

## Competing in a global economy

For many years, it has been noted that American teenagers do not generally perform as well on standardized tests as teenagers in some other countries. But how does the intellectual performance of young American adults in the workforce compare with that of their counterparts in other nations? In “Can Americans Compete in a Global Economy?” (*Economic Letter*, Federal Reserve Bank of San Francisco, July 18, 2008), Elizabeth Cascio delineates research on this topic that she conducted along with Damon Clark and Nora Gordon. Their research utilized data from the International Adult Literacy Survey (IALS), a 1990s study of the intellectual performance of people ages 16–17 and 26–30.

The questions on the IALS were intended to measure “general skills” and “literacy,” as opposed to occupation-specific knowledge. On a one-to-five scale, respondents who attained a score of four or five were deemed “highly skilled.” Out of a group of 13 developed countries, the United States had a smaller percentage of highly skilled 16- to 17-year olds than any other country in the group, with only 4.7 percent achieving a score of four or five. This contrasts strongly with Sweden, the highest ranking country, where more than 35 percent of respondents attained at least level-four proficiency.

However, 23 percent of American adults ages 26–30 scored a four or five, giving the United States a rank of 7 out of 13 (in the middle of the pack) in this age category. Because most American students are not placed on a university or vocational “track” early on, and because of the United States’ relatively large number of private universities in addition to its public universities, explains Cascio, Ameri-

can students have greater access to higher education than students in most other countries.

To corroborate this theory, Cascio, Clark, and Gordon conducted a correlation analysis, the results of which suggest that a country’s percentage of highly skilled people rises when more of the nation’s individuals complete a bachelor’s degree. Nevertheless, it is possible that U.S. adults ages 26–30 will not maintain their solid ranking in the distribution of skills throughout developed countries, because several countries invested more money in public funding for universities during the 1980s and 1990s and have since seen their university graduation rates rise to levels comparable to that of the United States.

## International price differences

Prices for the same goods can differ markedly from country to country, and prices are generally positively related to income—that is, the price of a basket of goods is higher in countries with greater per capita income. In seeking to understand this relationship, economists have tended to focus on differences in prices among countries for either tradable goods (goods that are easily or frequently traded) or nontradable goods (goods that are too costly to trade frequently among countries). One of the leading theories suggests that countries wanting to raise their per capita income should concentrate on producing tradable goods more efficiently. But in “Why Are Goods So Cheap in Some Countries?” (*Business Review*, Federal Reserve Bank of Philadelphia, second quarter 2008), economists George Alessandria and Joseph Kaboski take

a more balanced approach, suggesting a model of economic growth in which workers become more efficient at producing all goods, both tradable and nontradable, in order to increase their country’s per capita income.

Alessandria and Kaboski analyze some of the evidence that large price differences exist across countries for a wide basket of goods. Using data from the International Comparison Program and the Penn World Tables (international statistical programs sponsored by the World Bank and the Organization for Economic Cooperation and Development), they demonstrate that a clear positive relationship exists between prices in a given country and the country’s per capita income—for all goods and for tradable goods. Part of these differences can be attributed to the higher costs of retail and wholesale distribution in the wealthier countries. But even when the authors adjust the data to account for these differences, they find that consumers in the wealthier countries still pay more for the same set of goods. They conclude that exporters charge higher prices in the higher income countries, especially for consumer goods, regardless of their distribution and other costs.

According to Alessandria and Kaboski, traditional models of price differences between countries have focused on the differences in prices for nontradable goods. As a result, such models tend to attribute differences in income among countries to different levels of productivity in the tradables sectors of respective countries. This article, however, presents evidence that large price differences exist in the tradables sector as well, which suggests that policymakers in less wealthy countries should enact policies designed to improve productivity in all areas of the economy, not just in the tradables sector.