of America's prisoners were in employment. On that basis, a major study calculated that the growth in the prison population between 1995 and 1998 made unemployment 0.1 to 0.2 percentage points lower than if the prison population had remain unchanged – nowhere near enough to explain the big difference between unemployment rates in Europe and the United States.

The eighth and final myth is summarised in the aphorism '*The doctor won't see them now*'. Actually it should not be called a myth, since Gersemann thinks that some of the criticism of America's health system is sound. In 2001 health care in the United States consumed 13.9 percent of GDP compared with 10.8 percent in Germany. That may partly reflect individual preferences, but the claim that it also reflects higher costs is supported by the fact that a seventh of the population in America has no health insurance, whereas in Europe virtually everyone has health insurance cover of some sort.

Gersemann wisely avoids attempting a complete answer to the question of why US health care is so costly, but confines himself to two items – pharmaceuticals and the tort system – both of which are far costlier in the United States than in Europe. His conclusions on these two items are different: the high cost of pharmaceuticals is a net gain to Americans whereas the rising cost of litigation is a net loss. The potential benefits from investment in life-saving or life-lengthening drugs are huge, and Americans have chosen to realise those benefits by paying the necessary price. Europeans, in contrast, hold down the cost of their pharmaceuticals, but can afford to do so partly because the Americans don't: that is, they free-ride on the benefits of the research undertaken by American drug companies. As for litigation, Gersemann thinks this has become counterproductive: the damages awarded by American courts against negligent medical practitioners are so large that they are reducing the supply of medical care. Gersemann cites studies claiming that interventions like caps on damage awards could reduce hospital costs by 5 to 9 percent without harming the well-being of patients.

Gersemann's eight myths of 'cowboy capitalism', in so far as they are myths, are relatively easy to dispel. But Gersemann devotes several chapters to a criticism of American capitalism that is not on the face of it a myth at all, namely, that America is an increasingly unequal society. About 30 years ago the inequality in income distribution started to increase strongly (though more recently that trend has slowed). These chapters report many very interesting findings but I shall summarise Gersemann's conclusions as succinctly as I can.

First, inequality of incomes has increased in the United States because the rich have got richer, not because the poor have got poorer. In fact, all income groups have become better off in the last 30 years. There have been similar trends in other countries. Arguably poverty reduction is more important than whether incomes have grown more or less equal.

Second, rising inequality of incomes has not been reflected in rising inequality of consumption, most likely for two reasons: poorer people have better access to credit nowadays, and the American welfare system does a good job of targeting income support to people who really need it. Indeed, Europe's much bigger systems of income redistribution are far less efficient in this respect.

Third, income inequality is increasingly associated in the United States with rewards for entrepreneurship and work than with income from capital. This is in line with the ideal of America as a 'meritocracy' – a country where people are rewarded for their skill and effort rather than for their inherited wealth or status. But Gersemann admits to two problems. One is that the children of the new super-rich of recent decades will indeed be able to live off inherited wealth (although the 'rags to riches and back again in three generations' pattern may 'solve' that 'problem'). The other is the scandal of the giant salaries and bonuses collected (rather than 'earned') by some corporate executives. Gersemann sees this as a problem not of 'cowboy capitalism' but of corporate governance. He's right; indeed, the next phase in the evolution of the company will have to be about strengthening the rights of shareholders.

Fourth, rising inequality is linked with technical progress and the associated rewards from education. In recent decades the returns to education and training have increased and so have the numbers of Americans obtaining tertiary qualifications. In Europe, in line with its slower technological progress, the returns to tertiary qualifications are lower, and so is the share of the population that obtains them. In fact, in France and Germany the total tertiary enrolment was smaller in 2001 than in 1995.

Fifth, America is more equal than Europe in terms of educational opportunity. Not only does Europe spend less of its GDP on tertiary education than America, but that spending (overwhelmingly state-financed) is much more concentrated on the middle and upper income groups than is the mainly private spending in the United States.

Sixth, income mobility – the opportunity to become richer – is much greater in the United States than in Europe. Anecdotes about immigrants to America exchanging rags for riches do *not* amount to a myth. Gersemann cites surveys of attitudes to inequality that suggest that, whereas in Europe poorer groups resent inequality but richer groups are indifferent to it, in the United States it's the reverse: only the well-off seem to be offended by inequality.

Finally – and perhaps most important – there is the stark difference between the unemployment rates of the United States and Europe. Europe may be less unequal than America in terms of income distribution, but its unemployment rates of 10 percent or more amount to a scandalous injustice. The European experiment with high levels of legal protection for employment has been a complete failure. Gersemann cites research showing that Europeans in work actually feel less secure than Americans in work, because if their present jobs disappear their chances of finding other jobs are that much less. He also cites surveys that show that Americans are significantly more satisfied with and optimistic about their lives than are Europeans. In a world of nearly full employment, job mobility will be perceived as presenting opportunities rather than threats.

In all, then, Gersemann accepts that the United States is a more unequal society than those in Continental Europe. He leaves it to us to judge whether that is a good or a bad thing. He does not say that America could not be made less unequal (in fact he thinks the super-rich should pay more tax), but he does imply that European-type egalitarian policies not only might not work but could undermine some of the advantages that the United States currently enjoys over Europe.

This brings me back to Gersemann's point that Europe does not have to adopt the American way of life wholesale in order to overcome its present stagnation and malaise. I would like to take that as a cue for concluding with some broad observations.

The first is that, while it is true that 'we' in some collective sense can choose a particular balance between the individual and the collective realms of our society, we cannot evade the consequences of that choice. We can aim for a greater degree of equality but if we choose to do this by heavily redistributing income we will limit the amount of wealth we produce by reducing the incentive to work, save and invest. In that respect, national 'ways of life' are not really qualitatively different from each other; they simply represent different trade-offs, different points on a common spectrum of options. And in any free society, people ought to be able to choose the lifestyle they prefer, provided they don't become a burden on others; no one should force them to have materialistic aspirations.

So it's not irrational for Europeans to prefer more equality of income than exists in the United States. But they need to minimise the cost of that preference in terms of forgone economic growth and in order not to drive too many of their people to emigrate to countries where their skills attract greater rewards. Just now, the most promising policy candidate is a lower tax rate (ideally a flat tax). Low marginal tax rates seem to make the rich contribute more to total tax revenues than do high marginal rates, which in practice are full of exemptions and encourage people to work in the untaxed black economy. Germany in particular is already becoming more American in this respect and has started lowering top tax rates. The immediate pressure to do this is coming from eastern European countries which, after experiencing decades of communism following the Second World War, are less anti-American than their western neighbours and are now adopting flat tax regimes.

Nevertheless, even if Continental Europe does manage to restore respectable economic growth without sacrificing much of its egalitarian ethos, it is unlikely to sustain the image it has of itself as offering a superior way of life to the American one. The failure of the referenda on the EU constitution in France and the Netherlands is igniting new debate about the viability of the 'European social model'. Modern America is the most productive and successful society the world has ever seen, and by no means just in a material sense. One effect of that is to widen the range of options open to individuals, and so to sustain a multiplicity of 'ways of life'. Americans do typically spend more time at work than Europeans, but their overall prosperity is making possible a variety of ways of combining work and leisure that are not available to less prosperous societies. For example, in a fully employed, technologically sophisticated economy with freedom of contract, more people can choose to work for only a few months of the year or only part of the day. Prosperity in this extended sense is experienced as a widening of freedom of choice rather than just as a fat bank balance.

So I fully expect American ideas and practices to continue to exert in the twenty-first century the all-pervasive influence they did in the twentieth century and to set the standards by which all societies are judged, however much they may also be resented and subject to bogus criticism. It seems unlikely that hard-working Chinese, Indians and other Asians will be attracted to the European model. This contest of ideas is highly relevant to our forthcoming general election. Our Labour-led government has been Eurocentric in a number of policy areas: taxation, industry protection, employment law, welfare, Kyoto and foreign policy, to name a few. The main opposition parties are more US-oriented in their thinking. It will be interesting to see how that contest plays out.