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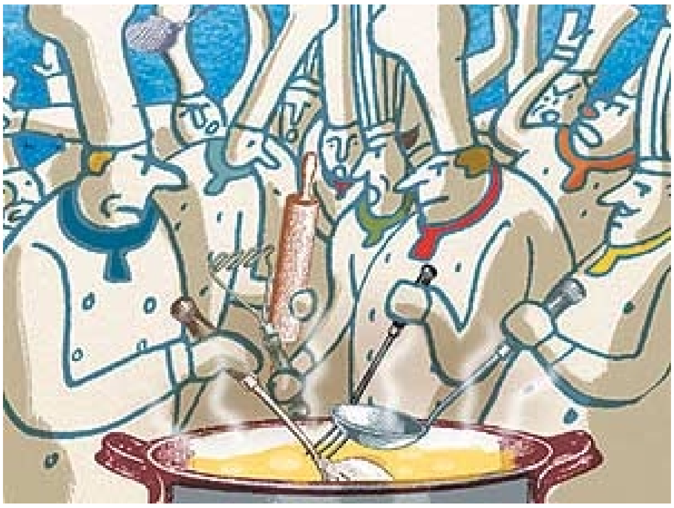
OPINION

European reform

Business as usual

Dec 2nd 2004
From The Economist print edition

The European Union has missed another opportunity to make its economy more competitive



ONLY four years ago at a summit meeting in Lisbon, the leaders of the European Union unveiled with all the flourish they could muster the grand goal of becoming the world's most competitive and dynamic knowledge-based economy by the end of this decade. Their declaration was supposed to herald wide-ranging reforms, whose centrepiece was supposed to be improving the rules that govern business. The idea was not just to create a deeper single market, but also to boost the EU's sluggish growth and cut its high unemployment. Last week, one of the most important reforms was finally agreed to by the EU's 25 member countries—a directive setting out a single set of rules for mergers of companies across national borders. This initiative has finally come to fruition after fully 20 years of discussion and debate (see article). Despite that investment of time and effort, and despite the ambitious goals set at Lisbon, the resulting directive is a hopeless failure.

Creating common rules for cross-border mergers may seem like mundane stuff, yet it is the kind of reform that is crucial for Europe's economy. At present, the EU's merger rules are a hotch-potch of national laws. In many countries there is no clear legal way to combine one firm with another in a different EU country. Instead, firms use costly legal contortions to do this, which puts smaller firms at a big disadvantage. This, in turn, helps to explain why mergers remain far less common than in America.

So the fact that the EU has at last agreed to some sort of common rules might seem like progress, albeit of a painfully slow sort. But in the negotiations Germany has succeeded in watering down the rules to such an extent that they may have little effect. It has been at pains to preserve its system of *Mitbestimmung*, or “co-determination”, in which workers are represented on company boards and participate in decision-making. No other EU country gives as much of a decision-making role to workers. In the decades after the second world war, co-determination gave German business peaceful labour relations, much envied elsewhere. But today's global competition has made it an anachronism, and an obstacle to Germany's own sorely needed restructuring.

Instead of reducing co-determination's role within Germany, the new EU merger rules might well export it to other countries, or kill off most prospects of cross-border restructuring, at least with German firms. At Germany's insistence, the new merger rules say that, if a third or more employees in a newly merged firm are covered by strong worker-participation rights, those rights will apply to the entire firm. In practice, an English or French company wanting to combine with a German firm could be forced to take worker representatives on to its board. That provision alone may be enough to destroy the chance of many such combinations. Germany's government seems to think that, with the support of others, it is fending off a foreign assault on its economic patrimony. Such intransigence will prove a costly mistake, and not just for Germany.

Germany's rules, Europe's problem

A more vigorous market for corporate control could help to boost Europe's productivity and create more efficient firms by reallocating excess capacity, as it has done in so many other places. Too many European governments have preferred to build so-called “national champions” by hand-picking merger partners for many of their country's leading firms. Germany and France have been especially keen on such meddling, which has a miserable record of success. Meanwhile, smaller firms go begging for partners.

Just as big a worry is the precedent that the takeover directive sets for forthcoming reforms. In “harmonising” business regulation, the EU seems set on a path of imposing the most stringent rules on all countries, rather than seeking the minimum level of regulation acceptable to all, or even moving towards the average. That does not bode well for coming attempts to harmonise rules on corporate tax. High-tax Germany is likely, once again, to fight fiercely for others to follow its lead, especially since its eastern neighbours have cut tax rates to more sensible levels and experienced a boost to their economies. For the rest of Europe, choosing higher corporate taxes would be a self-inflicted wound, and a bad one. All the grand promises of Lisbon have amounted to nothing.