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The link between income sharing and short-term and long-term growth

When we compare the United States and Europe, we are struck by the difference between these two regions in terms of income distribution: growth in real wages is much lower than growth in labour productivity in the United States, and identical to that of productivity in the euro zone.

In the short term, therefore, income distribution is in principle more supportive of household consumption and demand growth in the euro zone than in the US, although the trend in the household savings rate must also be considered.

In the long term, however, the increase in profitability of US companies enables them to finance R&D spending and investment in new technologies that is significantly higher than in the euro zone, hence the advantage in terms of potential growth for the United States. The problem with the US income-sharing model only arises when the extra profits it generates are not invested, but only fuel the rise in asset prices, which has been the case since 2014. However, the investment deficit does not concern investment in new technologies, which preserves the US advantage in terms of potential growth.

All in all, a key difference between the US and the euro zone concerns the degree of preference for the present, which appears to be stronger in the euro zone than in the US.

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Income distribution more favourable to households in the euro zone than in the United States

Charts 1A/B show that the income split between wages and profits has been more or less stable in the euro zone, whereas it has shifted sharply in favour of profits in the United States.

Chart 1A
United States : Real compensation per hour and productivity per head (business sector, 2002.Q1 = 100)

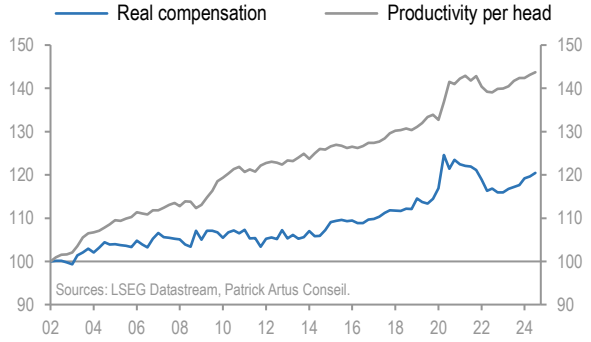
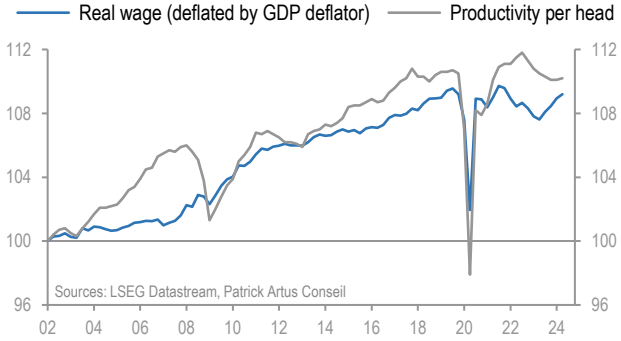


Chart 1B
Euro zone: Real wage and productivity per head (2002.T1 = 100)



This implies that household demand is, in principle, better supported in the euro zone than in the United States by the income distribution favourable to households. Yet household consumption has grown faster in the US than in the euro zone (Chart 2), but this is due to faster productivity growth (Charts 1a/1b) and to the fall in the household savings rate in the US, whereas it is rising in the euro zone (Chart 3).

Chart 2
Household consumption in volume terms (2002.Q1 = 100)

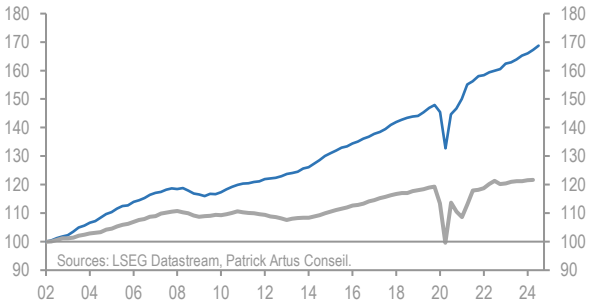
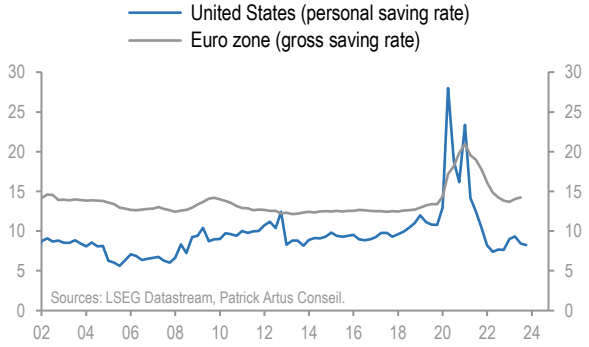


Chart 3
Household savings rate (as %)



Higher profitability of US companies and technical progress

The fact that the profitability of US companies is higher, and rising faster, than that of European companies explains why investment in new technologies and corporate R&D spending is higher in the United States than in the euro zone (Charts 4 and 5).

Chart 4
ICT investment including software (in value terms, as % of nominal GDP)

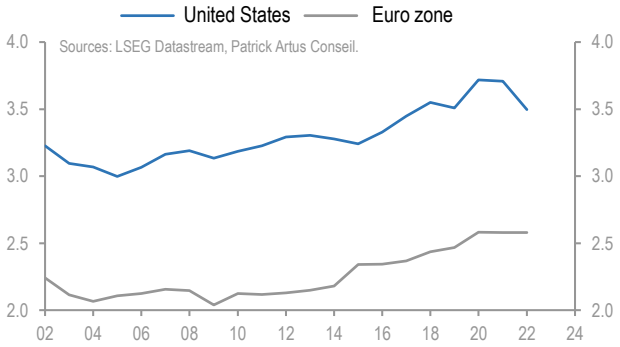
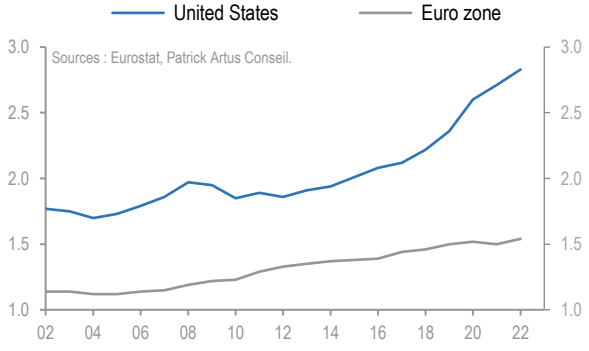
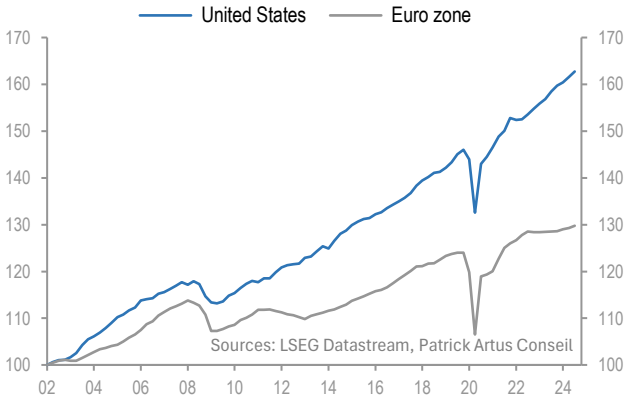


Chart 5
Corporate R&D spending (as % of nominal GDP)



These higher levels of investment in new technologies and R&D spending by companies in the United States, compared with Europe, explain why **labour productivity is rising much faster in the United States (Charts 1A/1B)**, and why potential growth is therefore stronger in the United States than in the euro zone (**Chart 6**).

Chart 6
Real GDP (2002.Q1 = 100)

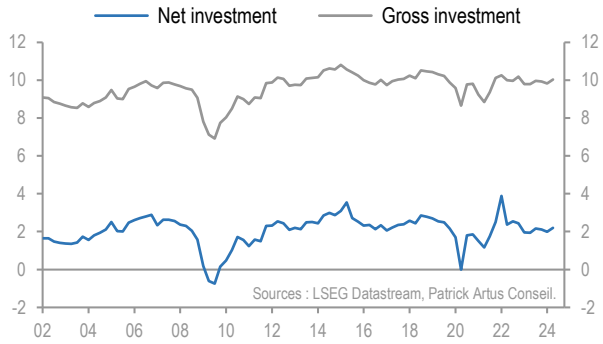


A difficulty with the American model

A difficulty may arise with the US model: **companies may use their extra profit due to the distortion of income sharing in their favour to buy financial assets (or other companies) and not to invest.**

Chart 7 shows that **the rate of investment by US companies has fallen slightly since 2014**, whether in terms of gross or net investment.

Chart 7
United States: Net and gross corporate investment
(in value terms, as % of nominal GDP)



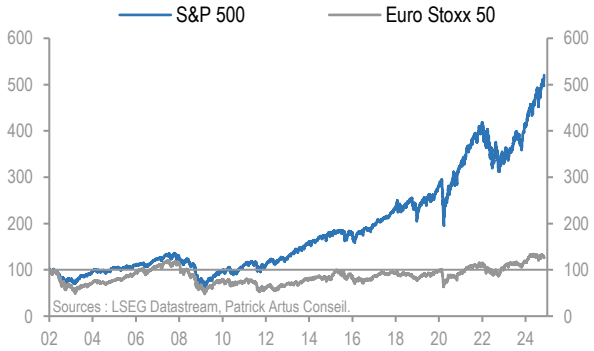
But we saw above that **this slowdown in investment does not concern investment in new technologies** (see **Chart 4** above), which implies that it has little negative effect on productivity gains or potential growth (**Charts 1A/B/6**).

Summary: the problem in the euro zone, a strong preference for the present

Income distribution in the euro zone and the United States shows that, **in the euro zone, economic agents have a strong preference for the present.** In the euro zone, there is a preference for distributing wages to households, whereas in the United States there is a preference for profits and investment in new technologies. The result is that productivity growth is much lower in the euro zone than in the US, leading to the depressing result that both household consumption and technological investment (and therefore labour productivity) are growing faster in the US than in the euro zone.

The only trap that the US model could fall into is if the extra profits were invested in shares or unquoted companies, driving up asset prices (**Chart 8**), and were no longer invested in productive capital.

Chart 8
Stock market indices (01.01.2002 = 100



This diversion of profits towards the purchase of existing assets has been observed in the United States but has not depressed investment in New Technology.

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