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## Europe's Daily Soap Opera Keeps Rolling

- By IRWIN STELZER



It's all right, then. The about-to-retire head of the European Central Bank and someone at the headless International Monetary Fund are discussing "financial modalities" which may or may not include "reprofiling" of Greek debt, "voluntary exchange" and other "involvement" of private-sector creditors, but must not include a "credit event," but must include a Greek agreement to a "reinvigoration" of reforms which include "rationalization in entitlements."

Translation: Greece is again promising to do what it has already promised but failed to do, while the euro zone's deep pockets plan a takeover of Greek finances, and struggle to find language that will impose losses on private-sector creditors without provoking the rating agencies into declaring default, or the ECB into cutting off the flow of liquidity to Greek banks. More euros to pour into bailouts, a bucket with a hole in it.

The daily soap opera being performed by the stars of Euroland drama is gripping fare. The Greek government and its trade unions; the European Central Bank; the International Monetary fund; various euro-zone institutions; German Chancellor Angela Merkel; and assorted bit players strut and fret across our television screens and financial pages, in the end signifying very little. Waiting in the wings are Italy, Spain, Belgium, perhaps even the U.K., if the current downturn proves to be the beginning of a tragic Grecian debt spiral.

But one way or another these immediate crises will be resolved. ECB boss Jean-Claude Trichet will in the end be reluctant to bring down Greece's banks. Ms. Merkel knows that if the troubled countries are

allowed to meet the fate written on their ledgers, the undercapitalized German banking sector might go down with them. And the eurocracy prefers buying time in the Micawberish hope that something will turn up to keep Euroland from fracturing, rather than face reality.

So much for the surface manifestation of the more fundamental problem: large portions of the euro-zone economy are lumbering dinosaurs trying to live in a world of fast-moving predators. Italy, being watched out of the corner of their eyes by the bond vigilantes, is in deep trouble. Its economy has grown by less than 3% over the past decade, and there are no signs of permanent improvement.

That's less than one year of unsatisfactory growth in the U.S., and less than one-third of the growth rate chalked up by China in a single year. Even if we add something to take account of the tax-avoiding black economy, that is a sorry economic performance indeed. Citigroup Global Markets notes that "low growth may start raising [additional] concerns about the medium-term sustainability of still-high public debt."

Portugal has done no better, nor has Spain since its socialist government rolled back the reforms instituted by José Maria Aznar. Both economies are somewhere between stagnant and shrinking. Even France has managed to grow its GDP by only 12% over the past decade, while never getting its deficit down to less than twice the euro-zone target of 3% and allowing its debt to reach 80% of GDP.

Then there is Germany, the paragon, growing rapidly, creating jobs, moaning about the economic failure of the nations whose begging bowls it is being asked to fill. But were it not for the economic problems of Greece and the periphery, the euro would be much more highly valued.

In short, like China, Germany is benefiting from a currency undervalued relative to its economic fundamentals. Which is a reason in addition to its shaky financial sector that Germany is desperate to prevent Greece from leaving the euro zone and depriving German exporters of the downward drag its membership provides the euro.

This poor growth performance reflects widespread economic rigidities, among them:

- barriers to entry doled out to incumbents by pliant politicians;
- impenetrable webs of regulation that among other things make it difficult for a robust venture capital industry to emerge;
- growth-stifling tax rates to support generous welfare schemes;
- rigid labor markets.

This is a failure of governance on a national level compounded by a failure of governance on the European level. National governments seem unable to stand up to the vested interests, which is why Greece will have to tolerate the presence of occupying forces to oversee its privatization and austerity programs.

On the euro-zone level, policy makers are acutely aware of these problems, but have been unsuccessful in tackling them. So they have turned their attention to imposing these antigrowth policies on their competitors.

France is insistent that Ireland raise its 12.5% corporate tax rate; the EU wants to impose its high-cost anticarbon policies on America by levying tariffs on made-in-the-USA products; EU Commissioner for Internal Markets Michel Barnier wants tighter regulation of Britain's world-class financial sector and European-style regulation of bankers' compensation in America; and French President Nicolas Sarkozy thinks that the Internet is such a major contributor to economic growth that, you guessed it, it needs more regulation.

It is not as if Europe's private sector can't survive in a globalized world. France has some first-class multinationals, Germany's work force and engineering firms can compete with the world's best, 30 Swedish companies are listed among Forbes Global 2000, Italy is a world leader in design, Ireland is blessed with an educated work force that speaks English, the lingua franca of world trade.

Good building blocks for any policy makers eager to unleash the "animal spirits" that John Maynard Keynes pointed out drive economies forward, and brave enough to end protective policies that prevent innovation—the process of "creative destruction" that Joseph Schumpeter argued convincingly supports productivity growth.

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