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CHAPTER 11 The Role of Government in Business

Should Europe Be More Like America?

The right economic model for the Old World is the subject of great debate at Davos. How to get there is even more debatable

by David Fairlamb in Davosin in Switzerland

Economists gathered in Davos, Switzerland, for the World Economic Forum say Europe won't achieve American-style growth rates of 5%-plus until governments speed up deregulation, liberalize sclerotic labor markets, and make deep structural reforms. Only then will Europe be more like the U.S.

But euro-zone business leaders aren't so sure that such advice is right. "We're already more flexible and less regulated than many observers think," says Ferdinand Piëch, CEO of Volkswagen, the German auto maker. "What we need isn't more liberal labor laws but lower taxes to boost our competitiveness. We should also improve the way the [European Union's] single market functions." Adds Daniel Bouton, chairman and CEO of Société Générale, France's second-largest bank. "Deregulation and labor reform is of secondary importance. The best way to strengthen Europe's economy is to improve the efficiency of the public sector. We don't need to get rid of the public sector."

"FLEXIBLE AND PRODUCTIVE." Despite the economic slowdown in the U.S., Piëch and Bouton expect the euro-zone economy to grow by as much as 3% this year. "Things are looking up economically," says Piech. "European industry is now flexible and productive. You can see that in the way we're creating jobs." Other corporate executives at Davos agree. "We used to lag behind the U.S, in terms of deregulation and restructuring," says Ron Sommer, CEO of Germany's Deutsche Telekom. "But we have made immense progress over the past five years, and now we're seeing the results." European unemployment, which topped 10% at the beginning of 2000 is forecast to fall to around 8.3% by the end of this year. More jobs are now being created in Europe than at any time in the past 20 years.

Still, the red tape that binds European companies so tightly needs cutting, execs complain. Setting up a new company in France, for example, involves 13 steps, compared with just four in the U.S. As a result, it can take three months for an entrepreneur to get going, as opposed to a few days on the other side of the Atlantic. Piech also has a point when he says lower taxes will improve industrial competitiveness.

Yet 9 of the 12 euro-zone countries have already unveiled tax cuts that will lop up to $500 billion off corporate and personal income taxes this year. That's 0.8% of the EU's gross domestic product. And a number of governments—Spain and the Netherlands, among them—have recently simplified the procedure for setting up new companies. Meanwhile, European growth has slowed since peaking last summer, and it's unlikely to move above 3% for the foreseeable future.

DILUTED STRENGTHS. That's not bad by traditional European standards. But it doesn't compare to the U.S.'s recent stellar performance. "Something is holding Europe back," says Michael E. Porter, professor of business administration at Harvard Business School and a specialist in international competitiveness. "Yet it has so much going for it that it could be the most dynamic economy in the world." Porter says Europe has a lead over the U.S. in a number of key areas. He says its workforce is better educated. The number of engineers Europe turns out is increasing, while in the U.S. it's declining. European companies use energy and raw materials more efficiently than their U.S. competitors. And the Continent leads in several important businesses, such as mobile telephony and carmaking. "But for all its strengths, Europe isn't performing," Porter says.

Too much red tape, Porter asserts. But it's also because competition in Europe is less intense. "The sharper the competition at home, the more productive companies tend to be," Porter says. "And in many sectors of the European economy, competition is lacking. More deregulation would clearly help." He thinks European companies would also definitely benefit if labor laws were liberalized.

At the end of the day, though, Porter agrees with Piëch and Bouton that structural reforms are of secondary importance. The crucial thing is to transform European attitudes towards capitalism, he says. "You often get the impression Europeans are ambivalent to free markets," Porter says. "They think there's a trade-off between economic efficiency and social well being."

HAVING IT ALL. Porter has a point. The EU's most productive countries are those where attitudes to business have been transformed over the past decade. Take the Nordic nations, where economic growth is strong, labor productivity high, and unemployment relatively low. Just 10 years ago, entrepreneurs were treated as social outcasts. Now they're praised. Thousands of new companies have been set up in recent years, boosting growth, creating jobs, and generating billions of dollars for national treasuries.

Yet these countries are still egalitarian societies with relatively high levels of social protection. "Scandinavia's success shows that you don't have to become completely like the U.S. to generate wealth," says Bouton. "It proves there isn't necessarily a single model for all the economies in the world." Emulating the U.S. is fine, but it doesn't mean that Europe has to turn into America.

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