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Why the U.S. Economy Is Trouncing Europe's

Americans do worse in education scores, but the Continent lacks the U.S. risk-taking culture.

By Edward Conard

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Illustration: Robert Neubecker

Economists never cite one of the most significant statistics about the U.S. economy. According to data released last week by the Organization for Economic Cooperation and Development, only about 12% of Americans score at the highest levels on internationally administered academic tests, while 34% score at the lowest levels—nearly three low scorers for every high scorer. Germany's figures are nearly even: 18% score at the highest levels and 20% at the lowest. Put another way, Germany's ratio of high to low scorers is almost three times America's. Scandinavia's is five times; Japan's, seven.

These enormous differences have profound economic implications. With more talent and fewer needy people, is it any wonder that Northern European countries can afford more-generous welfare policies than their neighbors to the south?

Yet America excels relative to Europe despite these enormous differences. While Europe has created 14 companies worth more than $10 billion in the past 50 years, with about $400 billion of market value in total, Americans have created nearly 250 such companies, worth $30 trillion.

That success has driven up America's middle-class incomes. The median disposable U.S. household income, according to the OECD, is now 25% greater than the median German household and 60% greater than the median household in Italy.

Europeans' incomes would be even lower if they weren't free-riding on American innovation, defense spending and higher drug prices, which incentivize research. America's median incomes would be higher if we had more talent devoted to supervising and creating jobs for blue-collar workers or Northern Europe-like distribution of test scores.

The outsize success of America's talented entrepreneurs doesn't stem from their superior intelligence. It comes from working at companies such as Google and Microsoft, which mine the technological frontier and expose employees to valuable knowledge, insights and opportunities. Apple is worth more than the 30 largest German companies combined. Apple's employees and its alumni use their knowledge and training to create more value than their counterparts in Europe.

Unlike Europe, the enormous success of American entrepreneurs motivated an army of talented Americans to get valuable on-the-job training, work longer hours, take risks and succeed. A small amount of success bubbles up from a large pool of failure.

The belief that taxing success more heavily will scarcely slow inevitable progress ignores the importance of being first to market and founding successful companies in America rather than the rest of the world, the enormous difference in the training and expected payoffs for successful risk-taking that it creates for America's talented workers, and the motivational effect higher expected payoffs for successful risk-taking have on our talented workers.

Studies of short-term tax elasticity laughably miss the enormous difference between the success of the U.S. and Europe. Even if Europe cut its tax rates, it would have a trivial short-term effect on the expected returns to risk-taking, because without companies such as Google, entrepreneurs wouldn't come up with ideas worthy of investment regardless of the tax rate. It takes decades of successful risk-taking to create companies and workers who can spawn the next generation of success.

The argument that we can heavily tax the tail of the distribution of payoffs without discouraging prudent risk-taking—since entrepreneurs such as Bill Gates and Steve Jobs took risks without expecting the enormous success they achieved—fails to recognize that outsize payoffs at the tail of the distribution critically drive overall expected risk-adjusted returns above break-even. Even with these successes, the returns to venture capital over the last 20 years have been mediocre at best.

When entrepreneurs capture as little as 5% of the value they create for others, it makes little sense to encourage successful risk-takers to quit working long before they achieve outsize success. With the effect technological success has on the productivity of talented American workers, who are our constraint to growth, and the effect of their productivity on the growth of middle-class incomes relative to Europe, that's not a "policy failure."

The fastest way to accelerate America's growth and increase tax revenues is to let high-skilled immigration expand our talent pool. Forty percent of America's billion-dollar startups were founded by high-skilled immigrants—roughly the same percentage of STEM doctorates held by foreign-born American workers.

Mr. Conard is a fellow at the American Enterprise Institute, a retired Bain Capital partner, and publisher of Macro Roundup.