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WSJE(12/20) Column: The Cure For Eurosclerosis

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In the mid-1980s, forward-looking European statesmen announced what was known as the single market initiative, aimed at freeing the movement of goods, services labor and capital across European borders by 1992. Today the results of that initiative are plain.

Labor-productivity growth in manufacturing sectors most affected by competition-enhancing reforms in the single market was double that of other European sectors. Europeans enjoy new choices: Following Europe's airline liberalization in 1993, for example, over 800 new licenses were granted and more people are using low-cost economy fares. The European Commission estimated recently that eliminating barriers to cross-border trade in business services alone -- representing one-third of all services -- would increase the European Union's gross domestic product by up to 4.2%.

Yet for all that, movement toward a single market has in many ways stalled. Contrary to received wisdom, rigidities and protections are not on the retreat. There is still too little cross-border competition in Europe, and too many internal trade barriers, outdated rules, and anti-competitive practices. Government policies still favor established business and trade-union interests, and work against new entrants, the unemployed, consumer needs, and dynamic growth. As the EU's internal market Commissioner Frits Bolkestein notes, "atavistic reflexes of a corporatist nature" remain alive and well. Consider the following examples:

-- Financial services offered by investment firms, pension managers and even securities markets are highly fragmented and still mostly national in operation. Operators in one country must often be established in another country to provide services there. Advertising and sales promotions are restricted. Rules preclude a company from taking its staff across borders to provide services.

-- In France, the government protects Electricite de France from domestic competition, while other member states use the EDF "threat" to limit competition and protect their domestic producers through the use of golden shares.

-- In Germany, which accounts for one-third of Europe's unemployed, labor markets are becoming more rigid rather than more flexible. Even small reforms are painful. Regulations dating to the 1930s and initially adopted as anti-Jewish measures remained on the books until last June, having been embraced by retailers in the post-war years as protection against such nefarious practices as money-back guarantees.

-- Even in pro-market Ireland, a local health board refused a license for a new pharmacy in a village that had no pharmacy, partly because it would hurt business at a pharmacy in another town.

These practices have real costs for Europeans. The average unemployment rate in the euro area is nearly double that in the U.S., and price differentials for new cars, fresh food and other products are far too high across Europe. Yet again contrary to received wisdom, neither interest-rate reductions nor alterations in exchange rates are likely to be of much use in improving the situation. Rather, a new single market initiative, based on further supply-side reforms, is urgently needed.

What should be the key elements of a revived single market initiative?

-- Completing and updating the single market. Europe has an unfinished agenda in many services such as transport, distribution, construction, insurance, medical services, and professional services. The continuing battle over restrictive labor-market rules is well known, but immigration issues need to be included in the framework of the single market if Europe is to maintain a labor force sufficient to support its aging population.

-- Better integrating economic and social policies. Economic and social issues are so intertwined that they must be dealt with together. Consumer protection in the Single Market should be the subject of general strategy, not ad hoc reaction to disasters as with food safety. The Commission's proposals on consumer protection of October 2001 have kicked off a helpful debate. Regional funds could be better coordinated with economic structural change to help regions undertaking market liberalization. Emerging issues such as regulation of GMOs should be handled in the context of a growth strategy that recognizes the imperative of drug and bioengineering research.

-- Building market institutions at national, regional, and European levels. The 15 EU members still vary widely in their capacities to oversee competitive markets, and this diversity will increase as new members are added. In some countries, weak telecommunications and energy regulators have been unable to control huge, recently privatized firms, permitting abuse of consumers. An added complexity is that economic policy is increasingly decided by regional governments that are generally ill-prepared to assume their new market functions.

-- Improving the decision-making capacities of European institutions. European institutions should overhaul their antiquated decision-making processes. Policies are developed, debated, and adopted at the European level without the most elementary safeguards on quality, transparency, and efficiency. European officials have almost no idea as to the economic impacts of their decisions. The risk of policy failure -- due to bad regulation, over-regulation, or under-regulation -- is high, and undermines EU credibility. Sound reforms, such as wider consultation and use of regulatory impact analysis, were recommended at the EU Stockholm summit in March 2001, and were echoed in July 2001 in the Commission's white paper on "European governance." Decisions and action should quickly follow, but have already been delayed into 2002.

In all this, urgent action is required. What seemed like brave reform before the Berlin Wall fell looks pale and outdated today, and has not kept Europe in the vanguard of best practices. The single market of 1992 focused on goods, while the new economy is moving toward services. Key reforms, particularly in the energy sector, are still held hostage by Europe's most protected interest. Meanwhile, there's a looming global recession, while consolidation of the euro zone next month and the imminent enlargement of the Union will entail new risks that can be managed only by a more flexible and integrated internal market.

European markets will never look like American markets. Because Europeans emphasize social cohesion over dynamism, they regulate more. Tight regulatory protections can be consistent with the paradigm of shareholder capitalism and competitive global markets. But Europe must regulate with a clearer vision of how market competition, rather than protection, is the key to prosperity, growth and security. A good step was taken in the Lisbon agenda of supply-side reforms adopted by EU states in March 2000, but follow-up has been poor. The meeting of the European Council in Barcelona in March 2002 offers the next best chance to launch a new single market initiative. Europeans -- and the rest of the world -- should watch closely.