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Europe: No Economic Juggernaut

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With turbulent credit and housing markets, looming fiscal and trade deficits, and a growing fear of impending recession in the U.S., some commentators have predicted that Europe will usurp America's place as the world's economic leader. In a recent article, Steven Hill, director of the New America Foundation, cheerfully debunked "5 Myths About Sick Old Europe" and asserted Europe's economic ascendance.[1]

While it is certainly likely that the U.S. economy is slowing as it adjusts to the credit crisis, Europe faces profound economic challenges of its own and must confront these challenges if it hopes to be competitive with the United States, let alone outperform it in the long term.

The Truth About Europe's Economy. With 27 member states, the European Union's economic performance generally ranks well compared to other, single countries. As a bloc, the EU is the world's largest trader and a top recipient of global flows of foreign direct investment. However, aggregate statistics mask the fact that it is the economic performance of a handful of member states that boosts the EU's statistics as a whole.

By opening its markets, lowering its corporate tax rate to just 12.5 percent, and investing in education, Ireland became the EU's Celtic Tiger, enjoying healthy levels of growth—5.7 percent in 2006.[2] The 2004 accession states from Central and Eastern Europe are currently enjoying strong growth as well, particularly the Baltic states. Estonia enacted radical free market reforms, including the introduction of a flat tax, the removal of price controls, and almost full privatization. As a result, its economy grew 10.9 percent in 2006, a rate which "old" European economies such as France, Belgium, Italy, and Germany can only envy. The robust British economy, which was radically reformed by Margaret Thatcher in the 1980s, is another positively distorting factor adding to favorable EU aggregate statistics. The City of London alone accounts for 42 percent of the global foreign equity market, 43 percent of the world's daily turnover in "over the counter" derivatives, and 32 percent of global daily foreign exchange turnover.[3]

Britain, Ireland, Estonia, and others introducing market-based reforms are reaping the benefits of greater competition, improved productivity, and outward-looking markets. Once these countries are added into the aggregate, Europe's statistics cannot help but look better.

Even so, America has more than held its ground against the EU as a whole. Between 2002 and 2006, the EU's gross domestic product grew by an average rate of 1.9 percent annually—compared to the U.S. average of 2.9 percent.[4] As of September 2007, Europe's unemployment rate was 7 percent—far

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greater than the U.S. rate of 4.7 percent.[5] Providing twice the level of U.S. agriculture support, the EU's Common Agricultural Policy (CAP) protects and funds Europe's richest farmers, forces Europe's families to pay more for food than they should, and excludes the world's poorest farmers from Europe's marketplace.[6] According to Her Majesty's Treasury (U.K.), when measured in terms of its share of global output at purchasing power parity, the EU has been in a chronic state of decline and is projected to decline further.[7]

However, there is a glimmer of hope on the horizon for old Europe. Facing competition from their Eastern neighbors, Spain, Germany, France, and Britain have all lowered their corporate tax rates in a bid to attract new investment. The EU's average corporate tax rate at the end of 2006 was a record-low 26 percent—far more competitive than the U.S. average rate of 39.3 percent in the same year.[8]

More generally, however, rather than learn from the lessons of Europe's star economic performers, many European countries continue to dogmatically defend the European social model against market-based economic policies and enhanced global competition. For instance, it is unlikely that old Europe will adopt Central and Eastern Europe's more promising reforms such as the flat tax. Instead, in February 2007, a group of nine EU member states issued an open declaration calling for stronger social, environmental, and work protections—all of which will further hurt competitiveness and sap economic growth.[9]

French President Nicolas Sarkozy's insistence on removing the EU's policy commitment to free and undistorted competition in the European Reform Treaty will further eradicate the free market ethos in Europe. Sarkozy did not even attempt to hide his motivation in doing so: "The word 'protection' is no longer a taboo," he said.[10]

However, protectionism in trade and investment is the last thing that Europe needs. As analysts Zuleeg and Hagemann state: "The message is clear: for the French, the change puts a new emphasis on public intervention in economic policy and the protection of citizens against the perceived threats of globalisation, away from competitive markets towards 'protection'."[11]

The EU: The Problem, Not the Solution. In March 2000, the European Union proudly announced that it would become the most dynamic and competitive knowledge-based economy in the world by 2010, with full employment and 3 percent yearly growth.[12] By 2005, however, it acknowledged dismal failure,[13] with poor projected growth rates and negligible reductions in unemployment.

1. Steven Hill, "5 Myths About Sick Old Europe," *The Washington Post*, October 7, 2007.
2. Economist Intelligence Unit, "Ireland Country Report - Main report: September 5th 2007," at *www.eiu.com* (November 7, 2007).
3. "Key facts about the City of London and the 'Square Mile,'" at *www.cityoflondon.gov.uk/Corporation/media_centre/keyfacts.htm.*
4. Calculations based on data from the Economist Intelligence Unit at *www.eiu.com* (November 27, 2007).
5. Eurostat, "Harmonized Unemployment Rate – Total - SA," at *http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=EUROIND_LM&root=EUROIND_LM/euro_lm/lm_un/lm010rt*; and Bureau of Labor Statistics, "The Employment Situation: October 2007," at *www.bls.gov/news.release/empsit.nr0.htm* (November 27, 2007).
6. Calculations based on data from OECD, "OECD Factbook 2007: Economic, Environmental and Social Statistics, Producer support estimate by country," at *http://oberon.sourceoecd.org/vl=1432110/cl=48/nw=1/rpsv/factbook/* (November 27, 2007).
7. Global Vision, "The EU's declining share of global GDP," at *www.global-vision.net/facts/fact14_4.asp#.*
8. Simon Kennedy, "Tax-Cut War Widens in Europe," *International Herald Tribune Europe*, May 28, 2007; and Scott A. Hodge and Chris Atkins, "U.S. Lagging Behind OECD Corporate Tax Trends," Tax Foundation Fiscal Fact No. 55, at *http://www.taxfoundation.org/news/show/1466.html* (November 27, 2007).
9. Honor Mahony, "Nine States Call for Revival of Social Europe," EUObserver.com, February 15, 2007.
10. Fabian Zuleeg and Sara Hagemann, "Sarkozy Sneaks in the 'P' Word," European Voice.com, September 27, 2007, at *www.europeanvoice.com/archive/article.asp?id=28931.*
11. *Ibid.*

According to The Heritage Foundation's *2007 Index of Economic Freedom*, "Europe suffers from the second-worst regional score in labor freedom and is dead last in fiscal freedom from government… [S]trong state sectors and rigid labor markets have already prompted significant social turmoil, not least in France."[14] Business regulations are a massive impediment to the creation of wealth. The EU's current body of law—the acquis communautaire—is estimated to cost business €600 billion per year.[15] Yet in the past few years, Brussels has continued to churn out reams of far-reaching and costly legislation, including notably the Registration, Evaluation and Authorization of Chemicals Directive.

Such massive government interference in the economy inevitably raises the ugly specter of corruption. The European Court of Auditors recently rejected the EU's accounts for the 13th year in a row. Open Europe, a British-based think tank, calculated that the areas of expenditure on which the Court gave an adverse opinion accounted for 57 percent of the overall budget.[16] This reflects an endemic and institutional problem for the European Union. It is difficult to see the EU being a driver of economic reform when it continually fails to get its own house in order.

In recent years, the EU has become synonymous with onerous regulation and politically driven initiatives to centralize power. The EU must take a critical look at its enormous body of laws and make an absolute commitment to reduce burdensome regulations and enact future legislation only on the basis of rigorous, independent, cost-benefit assessments.

Conclusion. The EU needs to regulate less in order for European countries to compete with the United States. The following measures would combine to form a solid foundation on which to implement further economic policy reforms: privatization; fiscal restraint; the reduction or—even better—the elimination of agricultural support under the CAP; and extensive labor market reform that improves worker mobility and reduces the cost of labor.

Under the auspices of Margaret Thatcher, the United Kingdom went from the sick man of Europe to an economic powerhouse. Under the leadership of Mart Laar, Estonia went from a poor Soviet outpost to a high-tech, knowledge-based economy. For Europe to realize its true potential—and be a real economic leader—it must suppress its socialist inclinations and embrace open markets and competition.

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12. European Council, "Presidency Conclusions," March 23–24, 2000, at *www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/00100-r1.en0.htm* (August 15, 2007).
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14. Tim Kane, Kim R. Holmes, and Mary Anastasia O'Grady, *2007 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2007), p. 61, at *www.heritage.org/Research/Features/Index/chapters/pdfs/index2007_RegionB_Europe.pdf.*
15. George Parker, "Uphill Battle Against Brussels Bureaucracy," *Financial Times* (London), October 10, 2006.
16. Press Release, "£43.4 Billion of European Taxpayers' Spending Open to Fraud, Open Europe, November 13, 2007, at *www.openeurope.org.uk/media-centre/pressrelease.aspx?pressreleaseid=59.*