

The Transatlantic Growth Gap

Daniel Gros

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The global financial crisis that erupted in full force in 2008 affected Europe and the United States in a very similar way – at least at the start. On both sides of the Atlantic, economic performance tanked in 2009 and started to recover in 2010.

But, as the financial crisis mutated into the euro crisis, an economic gulf opened between the US and the eurozone. As shown in the table below, over the last three years (2011-13), the US economy grew by about 6 percentage points more. Even taking into account the increasing demographic differential, which now amounts to about half a percentage point per year, the US economy has grown by about 4.5 percentage points more over these three years on a per capita basis.

Table 1. Contribution of selective components to GDP growth over the period 2011-13

	United States	Eurozone
GDP growth	6.5	0.5
Private consumption	4.6	-1.0
Public consumption	-0.8	-0.1
Investment	2.2	-0.9

Source: Author's own elaboration based on OECD data, national accounts.

The table suggests that the main reason for the gap is the difference in private consumption, which grew in the US, but fell in the eurozone, especially in its periphery. A retrenchment of public consumption actually subtracted more demand in the US (0.8 percentage points) than in the eurozone (0.1 points). This might appear to be somewhat surprising in light of all of the talk about Brussels-imposed austerity.

In fact, public consumption in the eurozone has de facto remained fairly constant over the last three years, whereas it has declined substantially in the US. (The same is true of public investment, although this constitutes such a small proportion of GDP that transatlantic differences could not have had a large impact on growth over a three-year horizon.)

Daniel Gros is Director of CEPS. A slightly shorter version of this Commentary was originally published by Project Syndicate, 21 July 2014 (<http://www.project-syndicate.org/commentary/daniel-gros-attributes-america-s-edge-over-europe-to-its-faster-bankruptcy-procedures>) and is reprinted here with its kind permission.

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The contraction of private investment in Europe accounts for only a relatively small part (one-third) of the growth gap. Although the financial-market tensions that accompanied the euro crisis had a strong negative impact on investment in the eurozone periphery, investment demand has also remained weak in the US, minimising the overall difference.

The resilience of private consumption in the US, the key to the growth gap, is not surprising, given that American households have reduced their debt burden considerably from the peak of more than 90% of GDP reached just before the crisis. The lower debt burden is also a key reason why consumption is expected to continue to grow much faster in the US than in the eurozone this year and next.

But the crucial question – and one that is rarely asked – is how US households were able to reduce their debt burden during a period of high unemployment and almost no wage gains while sustaining consumption growth. The answer lies in a combination of ‘no recourse’ mortgages and fast bankruptcy procedures.

Millions of American homes that were purchased with subprime mortgages have been foreclosed in recent years, forcing their owners, unable to service their debt, to leave. But, as a result of no-recourse mortgages in many US states, the entire mortgage debt was then extinguished, even if the value of the home was too low to cover the balance due.

Moreover, even in those states where there is full recourse, so that the homeowner remains liable for the full amount of the mortgage loan (that is, the difference between the balance due and the value recovered by selling the home), America’s procedures for personal bankruptcy offer a relatively quick solution. Millions of Americans have filed for personal bankruptcy since 2008, thereby extinguishing their personal debt. The same applies to hundreds of thousands of small businesses.

Of course, there has also been a surge of bankruptcies in the eurozone’s periphery. But in countries like Italy, Spain and Greece, the length of a bankruptcy proceeding is measured in years, not months or weeks, as in the US. Moreover, in most of continental Europe, a person can be discharged of his or her debt only after a lengthy period, often 5-7 years, during which time almost all income must be devoted to debt service.

In the US, by contrast, the corresponding period lasts less than one year in most cases. Moreover, the terms of discharge tend to be much stricter in Europe. An extreme case is Spain, where mortgage debt is never extinguished, not even after a personal bankruptcy.

This key difference between the US and (continental) Europe explains the resilience of the US economy to the collapse of its credit boom. The excessive debt accumulated by households has been worked off much more rapidly; and, once losses have been recognised, people can start again.

The cause of the transatlantic growth gap thus should not be sought in excessive eurozone austerity or the excessive prudence of the European Central Bank. There are structural reasons for the eurozone economy’s slow recovery from the financial meltdown in its periphery. Most important, compared to the US, the excess debt created during the boom years has been much more difficult to work off.

European officials are right to promote structural reforms of EU countries’ labour and product markets. But they should also focus on overhauling and accelerating bankruptcy procedures, so that losses can be recognised more quickly and over-indebted households can start afresh, rather than being shackled for years.