EUROPE VS. THE U.S.: AN ECONOMIC COMPARISON

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ABSTRACT

The most significant financial event of the last several decades is the establishment of the Euro as the single currency of 11 European countries. This is a giant step toward the creation of a much more integrated unit that was, at one time referred to as the United States of Europe. The U.S. and Europe, are of comparable size and population. It is instructional to determine Europe's competitive position relative to the U.S. in terms of how closely Europe resembles us, and how rapidly they are moving to become competitive across a spectrum of political, social and economic activities. Recent news demonstrates that in some areas they are moving rapidly to emulate us. In some areas they do not want to emulate us, and in other areas it will take a relatively long time to achieve comparability with the United States. The total picture then is one of Europe making great strides in efficiency within their union, but an area of the world that may never fully embrace the American social and business model. Their success in achieving economic superiority over the U.S. is going to depend largely on whether the European model is, over time, the better economic model.

INTRODUCTION

For several years the world has awaited the arrival of a single currency in Europe. That day, January 1, 2002, is fast approaching. That currency, the Euro, is often seen as an essential tool needed to allow Europe to compete head-to-head with the United States. Given that the U.S. and Europe are two of the most economically developed parts of the world, and are of comparable size, comparisons of the two regions to gauge just how equal they are should be instructive. How is the advent of a single currency directly or indirectly affecting Europe's regional differences, which differences are being addressed by other means, and what will be the overall significance of all the actions taken be to the achievement of true economic equality with the U.S?

HOW SIMILAR ARE EUROPE AND AMERICA

A recent *Wall Street Journal* article suggested that Europe is now where the U.S. was 15 years ago-- on the brink of a tremendous economic boom. The unspoken assumption was that Europe wants to be like the U.S. Another implication of the article was that, with the employment of a single currency, Europe and the U.S. are approaching a mirror-like identity. Both of these suggestions are incorrect, at least at present. With only a moment of reflection, we can appreciate that the division of the U.S. into states, and the division of Europe into countries represents two vastly different situations. European states are much more clearly divided by language, custom, history, war, law, sovereignty, etc. than America has ever been. Europe differs from the U.S. significantly in the degree to which they accept socialism as a desirable form of government. Custom and circumstance have led Europe to adopt business practices that do not have broad correlation to American business practices.

Despite the obvious differences between us, it is still useful consider the competitive advantages the U.S. enjoys because it is a single country using a single currency, governed by a single government. It is only a modest stretch to also say that, at least in the business or government sense, we are a homogeneous people. America is a single entity in a number of ways. At present Europe is a single entity only in the fact that they (soon will) share a single currency.

A major difference between the U.S. and Europe is in how each is governed. While the U.S. has slowly, almost stealthily, drifted into becoming a socialistic state, we lag far behind Europe in embracing the concept of socialism. From the standpoint of business, socialism tends to make the economy a lumbering giant. Mainly, this is because the government absorbs a greater percentage of the gross domestic product. Governments are not noted for the efficient use of assets. In addition, once it has committed assets to a particular cause, government is not very agile in re-directing those resources to better purposes.

The general effect, from a business perspective, is that businesses are less competitive because the government takes a larger percentage of their revenue. High taxes discourage entrepreneurs from taking risks. Consider that in America in recent years, start-up companies use generous stock options to attract talent for relatively low salaries. In France, however, the government takes two-thirds of any profit from options (Economist). This is one reason that starting a company takes more capital in Europe than it does in America. A less obvious result of high taxes is that there is higher unemployment in Europe, partly because the cost to employers of hiring are high. Adding to the problem, people are less willing to work because unemployment benefits are high. One might think that courageous politicians could resolve this problem: Cut Benefits.

WILL EUROPE CHANGE

Recently, I was talking to a former European student of mine who is now a director of a Swiss bank. In addressing the state of socialism in Europe, he made the following statement: "We (Europeans) think America is far behind Europe in providing for its people--especially in the area of health care. No one should be denied medicine or hospital treatment of any kind because he cannot pay for it. While it is possible that America will take a step away from socialism, Europe will never do so. There are two reason for this situation: One, we like our government benefits. Two, unlike Americans, when government tries to take benefits away, our people throw stones at the politicians." A European CEO expressed similar thoughts recently: "I believe that the capitalist world has been the best system invented by humanity to create wealth. But it is not necessarily the best system to distribute wealth and enhance the quality of life for humanity." (Fox, 2000)

The ex-student's perspective of given support by the fact that we elected Ronald Reagan in 1980. By this act we can imply some conscious intent to move toward less government and freer markets. Americans place a lot of reliance on individual responsibility, and acknowledge that such a system leaves some people behind. During the same period, and since, Europeans have typically elected socialists. Europeans see socialism as a path to modernization that avoids what they consider to be the insensitive worker dislocations. Socialism in has been referred to as "free markets with a human face", or as modernization with social responsibility. And, Germany has been quite successful in redistributing income so as to achieve a low level of poverty unknown in the U.S. (Fox) Other socialist nations, it might be said, have approached equality by lowering the standard of living of the upper economic classes.

HOW EUROPEAN GOVERNMENTS IMPEDE COMMERCE

Government hampers commerce in other ways. Europeans wanting to start a business face a discouraging morass of regulations that consume capital. Once in operation more regulations constrain the businessman from fulfilling his vision on how best to meet customer demands. In some cases, discounts or guarantees are banned, or the hours of operation are controlled (Fox).

European governments take an even more direct hand in influencing business. A KLM Royal Dutch Airlines venture with Alitalia was imperiled in May 2000 because it was suspected that the Italian government was giving privileged treatment at Italian airports (*WSJ 05-01-00*). The German government freezes capital by imposing a 50% capital gain in the profit from the sale of stock. The reverse effect is expected when the German government ceases this practice in 2001. A perhaps more subtle, but more pervasive brake on European economies is a result of the interlocking interest of government in businesses and financial markets. Businesses that should be allowed to fail soak up capital as banks, at the direction of politicians, keep failing businesses afloat with scarce money. Alitalia, for instance was the beneficiary of an estimated $1.32 billion state bailout. Until the European Union imposed constraints on European banks as a pre-requisite to joining the Union, national banks routinely printed money at the direction of politicians who needed funds for a project, or to win an election. America is not without similar problems, but the level of government interference in the market is much less here than it is in Europe.

The English government similarly pumped $1.4 billion into the Rover automobile company only to see it floundering again. Prime Minister Blair's Labor Party is in a difficult position. They have stated their commitment to a market economy, but they also feel the union pressure to save the thousands of jobs that will probably be lost if BMW follows through on its April promise to break-up Rover, Not too long ago the government would have nationalized the firm to "save" it (Fox, 2000). Investing in firms that would otherwise fail is proving to be an unrewarding allocation of capital.

GOVERNMENT INFLUENCE IN COMMERCE

What is becoming increasing clear to European governments is their inability to influence economic events. To date, the Union has not been very successful in even stabilizing the value of the euro. Since the introduction of the euro in January 1999, it has lost about 25 percent of its value against the U.S. dollar. Foreigners may cheer because their European vacation money buys more. But, cheap money can also lead to inflation. The European Central Bank (ECB) employed the usual procedure to raise the value of their currency. It raised interest rates one-quarter point. The euro value continued its fall in value to $0.91 on May 2, 2000.

One train of logic puts the blame at the feet of government. The government wants low interest rates to help finance Europe's recovery from a stalled economy. The result has been a 2-point spread between European and American bonds that has money rushing, as one would expect, to the higher yield American Treasury bond. Hence, the falling value of the euro. Now Europe faces two unpalatable choices: Do nothing and live with a weak currency, or raise interest rates substantially and stall the economy. The European economy is easier to stall because it is more cumbersome than the U.S. economy due to its higher levels of taxes and government regulations (*WSJ, 05-02-00*). This is, then, another example of how socialism is incompatible with a free market model. One other problem plagues the ECB. The public sees the ECB as being unpredictable. Although an examination of the ECB's actions leads to the conclusion that the ECB is more predictable than the U.S. Federal Reserve, the perception of unpredictability anticipates risk, which undermines the value of the currency (*WSJ* 05-02-00).

INTERNATIONAL COOPERATION

The stability of the euro is also at risk from the actions, or inaction, of other governments. The three major currencies could coordinate action to stabilize the relative values of all three major currencies, the yen, the U.S. dollar and the euro. The resulting stability would approximate the stability of having a single currency for the three markets--a circumstance that would eliminate currency risk between the markets, and that would allow capital to flow to its opportunities of highest yields. However, with Japan in recession, and the U.S. in an election year, neither is likely to put long-term currency stability ahead of its own short-term goals (*WSJ 05-02-00*).

Europe and America each have a single monetary policy for their geographic area. So one might say that, in this instance, Europe is at par with the U.S. The European Union also has strict rules on budgeting to avoid conflicts with the monetary policy, again putting it on a par with the U.S. Other policies, however, are decentralized to allow individual countries to address internal problems. This, in turn, allows countries to yield to unions on wage increases that are not tied to productivity. It also allows individual countries to unilaterally raise taxes. Such policies can alter the competitive positions of countries within the Union, actually threaten employment, and redirect capital away from the offending country. When taxes are raised in America, the change affects the whole geographic area, not solely the northeast or the southwest.

It is interesting that today we see the euro as a tool for achieving economic strength. However, initially, France's motivation for supporting a single currency was that it would more closely bind France to Germany, and hopefully prevent wars between them. Political supporters of the euro did not consider the single currency as a tool that would reduce government influence in the lives of its people, or in the economy.

THE AMERICAN VS. THE EUROPEAN BUSINESS MODEL

From an American perspective, European business is also hampered by a socialistic business model that has been called the corporate wealth model (CWM). The CWM model varies significantly from the market model, or shareholder wealth model (SWM) widely used in the U.S. In the SWM, management works for the enrichment of the shareholder only. Workers are paid what they need to be paid to work, and the firm has no social responsibility to suppliers, or the community. Practitioners of the CWM tend to work for the betterment of their workers, their suppliers, and their community, as well as for the shareholders. The costs of this philanthropy has at least two results. First, the stockholder is denied part of the profits of production. This in turn depresses the price of the stock. One major company in America seems to have adopted this social model. Bank of America earmarks hundreds of millions of dollars for social causes.

One American firm long recognized for making business decisions with their eye on being a socially conscious entity is Ben & Jerry's Homemade Inc. The firm allocated 7.5% of its profit to worthy causes, kept the ratio of pay between the highest and lowest paid employee low, refused to use mild from hormone-treated cows, etc. Perhaps this business could have been successful operating in a more socialistic economy, but competitive stresses made the company uncompetitive in the long-run, leading the founders to sell out to a standard profit oriented firm. It is very instructive to see know that the ice-cream firm rejected the bid of a socially aware firm, and accepted the higher bid of Unilever (Brancaccio, 2000).

Under the CWM, a longer view of profits is common. It may be acceptable to sustain losses for several periods, if profits are probable in the long-run. Managers, under the CWM also do not feel the pressure from the stockholders because the one-share-one-vote rule, so prevalent in the U.S. is largely absent in Europe. Finally, the practice of unfriendly takeovers, so common in the U.S. was, until recently, considered rude in Europe. Again, this allowed for the mis-allocation of capital.

CHANGES IN EUROPE

However, Europe is moving our way. Laws are changing to free up capital by reducing the tax burden on profit, mergers are occurring with great regularity, and companies are issuing voting stock. In each case, the pressure to change, so as to more closely approach the SWM, has come from the great American economic success and growth over the last 15 years or so. Over time, European managers have been convinced that, among other things, the SWM is a better competitive model--even though they consider the necessary cost conscientiousness brutal.

Labor

Should Europe achieve tax and regulatory equality with the U.S. it still faces competitive pressures in other areas. For one, unions in Europe are much more firmly entrenched than are the American unions. When benefits are threatened, they seem to neither care nor understand the need for their employers to be competitive. They are not above encouraging the stone throwing mentioned earlier. In April 2000, unions were blamed for the collapse of merger negotiations between a French a Canadian and a Swiss aluminum producer that would have reduced the cost of production of their combined output by $600 million (*WSJ 04-14-00*). In 1998, a German steel producer accepted a bid for one of its divisions. The successful German bidder bid $100 million less than did an Austrian bidder. But the lower bid avoided political and union hassles (Fox).

Again, it is instructive to look to America and appreciate that the American worker is free to go anywhere in the country to find a job. American labor is liquid. European law puts many roadblocks up for the worker who wants to move 100 mile to another country to find work. In addition there are restrictions on flexible work patterns such as part-time work. Rigid wage-setting structures also hold back business. The Confederation of British Industry is trying hard to influence the European Union to remove many of the barriers to economic growth (Taylor, 2000). However, even if all the legal obstacles to labor movement were removed, there would still be cultural barriers in place that would take a long period of time to overcome. Many European workers will not even consider crossing a border to find work Cultural and legal barriers impede the flow of workers across national barriers.

Cultural Differences

The existence of several cultures affects business in other direct ways. Europe represents a less homogeneous market than does the U.S. In most cases, an American one version of a product can sell everywhere in America. In Europe is it often necessary to alter the product to satisfy each culture. The problem is similar to the American altering of skin and hair products to attract black customers, but multiplied many times. Product distribution systems, and corporate presence tend to be much more localized than in the U.S.

Finally, Europe cannot easily overcome the complications of having several languages spoken in their market. Even within the relatively small confines of the European Central Bank, having to deal with 11 languages has posed some major communications problems. While most Europeans are multi-lingual, there are still language related complications in Europe that America does not have to deal with in its primary market. To a large extent, English is the international language of business. And, there is a move to make English, a variation of English, or an English-like language the official language of Europe. While this seems to make great economic sense, it is tough to see the French buying into this concept. In any case, world-wide English is going to be a long time coming.

CONCLUSION

In summary then, what seems to be the status of Europe vs. the United States? The first thing is that unless the U.S. moves to become more socialistic, the shareholder wealth model will always be a more profitable model than is the socialistic model. The shareholder model is more responsive to changing conditions simply because it has a single goal. It helps greatly that the U.S. government places fewer barriers to the movement of capital. While Europeans are moving towards the SWM we should not expect Europe to mirror the U.S. Europe's long history of socialism has left them unwilling to accept the harsher elements of our model. Having English as to main language across our American market will always provide us at least a small advantage. Having a single government is also an advantage for America, as is the liquidity of our workforce.

America has a vested interest in the success of Europe. For one thing, economic success may be a real deterrent to war. Economically, we know that a successful Europe provides America with a large potential customer base. Success of the euro could set the stage for a single currency world-wide. The probability of the European economy dominating the U.S. economy rests on developing their ability to surpass us in technology, and on the fact that the European market is somewhat larger than is the American market. However, the total American system seems to have a number of advantages over the total European system, that Europe will not overcome any time soon.

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