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p-Watch — Europe

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The Euro and Productivity

Since March 2002, the euro has become the exclusive common currency of more than 300 million citizens of a dozen countries of the European Union (EU), i.e., except Denmark, the UK, and Sweden. Soon, another 100 million people will be affected when central and eastern European countries convert their national currencies to the euro on joining the EU. The euro's arrival is clearly a major event, both for European integration and international economics. But what could be its impact on productivity? There are at least four dimensions to consider.

Good Government

The first and by far the most important dimension concerns improved national housekeeping. A mutually agreed 'Stability and Growth Pact" sets out the conditions that all EU governments must meet as members of the "euro bloc" including the fines to be levied on euro-currency countries that do not meet them This pact requires governments to reduce their debts, keep inflation low, and ensure a better business environment. Meeting these conditions should enable enterprise to flourish and productivity to boom.

Through this pact and the fact that governments no longer have control over monetary policy (which is the role of the new European Central Bank), countries that have had a long history of poor economic management, like Italy, Spain, Portugal, and Greece have already been forced to impose strict rules. In particular, they are having to reduce subsidies and hand-outs to nonproductive groups, albeit not without strife.

Paradoxically, it was Germany, the locomotive of the EU's economy and the driving force behind the pact, that received the first warning to tighten up on public profligacy. Many are of the opinion that the burden of its particular version of the welfare state seriously hampers its entrepreneurship. Under peer pressure, Germany has promised to sort itself out by 2004.

Greater Transparency Leads to Greater Competition?

Europeans talk a lot about "transparency," the ability to see and understand realities more clearly. Now that continental European countries' production inputs and outputs are priced in the same currency, it should be much easier for managers as well as consumers to compare costs and values and purchase where they get the best value for money. However, at least so far, there is little tendency for prices to become more harmonized. This is because taxes and transportation costs are different, for example, as well as products (detergents, foodstuffs, etc.). Products sold under the same brand name can differ very much in content from one country to another to meet different requirements. For example, stains in the south of Europe differ from those in the north because the French and Finns eat different types of food. Household detergents must reflect that difference. But in the longer run, more companies will follow the BMW example of selling the same product at the same price across Europe.

Nor is labor cost the determinant for corporate location. More important is labor productivity. Thus, "unit labor costs" are all important for national and corporate competitiveness. So, too, is the quality of tangible and intangible national infrastructure, such as transportation and communications systems and the educational quality of a nation's workforce. In all these respects, high labor-cost countries outperform their cheaper rivals considerably.

Wages?

The advent of the euro is having some, albeit contrasting, impact on wages. Take, for example, the metal workers. On the one hand, they are trying to strengthen coordinated wage bargaining in Europe as they have seen employees' share of national income decline significantly in the last two decades. But their leeway is limited because productivity performance differs widely across the countries.

Productivity is again playing a greater role in wage determination, although not because of the advent of the euro. Nor should it be forgotten that labor productivity is the outcome of the workforce working not just harder but also smarter through continuously improving technologies. For Germany to survive its lower value-added, industries need to deviate from current wage norms and move toward more decentralized collective bargaining, individualized employment contracts, and profit- and productivity-sharing schemes. That this is being hampered by German trade union attitudes and behavior is the subject of European Commission and OECD criticism. The current German government is loath to advocate significant action for fear of fracturing half a century of labor-management partnership that has underpinned Germany's past productivity and quality performance.

Time and Space

Productivity is not just about labor and capital, but also about time and space. The advent of the euro should make time more productive as transaction payments, say, from a Belgian to an Italian bank account should not just be cheaper but also faster. This in turn will contribute to the development of cross-border business cooperation, embracing both private companies and public bodies.

In terms of space and greater mobility, introducing the euro does little to reduce hindrances to free movements across borders. While the people no longer need to change francs into marks, geographical, bureaucratic, legal, and behavioral hindrances limit freedom of movement.

Strengthening Competition Policies

The new currency is almost completely stable for the participating nations. This provides businesses with continuity when making investment decisions. But should there not now be more harmonization of fiscal, competitive, and welfare policies among the EU member states? All are agreed that the economic playing field should be leveled (excepting, of course, where their vital interests are concerned). Each state's interests are different and national subsidies still play a significant role in some industries, notably transportation and agriculture. But if fiscal harmonization is excluded (income tax regimes vary considerably), competition policy increasingly focuses on stimulating productivity and reducing tendencies toward monopoly. In this area, the European Commission plays a significant role world wide, as has been shown by its refusal to accept high-profile intended mergers in 2001.

As the guardian angel of European economic growth, the European Commission will have to push hard for open competition in all spheres of working life. To sharpen this 'spur to innovation:' to reiterate the core of the European Association's Memorandum on Productivity, smooth productivity development is needed at both the enterprise and national levels, which can only be achieved through continuing partnerships between managers and workforces.

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