EEI POLICY PAPERS

Johnny Munkhammar

What Competition Has Done for Europe

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About EEI Policy Papers

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The EEI works to facilitate research and debate in all areas of policy with impact on the conditions for entrepreneurship, incentives for innovation, competitiveness and economic prosperity. The EEI does not take any institutional opinion on individual issues but actively encourages an opinionated dialogue among stakeholders.

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A Word from the Publisher

Peter Jungen
President of the European Enterprise Institute

President Sarkozy's question "Competition as an Ideology, as a Dogma, what has it done for Europe?" is an invitation to a fundamental debate explaining the economic success of Europe and its future development for the benefit of the European citizens. The European Enterprise Institute welcomes this initiative and presents the paper by Johnny Munkhammar with the introduction by Gunnar Hökmark MEP as a starting point of such a discussion.

That the Bourgeoisie had produced more economic wealth since industrialisation than all generations of mankind before has already been stated by many people, including Karl Marx. But why was it the West which became rich? Why not other parts of the world? Why did it start just in Britain and then in continental Europe?

The combination of the values of the bourgeoisie and of capitalism, based on the best ideas Europe ever brought about - the Scottish Enlightenment and the Austrian School of Economics - have kicked off industrialisation and made us rich.

At the heart of this economic dynamic process lies innovation created by unfettered competition. The American Revolution started only after these ideas and thoughts and their connected values of the bourgeois had been exported from Europe to America. At a time when Western Europe becomes reluctant to make them flourish in Europe we can watch the world adopting these ideas of European origin and successfully applying them.

EU Enlargement is a great success story fostering the renaissance of the European ideas of capitalism with free markets, competition, innovation, entrepreneurship and job creation as an agenda for a successful Europe. When Communism disappeared the adoption of those ideas and values led to the strikingly successful development of the new member countries. Why have West European politicians not been able to explain this to their own people?

We all should be grateful to President Sarkozy for starting a debate about what made Europe successful and what would make it successful in the future. His question has already provoked many quick and simple answers, from all sides of the political spectrum. President Sarkozy's economic ideas and reform proposals require a much more serious, broader and deeper debate.

The European Enterprise Institute offers this Policy Paper and its Website to serve as an international platform for such a discussion.

Foreword

Gunnar Hökmark MEP
Co-chairman of European Enterprise Institute

Why is it that Europe emerged as a world leading economy and for centuries came to be the dominant region with control over world trade, and the centre for world politics as well as a superiour military force? How does it still, together with the US, manage to occupy such an important role on the world stage?

The main reason for this was not that science and knowledge in Europe were superior to those in other parts of the world. In the 16th and 17th centuries, China, India and the Arab world were certainly not culturally or intellectually inferior to Europe. The crucial reason for Europe's success was that it then was more open to new ideas, new innovations and new enterprises. It was this, more than anything that ensured modern Europe's enduring prosperity and freedom.

First, Europe was ruled by different kingdoms and elites. What was impossible or forbidden in one state was accepted, tolerated or even supported at another court. Thus, it was possible for Christopher Columbus to find someone who would finance his enterprise, even if he had been turned down elsewhere. Ideas that were suppressed or looked upon with great suspicion in some countries could be supported and developed elsewhere. Thus, the structure of power in Europe triggered the extraordinary diversity of advances in knowledge and technology that made Europe prosper.

In addition to this, there was also in most European states an emergence of competing institutions of power. The kings and queens had no absolute power and the church had no hegemony over society. New research and new knowledge were not seen as challenges to religion or to the stability of society. Rather, they were a natural blossoming of a Europe formed by the Renaissance, the Reformation and the Enlightenment. What we really saw was the emergence of competition, based on merit and not dependent on the approval of monolithic authorities, be they worldly or religious rulers.

The society of privileges, licences and monopolies gave way for a society of merchants, manufacturers and innovators. The result was not only competition by competing producers; it was new trade, new investments and a financial system that allowed for risk-taking and thereby for new enterprises. It created a dynamic environment which gave us innovations and new products, changing the face of European society and giving Europe the lead in the global economy.

New knowledge engendered innovations, investments and trade beyond the control of ruling power elites, be they economic or political. And it was driven by competition on the financial markets and by competition amongst producers, manufacturers and merchants.

This was not possible in the hegemonic cultures of other leading civilizations of that time, where new knowledge was rather seen as a tribute to a superior culture than as a possibility to change the society. Where the economy and the society as a whole were in the hands of the ruling power, everything that was new had to be approved by those who really did not want any change as it could threaten the stability of the state.

This was exactly what we could see in the communist part of the world. We can see it today in the countries of the Muslim world where religion is seen as an ideology above everything else, and indeed anywhere where rulers want to control the whole of society. It is remarkable, that it is when countries like China or India first open up to free trade and competition that we see them rise.

Competition gave Europe growth, dynamics and development of knowledge, innovations, culture and philosophy. The European society could explore, research, enterprise, expand and develop, thanks the opportunities of competition. It has for centuries given Europe a leading role in economy, culture, philosophy, science and politics.

Prosperity, freedom and democracy have been the result. This is what competition has given Europe, should anyone ask. Or you could say that competition has given Europe Egalité, Liberté et Fraternité, through the opening up of old structures and through making everything possible for everyone. That's not bad.

In a time when Europe's leading role is challenged for the first time in centuries, we should stick to the competition that made Europe great. In the future no region of the world will be able to lead the world that as Europe once did. Today, people in other parts of the world also profit from the opportunities of competition. There are therefore now many more producers to rival our own, but also more consumers of our goods and services, as long as we maintain our high standard of production and development.

That's why Europe needs competition even more than in the past, as competition is not just about better quality, or more efficient production and lower prices, or plurality of products and services, or the freedom of choice. Though all these factors are important, and a result of free competition. But more importantly, competition makes it possible to do things better than good. There is always an opportunity to develop something that is even better than good products and services. Not because the old ones are bad but because the new ones are even better.

Even better cars, even smaller and more advanced mobile phones, new ways of distributing furniture, new services on the net, better medicine, more enjoyable music, more thrilling movies, more knowledge and new science, or whatever. Thanks to competition we can do things better than before and that makes the world move. That is not only a matter of economics but of culture and civilisation, to take steps forward, to make things better for each other and explore our opportunities and skills. Competition has given Europe a lot but still has a lot more to give.

European Enterprise Institute is proud to present this paper "What competition has done for Europe". It is reading for young and old, politicians or bureaucrats and, not the least, for citizens and presidents. We will certainly continue to put the need for competition in focus for European politics.

What Competition Has Done for Europe

Johnny Munkhammar

Born in 1974. Program Director, Timbro, a policy research institute in Sweden. He has a Master's Degree in Political Science and Economics. Author of four books on economic policy, the latest is "European Dawn – After the Social Model". His previous professional experience includes Senior Advisor for the Confederation of Swedish Enterprise, Editorial Writer and Partner in a Public Affairs Consultancy. He has written chapters in several books – such as in "2007 Index of Economic Freedom" (Heritage/Wall Street Journal) – and published numerous reports and papers. He is a frequent speaker at conferences, universities and seminars all over Europe, and appears regularly in the media as a columnist, and as a commentator on radio and TV. Web log: www.munkhammar.org.

Prologue

A PETITION

From the Manufacturers of Candles, Tapers, Lanterns, Sticks, Street Lamps, Snuffers, and Extinguishers, and from Producers of Tallow, Oil, Resin, Alcohol, and Generally of Everything Connected with Lighting

To the Honourable Members
of the Chamber of Deputies

Gentlemen:

You are on the right track. You reject abstract theories and little regard for abundance and low prices. You concern yourselves mainly with the fate of the producer. You wish to free him from foreign competition, that is, to reserve the *domestic market* for *domestic industry*. We come to offer you a wonderful opportunity for your – what shall we call it? Your theory? No, nothing is more deceptive than theory. Your doctrine? Your system? Your principle? But you dislike doctrines, you have a horror of systems, as for principles, you deny that there are any in political economy; therefore we shall call it your practice – your practice without theory and without principle.

We are suffering from the ruinous competition of a rival who apparently works under conditions so far superior to our own for the production of light that he is *flooding* the *domestic market* with it at an incredibly low price; for the moment he appears, our sales cease, all the consumers turn to him, and a branch of French industry whose ramifications are innumerable is all at once reduced to complete stagnation. This rival, which is none other than the sun, is waging war on us so mercilessly we suspect he is being stirred up against us by perfidious Albion (excellent diplomacy nowadays!), particularly because he has for that haughty island a respect that he does not show for us.

We ask you to be so good as to pass a law requiring the closing of all windows, dormers, skylights, inside and outside shutters, curtains, casements, bull's-eyes, deadlights, and blinds – in short, all openings, holes, chinks, and fissures through which the light of the sun is wont to enter houses, to the detriment of the fair industries with which, we are proud to say, we have endowed the country, a country that cannot, without betraying ingratitude, abandon us today to so unequal a combat.

Be good enough, honourable deputies, to take our request seriously, and do not reject it without at least hearing the reasons that we have to advance in its support. First, if you shut off as much as possible all access to natural light, and thereby create a need for artificial light, what industry in France will not ultimately be encouraged? If France consumes more tallow, there will have to be more cattle and sheep, and, consequently, we shall see an increase in cleared fields, meat, wool, leather, and especially manure, the basis of all agricultural wealth. If France consumes more oil, we shall see an expansion in the cultivation of the poppy, the olive, and rapeseed. These rich yet soil-exhausting plants will come at just the right time to enable us to put to profitable use the increased fertility that the breeding of cattle will impart to the land.

Our moors will be covered with resinous trees. Numerous swarms of bees will gather from our mountains the perfumed treasures that today waste their fragrance, like the flowers from which they emanate. Thus, there is not one branch of agriculture that would not undergo a great expansion. The same holds true of shipping. Thousands of vessels will engage in whaling, and in a short time we shall have a fleet capable of upholding the honour of France and of gratifying the patriotic aspirations of the undersigned petitioners, chandlers, etc.

But what shall we say of the *specialities* of *Parisian manufacture*? Henceforth you will behold gilding, bronze, and crystal in candlesticks, in lamps, in chandeliers, in candelabra sparkling in spacious emporia compared with which those of today are but stalls.

There is no needy resin-collector on the heights of his sand dunes, no poor miner in the depths of his black pit, who will not receive higher wages and enjoy increased prosperity. It needs but a little reflection, gentlemen, to be convinced that there is perhaps not one Frenchman, from the wealthy stockholder of the Anzin Company to the humblest vendor of matches, whose condition would not be improved by the success of our petition.

We anticipate your objections, gentlemen; but there is not a single one of them that you have not picked up from the musty old books of the advocates of free trade. We defy you to utter a word against us that will not instantly rebound against yourselves and the principle behind all your policy.

Will you tell us that, though we may gain by this protection, France will not gain at all, because the consumer will bear the expense? We have our answer ready: You no longer have the right to invoke the interests of the consumer. You have sacrificed him whenever you have found his interests opposed to those of the producer. You have done so in order *to encourage industry and to increase employment*. For the same reason you ought to do so this time too. Indeed, you yourselves have anticipated this objection. When told that the consumer has a stake in the free entry of iron, coal, sesame, wheat, and textiles, "Yes," you reply, "but the producer has a stake in their exclusion." Very well, surely if consumers have a stake in the admission of natural light, producers have a stake in its interdiction.

"But," you may still say, "the producer and the consumer are one and the same person. If the manufacturer profits by protection, he will make the farmer prosperous. Contrariwise, if agriculture is prosperous, it will open markets for manufactured goods." Very well, If you grant us a monopoly over the production of lighting during the day, first of all we shall buy large amounts of tallow, charcoal, oil, resin, wax, alcohol, silver, iron, bronze, and crystal, to supply our industry; and, moreover, we and our numerous suppliers, having become rich, will consume a great deal and spread prosperity into all areas of domestic industry.

Will you say that the light of the sun is a gratuitous gift of Nature, and that to reject such gifts would be to reject wealth itself under the pretext of encouraging the means of acquiring it?

But if you take this position, you strike a mortal blow at your own policy; remember that up to now you have always excluded foreign goods *because* and *in proportion* as they approximate gratuitous gifts. You have only *half* as good a reason for complying with the demands of other monopolists as you have for granting our petition, which is in *complete* accord with your established policy; and to reject our demands precisely because they are *better founded* than anyone else's would be tantamount to accepting the equation: + x + = -; in other words, it would be to heap *absurdity* upon *absurdity*.

Labour and Nature collaborate in varying proportions, depending upon the country and the climate, in the production of a commodity. The part that Nature contributes is always free of charge; it is the part contributed by human labour that constitutes value and is paid for.

If an orange from Lisbon sells for half the price of an orange from Paris, it is because the natural heat of the sun, which is, of course, free of charge, does for the former what the latter owes to artificial heating, which necessarily has to be paid for in the market.

Thus, when an orange reaches us from Portugal, one can say that it is given to us half free of charge, or, in other words, at *half price* as compared with those from Paris.

Now, it is precisely on the basis of its being *semigratuitous* (pardon the word) that you maintain it should be barred. You ask: "How can French labour withstand the competition of foreign labour when the former has to do all the work, whereas the latter has to do only half, the sun taking care of the rest?'" But if the fact that a product is *half* free of charge leads you to exclude it from competition, how can its being *totally* free of charge induce you to admit it into competition? Either you are not consistent, or you should, after excluding what is half free of charge as harmful to our domestic industry, exclude what is totally gratuitous with all the more reason and with twice the zeal.

To take another example: When a product – coal, iron, wheat, or textiles – comes to us from abroad, and when we can acquire it for less labour than if we produced it ourselves, the difference is a *gratuitous gift* that is conferred up on us. The size of this gift is proportionate to the extent of this difference. It is a quarter, a half, or three-quarters of the value of the product if the foreigner asks of us only three-quarters, one-half, or one-quarter as high a price. It is as complete as it can be when the donor, like the sun in providing us with light, asks nothing from us. The question, and we pose it formally, is whether what you desire for France is the benefit of consumption free of charge or the alleged advantages of onerous production. Make your choice, but be logical; for as long as you ban, as you do, foreign coal, iron, wheat, and textiles, *in proportion* as their price approaches zero, how inconsistent it would be to admit the light of the sun, whose price is *zero* all day long![1]

1 Bastiat, Frédéric, Sophismes Économiques, 1845

Introduction

Competition as an ideology, as a dogma, what has it done for Europe?

This question was asked by French President Nicolas Sarkozy at a press conference following the Summit of the European Union's Heads of Government in late June, 2007. It was part of his motivation for the replacement of the phrase "an internal market where competition is free and undistorted" with the mere words "a single market" in the new proposed EU Treaty.

President Sarkozy's question is fundamental. Competition is an essential feature of a free economy, whereas no competition is a main feature of a centrally planned economy. Freedom or control – the history of Europe is indeed a struggle between these two opposites, in different shapes over centuries and decades: Trade or protectionism, laissez-faire or mercantilism, capitalism or communism.

The question is also relevant today. Issues of competition arise in many – if not most – policy debates; locally, nationally and internationally. Whether the topic is trade, investments, labour markets, taxes, health care, education or product markets, competition often plays a central part in the discussion. How competition as such is viewed will affect numerous policy outcomes. Every policy area contains a battle between those that want more competition and those that want more central control.

President Sarkozy seemed to indicate that his response to the question was: "Not particularly much." Why else would free competition be erased, but other EU aims such as "sustainable development" remain? A protocol claiming that competition is still important was added to the Treaty. Its legal value can be discussed. That is, however, not very relevant. The symbolic value of erasing competition is in any case overwhelming. It might contribute to tilting many policy agendas in Europe against competition and set Europe going towards more control.

The issue of more or less competition will decide much of Europe's future fate. Since the autumn of 2005, France has experienced returning riots. Socially excluded and desperate people have raged the streets violently. Clearly, there are serious problems in a number of European countries, to a large extent the consequence of current economic policies and institutions. The riots provide a dramatic illustration of the problems. Still, today's policies are often fiercely defended. Reforms that would open up the economy for more external and internal competition are resisted. That resistance protects the causes of many problems and prevents possible solutions.

Though competition versus control has been an ongoing debate for a long time, it has emerged strongly in recent years. It might be fair to say that Europe has come to a crossroads between policies of openness and reform on one side and policies of protectionism on the other. A key element in that choice of path is the degree of competition. Openness and reforms increase competition, whereas protectionism restricts it. The hot debates over the EU services directive, the "Polish Plumber", tax competition, and corporate mergers reflect this battle. One analysis underlined the significance, in this context, of erasing free competition from the Treaty:

This is about the worst moment for Europeans to seek refuge in the warped ideas of Jean-Baptiste Colbert, the 17th-century mercantilist par excellence. The revival of Colbertism suggests fewer market freedoms, less competition, more economic nationalism and trade protection, exchange rates managed by politicians, and a macroeconomic policy based on short-sighted goals. Europe's future does not lie in ideas of the pre-enlightenment era.[2]

Competition issues can often be made large and complicated. Indeed, in a complex world, sometimes they prove to be. But the basic questions concerning competition are small and simple: Should anyone be allowed to compete to satisfy the demands of a consumer or not? If not – who should be allowed? And who should determine that if not the consumer? Should I be allowed to start a business in order to create something new or not? If not – who should create the new? And what should be created?

Freedom and competition are two sides of the same coin. If there are few barriers to economic exchange, there will be competition. There will be innovators and entrepreneurs – a term invented by the French philosopher Jean-Baptiste Say – that try to find new and better ways of producing goods and services. This creates a pressure for development towards ever improving quality, variety and lower prices. The opposite – a monopoly – has no such incentives. Few and low barriers to entry is the main guarantee that a market does not become monopolistic. An entrepreneur will find ways to be better than the dominant player.

Competition creates free choice for consumers. The entrepreneurs that compete for the choice of a consumer are dependent on other parts of society being free too. They may need to import items, thus foreign companies have to be able to offer that freely. Entrepreneurs might want to export products and are dependent on other countries not being protectionist. They may need investments and thus there has to be competition between investors. They may need to hire people and thus people must be allowed to freely offer their services.

Barriers to competition can be of many kinds. A whole sector of society may be excluded from competition because goods or services are delivered by public monopolies. There can be state subsidies to some companies, putting competitors in a tough spot. Regulations can distort competition, and bureaucracy can suppress entrepreneurship. Taxes or tariffs might decrease economic exchange. The barriers can be – but are not always – created by the state, which means that it is often within the power of politicians to facilitate competition.

Sometimes, barriers to competition are motivated by policies dedicated to creating "European Champions", that is, successful global companies. This illustrates the conflict of how the development of society should be determined – freely or centrally planned. Can politicians actually know in advance which company will be successful in the future?

2 Münchau, Wolfgang, Europe's Drift to Mercantilism, Financial Times, 24th of June, 2007

Why, in that case, would that company need protection from competition? In the world of sports – from which the term "champion" originates – one has to win a fair game to be a champion:

Imagine a world in which the team winning a football league succeeded not through a series of competitive games but, instead, through decisions made by politicians. Tony Blair would presumably choose Newcastle United. David Cameron might opt for Aston Villa. Gordon Brown, the incoming Prime Minister, could favour Raith Rovers. … Sometimes, though, politicians like to pick winners even if they don't obviously have the requisite skills. They have a distaste for capitalist competition, recognising that market forces can upset their best-laid plans.[3]

Competition is criticised from many directions. It is said to be hard and cold, destroying lives of people that can't keep up with "running faster". Large corporations are criticised for pushing older and smaller competitors out of business. Competition is said to harm social and cultural values. At times, competition is referred to as something non-European – an "anglo-saxon" idea. Jobs are said to be in danger. There are fears that consumers cannot handle all the information in the market. To a large extent, the criticism is founded on misconceptions and misunderstandings – timelessly revealed by Frédéric Bastiat in his "Petition".

A main theme in the criticism of competition is that restricting it would somehow create a more "social" society. Though President Sarkozy managed to highlight the issue, this argument has been frequent in politics for a long time and competition has been fought from many different political directions. The colour of the political party doesn't always determine the views of its representatives of competition. The idea that restricting competition would improve social conditions is the biggest misconception of them all. Restricting competition means restricting opportunities to improved living standards and indeed social progress. Competition unleashes those forces in society that create more prosperity, and nothing is more important to improve social conditions, such as decreasing poverty.

Competition is naturally not the solution to all of mankind's problems. Its consequences are not always easy in the short run: A society of free competition is a society of change, where old goods, services, factories and jobs will disappear. And there is a need for laws and regulations that facilitates a well-functioning competition. But free competition is the main driver of progress and prosperity. It is the way in which people interact freely to create a better society. In fact, competition is what made Europe so successful and prosperous for so long. A reason why many other parts of the world are at least as successful today is that they have also introduced high degrees of competition. The mechanism has been described famously by Scotsman Adam Smith:

...every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows

[3] King, Stephen, European Champions Need the Competition, The Independent, 25th of June, 2007

how much he is promoting it. ...He intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good.[4]

Competition has brought tremendous advantages for Europe. To a very large extent, it made Europe what it is – not only in the economic sense. Free and competing artists created a massive cultural heritage. Free and competing scientists paved the way for knowledge. Free and competing explorers discovered the world. And the very idea of being free to compete is to a very large extent European, developed in theory and practice in our continent. Still, Europe of today has many barriers to competition and discusses to introduce more. Europe should do the opposite.

The aim of this publication is to show that competition has done very much indeed for Europe. There will be theoretical, historical and comparative evidence showing that competition is the main explanation for European prosperity. There are also facts about how the lack of competition hurts Europe today. Furthermore, there are also arguments concerning why, where and how competition in Europe should increase – and how the EU should contribute.

There are often discussions about how the state should support entrepreneurs. How about first identifying and taking away some of the barriers created by the state? Europeans need more freedom to be able to compete in today's world. In the words of the entrepreneurs that faced the mercantilism of their time: "Laissez-nous faire!".

4 Smith, Adam, The Wealth of Nations, 1776

Competition – History and Effects

The bourgeoisie (i e capitalism) has accomplished wonders far surpassing Egyptian pyramids, Roman aqueducts, and Gothic cathedrals; it has conducted expeditions that put in the shade all former exoduses of nations and crusades. ... (It) draws all, even the most barbarian, nations into civilization. ... (It) has created more massive and more colossal productive forces than have all preceding generations together. Subjection of nature's forces to man, machinery, application of chemistry to industry and agriculture, steam navigation, railways, electric telegraphs, clearing of whole continents for cultivation, canalization or rivers, whole populations conjured out of the ground – what earlier century had even a presentiment that such productive forces slumbered in the lap of social labour? … The feudal organization of agriculture and manufacturing industry…hindered production instead of developing it. … (I)nto their place stepped free competition accompanied by a social and political situation adapted to it.[5]

This was written by Karl Marx and Friedrich Engels in the very early days of the emergence of the free economy in Europe. They concluded that this development was bound to come to an end, that capitalism in itself was unsustainable, but did not fail to acknowledge its substantial success. Almost 160 years later, this development has not come to an end, and it has continued to bring enormous advantages to people in the world. The magnitude of the success is almost hard to grasp. And indeed this development gave Europe a leading role in the world. William J Baumol has summarized some of the results:

It is the spectacular and historically unprecedented growth rates of the industrialized market economies – the growth rates of their productivity and their per capita incomes – that, above all, set them apart from all alternative economic systems. Average growth rates for about one and a half millennia before the Industrial Revolution are estimated to have been approximately zero… In contrast, in the past 150 years, per capita incomes in a typical free-market economy have risen by amounts ranging from several hundred to several thousand per cent![6]

In a classic work studying the development of 16 industrialised countries since 1820, Angus Maddison pointed out that the total product has increased seventy fold and that average per capita income is now 14 times higher. Below is the list of countries and how much their per capita income multiplied between 1820 and 1989.

5 Marx, Karl, Engels, Friedrich, The Communist Manifesto, 1848

6 Baumol, William J, The Free-Market Innovation Machine, Princeton University Press 2004

How many times the per capita income multiplied in 16 industrialised countries 1820-1989[7]

Country	Coefficient of multiplication
Australia	11
Austria	12
Belgium	13
Canada	n.a.
Denmark	14
Finland	22
France	13
Germany	15
Italy	13
Japan	26
Netherlands	10
Norway	19
Sweden	16
Switzerland	n.a.
UK	8
USA	17
Average	14

Thus, production increased seventy times, but the populations increased too, so average incomes per capita increased fourteen times. And in order to produce fourteen times more, we still work far fewer hours a year today. This enormous increase in economic output also had very social effects. Life expectancy more than doubled and poverty decreased sharply. This development started off in Europe and has since then been spreading over the world. The recent decades where the free economy has been spreading fast have shown a particularly positive global development.

The global economy grew by 2,9 per cent on average annually 1990-2000 and 2,5 per cent on average 2000-2004. The figures for low income countries are 4,7 and 5,5 per cent.[8] The projections point to a global growth level over 4 per cent every year until 2012.[9] Never before have so many people been part of the global workforce, and still

7 Maddison, Angus, Dynamic Forces in Capitalist Development: A Long-Run Comparative View, Oxford University Press 1991

8 World Bank, 2006 World Development Indicators

9 IMF, World Economic Outlook, April 2007

there are hundreds of millions of people on their way. The share of the world's population that has an income of only $1 per day or below decreased from 40,4 per cent in 1981 to 18,4 per cent in 2004, or, expressed in absolute numbers, from 1 482 million to 985 million.[10] At the same time, the environment has improved substantially on many accounts in the wealthier parts of the world, not least in Europe.[11] People's subjective happiness is higher in wealthy countries.[12]

With the Industrial Revolution of the 19th Century, the development towards greater prosperity took off rapidly in Europe. But the foundation was laid before that. The origins of wealth creation go back to several factors. The Kings and the Church started to lose their grip on society. Trade and commerce were initiated in some city-states in Europe. In fact, the lack of central control in Europe due to its many fragmented nation-states – and their competition to shape the best laws and institutions – has been pointed out as a main explanation for the initiation of growth in Europe.[13] William J Baumol points to the need for innovation:

…entrepreneurs – that is, independent innovators – have played a critical role in the growth performance of the capitalist economy. They were indispensable at its inception, introducing new business methods and other innovations without which the free-enterprise system could not have prospered. They adopted new processes, ranging from the use of better ships provided by the Venetians, the Genoese, and the Dutch, to financing innovations such as the introduction of equity as supplement to debt in the financing of business ventures, and procedures such as double-entry bookkeeping.[14]

The free market unleashes creativity and change. It has been estimated that three-quarters of all products today did not exist in any form 100 years ago.[15] Joseph Schumpeter's point about destruction of the old being a necessary condition for creation of the new is both relevant and visible in society.[16] In the year 1800, in Western Europe, between 70 and 90 per cent of the population were employed in agriculture versus about three per cent today, and today's farmers produce more total output.[17] That is one way to describe the increase in productivity in agriculture. The majority of the population is now able to work in other sectors, producing other goods and services.

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10 World Bank, World Development Indicators (WDI) 2007, http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS0,,contentMDK:21298138~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html

11 European Environment Agency, The European Environment – State and Outlook 2005

12 The Economist, Where Money Seems to Talk, 7th of July, 2007

13 Rosenberg, Nathan, Birdzell Jr, L E, How the West Grew Rich, Basic Books 1986

14 Baumol, William J, The Free-Market Innovation Machine, Princeton University Press 2004

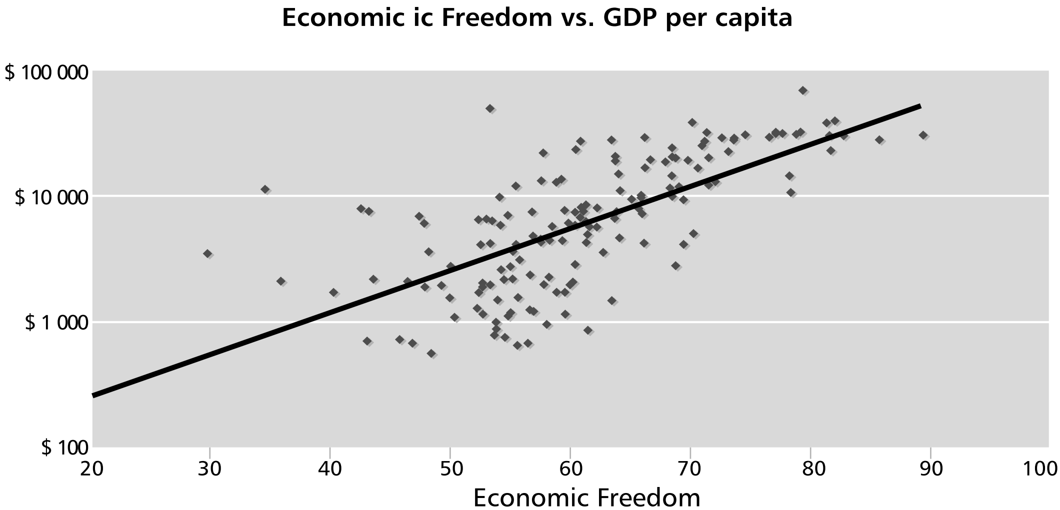
15 Nordhaus, William D., "Do Real-Output and Real-Wage Measures Capture Reality? The History of Lighting Suggests Not," in Bresnahan, Timothy F., and Gordon, Robert J., eds., The Economics of New Goods, University of Chicago Press, 1997

16 Schumpeter, Joseph, Capitalism, Socialism and Democracy, Harper, 1975

17 Maddison, Angus, Dynamic Forces in Capitalist Development: A Long-Run Comparative View, Oxford University Press 1991

In the annual "Index of Economic Freedom", the degree of economic freedom is assessed in 157 countries. In 2007, it was published for the thirteenth consecutive year, and measured the degree of economic freedom in 157 countries. The analysis is based on objective data from, for example, the OECD and the World Bank, and looks at ten categories – in turn based on a large number of indicators. The ten categories are: Business, trade, fiscal, government size, monetary, investment, financial, property, corruption and labour. In each category, the degree of freedom for economic exchange is assessed on a scale from 1 to 100.[18] The basic notion is that countries with large freedom for economic exchange are more prosperous.

The correlation between economic freedom and prosperity



As this diagram shows, there is a strong correlation between a high degree of economic freedom and prosperity. Countries with a high degree of economic freedom also have lower unemployment. A core feature of the concept of economic freedom is competition. A high degree of openness to trade, financial openness, functioning markets, low taxes, limited government – they are all about a high degree of competition.

When there are competing entrepreneurs, there will be specialisation – the entrepreneur will specialise in producing whatever he or she does the best. In the village, one might have become a farmer, another might have become a teacher, and a third a baker. And then, they exchanged their goods and services. That way, every person doesn't have to do everything. In the words of Anne-Robert-Jacques Turgot:

The same motive which has established the exchange of commodity for commodity, between the cultivators of lands of different natures, has also necessarily brought on the exchange of commodities for labour, between the cultivators and another portion of

18 Heritage Foundation/Wall Street Journal, 2007 Index of Economic Freedom, www.heritage.org/index

society, who shall have preferred the occupation of preparing and completing the productions of the earth, to the cultivation of it. Every one profits by this arrangement, for every one attaching himself to a peculiar species of labour, succeeds much better therein. The husbandman draws from his field the greatest quantity it is able to produce, and procures to himself, with greater facility, all the other objects of his wants, by an exchange of his superflux, than he could have done by his own labour. The shoemaker, by making shoes for the husbandman, secures to himself a portion of the harvest of the latter. Every workman labours for the wants of the workmen of every other trade, who, on their side, toil also for him.

As technology developed, trade could be stretched to whole regions and nations. Today, we have a global competition and specialisation. The gains of this are well-founded in basic trade theory about absolute and comparative advantages.[20] One recent study estimated the gains for the United States from trade, the figures are likely to be similar for Europe:

We find that trade opening since World War II has added between $800 billion to $1,4 trillion to the US economy, or about $7 000 to $13 000 per household. More speculative estimates of the potential additional gains from removing the rest of US trade barriers range from $400 billion to $1,3 trillion, or about $4 000 to $12 000 per household. Since trade opening permanently raises national income, these gains are enjoyed annually.[21]

Economic freedom within a country is closely related to its openness to the world. A country that believes in the positive effects of competition within the country is unlikely to try to shield off competition from abroad. An interesting side effect of protectionism has been the fact that before the great wars, international trade has decreased fast. Ben Bernanke, Chairman of the United States Federal Reserve, has done a few observations in that field:

A telling confirmation of Ricardo's insight is that, when nations go to war, their first order of business is often to try to block the other's access to trade. In the American Civil War, the North won in large part because its blockade of Southern ports prevented the Confederacy from exporting its cotton. In the twentieth century, the fact that Great Britain and its allies were able to disrupt German trade more successfully than Germany could impede the flow of goods into and out of Great Britain bore importantly on the ultimate outcomes of both world wars.[22]

Entrepreneurship, trade and specialisation all started in Europe. They all demand free competition. The gains have been enormous – and continue to be. But during

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19 Turgot, Anne-Robert-Jacques, Reflections on the Formation and Distribution of Wealth by M. Turgot, Comptroller General of the Finances of France, In 1774, 1775 and 1776, Printed by E. Spragg, For J. Good, Bookseller, No. 159, New Bond Street

20 Husted, Steven, Melvin, Michael, International Economics, Harper Collins 1995

21 Summary of Bradford, Scott C., Grieco, Paul L. E., Hufbauer, Gary Clyde, The Payoff to America From Globalization, Blackwell Publishing 2006

22 Bernanke, Ben, Embracing the Challenge of Free Trade: Competing and Prospering in a Global Economy, Montana Economic Development Summit 2007, Butte, Montana, 1st of May 2007

a few decades, Europe left the traditional path of free economy and competition step by step. The centrally planned war economy was perceived as superior to the market economy. The visible hand was widely considered better than the invisible one.[23] Taxes were doubled several times, companies were socialised, markets were regulated, welfare services delivered by public monopolies and social security systems, such as pensions, run by the state. Consequently, European economies began to stagnate:

In the 30 years from 1945 to 1975, west European countries that had been devastated by war rebounded with astonishing speed. From 1950 to 1960, German GDP grew at an average of 7.9 per cent a year. The number of private cars in France and Germany increased 20-fold between 1950 and 1966. The spread of affluence and the rise of the consumer society became a familiar story across the western world, but growth in Western Europe was even faster than in the United States. Average income in Western Europe rose from about 40 per cent of American levels in 1950 to just over 70 per cent by 1973 … But whereas some peripheral European economies boomed after joining, the core European economies that they sought to emulate began to stagnate … Average income levels, having risen to 70 per cent of America's in the early 1970s, have been stuck there ever since and are now declining in relative terms.[24]

From the 1980s, however, many European countries reversed the development again, with policies relying less on the ideas of Karl Marx and John Maynard Keynes and more on Friedrich Hayek and Milton Friedman. State interventions in the economy were rolled back – by decreasing taxes, selling state-owned companies, cutting subsidies, de-regulating markets and opening up for trade. Many restrictions against competition were abolished. Free economic exchange was facilitated. In the countries that did the most reforms, there were very strong results in terms of growth, employment and rising living standards. But many countries in Europe did not increase competition in the economy more than marginally, such as Italy, Germany and France, which explains parts of their continued relative decline against the US.

The countries that launched the most radical reforms also experienced substantial social improvements. In the highly reforming United Kingdom and Ireland, the share of households with a net income of $ 20 000 a year or below, decreased by two thirds between 1990 and 2004, whereas the decrease in the not so reforming Germany and Belgium was quite limited. The incomes of the poorest 10 per cent of the population increased between 1995 and 2004 by 79 per cent in Ireland, 59 per cent in Britain but only 10 per cent in the somewhat less reforming Sweden.[25]

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23 Blundell, John, Waging the War of Ideas, Institute of Economic Affairs 2005

24 The Economist, Public spending, 18th of March, 2004

25 Euromonitor, World Income Distribution 2006/2007, www.euromonitor.com/World_Income_Distribution

In fostering globally successful companies – “champions” – the main path is not state interventions. The United Kingdom is a prime example of that. Anyone can just compare the success of the large British companies like BP today compared with their terrible state during state ownership and protection against competition during the 1970s. The Forbes list of the world’s largest corporations today contains few examples of state-owned, protected, companies, especially among the quickly emerging ones.

Forbes Top 10, 2006[26]

Citigroup
General Electric
Bank of America
American Intl Group
HSBC Group
ExxonMobil
Royal Dutch/Shell Group
BP
JPMorgan Chase
UBS

[26] Forbes, The World’s 2000 Largest Public Corporations, 2006, http://www.forbes.com/2006/03/29/06f2k_worlds-largest-public-companies_land.html

Capitalism Versus Communism

Communists and agrarian reformers believe they offer the solution to the second of these problems (unequal distribution of wealth). They are mistaken. Their method of distribution kills production: equal sharing abolishes competition and, in consequence, labour. It is distribution carried out by a butcher, who kills what he distributes. It is impossible to accept these specious solutions. To destroy wealth is not to share it.

Victor Hugo, in Les Misérables

Why is Eastern and Central Europe so different in 2007 compared to 1987? Factors like geography, culture, religion did not change. What is completely different is the political and economic situation. In 1987, Eastern and Central European countries were involuntary parts of the Soviet Union sphere and its totalitarian political system with the centrally planned economy. Now, the countries of that region have stable democratic institutions and market economies, and indeed many have joined both Nato and the EU. In the economic sense, they are a showcase of what happens if you destroy competition completely – and what happens when you radically open up for it.

When the Berlin Wall came down and Iron Curtain was lifted in 1989-90, the massive misery in these countries became open to the world. The centrally planned economy had destroyed not only wealth but also the environment and peoples hopes for the future.[27] In a society where bureaucrats decide everything, there is no need to do anything. There will be no creativity, no entrepreneurship, no improvements, no progress – just hopelessness. Living standards and social conditions will deteriorate. This is indeed what happened too. There were differences between the various Marxist-Leninist systems in different countries, but the centralisation of the economy was largely the same.

The Soviet Union economic system centralized ownership and production. By definition, with a centralized production, there is no competition. Everything is managed top-down, with bureaucrats making calculations of demand and sending dictates about production. There is no room for ideas, innovations or entrepreneurs. Any proposal about changes would disturb a very complex, hierarchical order of production. This is a main reason why the centrally planned economy destroyed resources and eventually collapsed.[28] For decades, it never even managed to meet the most fundamental needs among citizens – the lines of people waiting for bread were the trademark of these countries.

In the early 1990s, after liberation from oppression, many feared that these countries would never be able to compete. Their old industries, protected from competition, producing according to central dictates, would have to be shut down. There were widespread fears that there would be mass unemployment, sharp increases in poverty and indeed migration to the West. Thus, there were also recommendations from various international organisations to reform slowly and open up stepwise. The fears proved to

[27] World Database of Happiness, http://worlddatabaseofhappiness.eur.nl/

[28] Predicted and described by Friedrich Hayek already in 1944, and he also pointed out that a centrally planned economy can never be combined with democracy. Hayek Friedrich, The Road to Serfdom, 1944

be unfounded. In retrospect, some fifteen years later, the countries transformed very rapidly. And the more radical the free-market reforms were, the more substantial have the positive results been.[29]

Growth levels have on average been twice the rate of the average in EU-15 – the European Union before the big enlargement in 2004 – during the last ten years.[30] This success is especially true for the three Baltic countries, with growth rates at about ten per cent during the last years. Part of this is probably a catching-up effect, but if that had been the dominating explanation, why were they not catching up in 1987?

Few believed that the countries of eastern and Central Europe would join the EU very fast, at least not more than one or two countries. Rather triumphantly, eight post-communist countries joined in 2004 and two more in 2007. Olli Rehn, EU Commissioner for Enlargement, concluded that: "Many doomsday scenarios preceded the Eastern enlargement, none of which has materialized". In a number of Eastern and Central European countries, the average income has increased by more than 100 per cent, also in the groups with the lowest incomes.[31]

Trade in the ten new EU members, exports plus imports, represents 93 percent of their GDP on average, compared with an EU-15 (the old members) average of 55 percent. The EU-10 also attracted significant new foreign direct investment (FDI), reaching a total of 191 billion euro in 2004, or 40 percent of their total GDP; it was virtually non-existent only a decade earlier. In the countries of the former Soviet Union and the countries of Eastern and Central Europe, the number of people living in poverty decreased by 40 million between 1998 and 2003.[32]

In the early 1990s, many feared that the countries of Eastern and Central Europe would be dependent on foreign aid for many years. Quite the contrary – they quickly became fairly strong competitors, and some politicians in the West started worrying about how to restrict their opportunities to compete, for example by EU tax harmonization. But one country did become partly dependent on foreign aid – the five states of Eastern Germany. They did not launch radical free-market reforms, instead Western Germany started to provide huge amounts in subsidies. It is probably fair to say that this is now the least successful of all the parts of Eastern and Central Europe. Instead of reforming and competing, they received money for nothing.

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29 An account of the early years after liberation can be found in Holmes, Leslie, Post-Communism, Polity Press 1997

30 European Commssion, Eurostat, http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=Yearlies_new_economy&root=Yearlies_new_economy/B/B1/B11/eb012

31 Euromonitor, World Income Distribution 2006/2007, www.euromoitor.com/World_Income_Distribution

32 World Bank, Growth, poverty and inequality: Eastern Europe and the Former Soviet Union, World Bank 2005. European Commission, Enlargement, Two Years On: All Win As New Member States Get Richer, 3rd of May 2006

Today, only marginal sects argue that a fully centrally planned economy is an attractive alternative. This has proven in theory and practice to be a highly destructive economic system. But the comparison of Eastern and Central Europe in 1987 with 2007 is relevant, both to show what complete absence of competition leads to as well as what rapid reforms to increase economic freedom actually creates. Also, sometimes, it is important to see the broad picture and the opposite ends of a scale to be able to understand the finer nuances. If absence of competition proves to be a complete disaster, why would it be any good to be half way towards that situation?

Areas in Need of Competition

A state is better governed which has few laws, and those laws strictly observed.

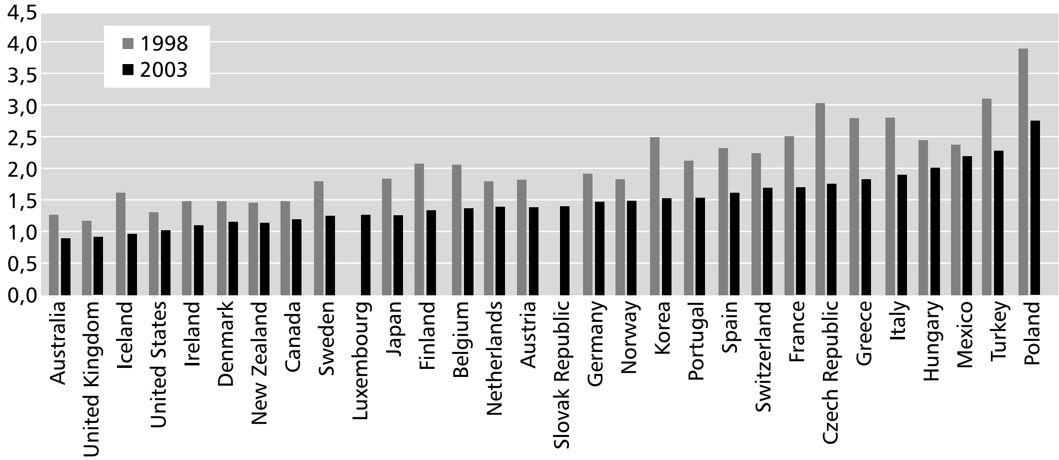
Réné Descartes

The trend towards more state interventions and less competition was indeed reversed about two or three decades ago. Throughout the OECD, there have been reforms that have withdrawn state interventions and increased competition once again. This has not least happened in European countries. The results have often been better than expected. But a lot more can be done to increase competition. The aim can not be to abolish every regulation or tax – there will always be a need for regulations that facilitate the functioning of the market and of taxes that pay for public expenditure. But there remain a great number of unnecessary interventions that are harmful in a number of areas, where competition could increase substantially.

Product Markets

Imagine regulations demanding that hairdressers have to be closed on Mondays, that there is a limit on the number of allowed tour guides in a city, that petrol stations are forbidden to sell anything but oil products, that you can't sell your motorbike without a notary writing a complicated contract, and there is a fixed number of taxi licenses in parts of cities through the decades. Up until recently, that was the case in Italy.[33] And that is just a handful of regulations in product markets, which were parts of everyday life in many European countries. This is now decreasing, as the diagram below shows.

Product market regulation, OECD countries, 1998 and 2003[34]



The sum of market regulation indicators in each country, with high levels showing more regulations

[33] Barber, Tony, Michaels, Adrian, In For a Trim – An Italy Anxious For Growth Tries To Stimulate Competition, Financial Times, 28th of February, 2007, http://www.ft.com/cms/s/b2e1dbca-c6d0-11db-8f4f-000b5df10621.html

[34] OECD Statistical Database, May 2007, http://www.oecd.org/dataoecd/25/9/34634249.xls

There are still large differences in the degree of regulation in product markets. Evidence suggests that about half the difference in prosperity between the United States and euro area can be explained by less competition in the euro area.[35] That is, lacking competition is responsible for several thousands euro in lower annual income for the average European – and still, the United States could also benefit from more competition in several areas. There is a need for further de-regulations in European product markets, such as energy markets.

Since a number of product markets have been de-regulated in European countries, there is a lot of evidence about the positive effects. Of course, they may differ, due to differences in reform design and implementation. Telecom markets have largely been de-regulated, and since 2000, the EU weighted average charge of a 3 minute call has fallen by 65 per cent and the cost of a 10 minute call by 74 per cent.[36] Similar developments have been observed in other de-regulated product markets. There will be more entrepreneurs that compete with new solutions to satisfy consumers.

Competition in financial markets is also very important for long-term prosperity. There is evidence that there is a positive correlation between financial sector competition and financial openness. And the more financial competition there is, the higher is economic growth.[37] There are still a number of national restrictions in parts of the financial markets and thus a great need of de-regulation.

Entrepreneurship

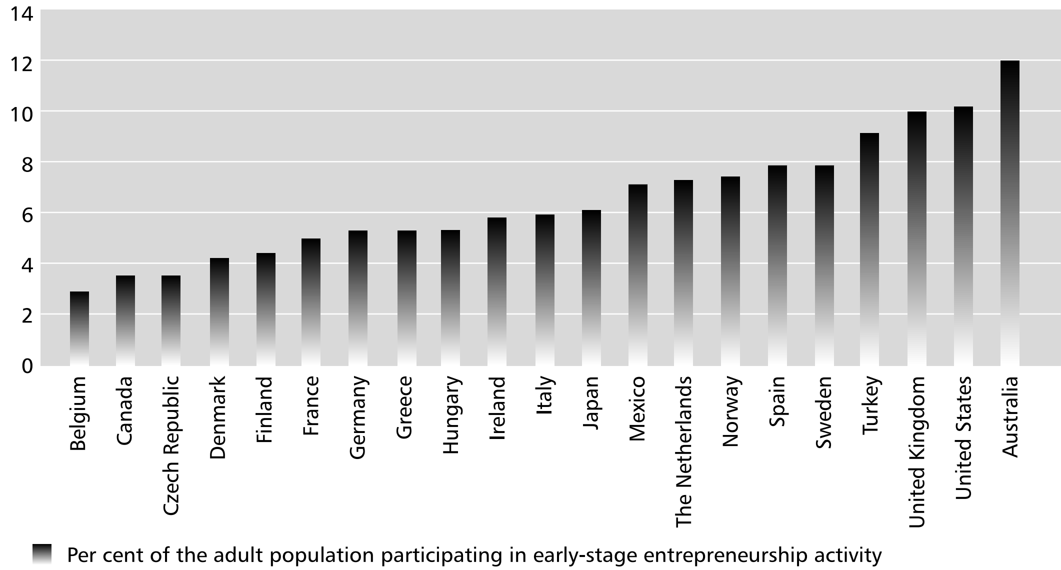
Historically, entrepreneurs have had an essential role for economic development, and it is the entrepreneurs that have to be allowed to compete – not least by easily entering product markets. The degree of entrepreneurship is relevant when analysing competition. The Global Entrepreneurship Monitor combines the new business owners with those in the process of starting a business, and thus creates a figure for early-stage entrepreneurship activity. The highest levels of entrepreneurship are in Australia, the US and the UK, and the lowest levels are in Belgium, Canada and Czech Republic.

[35] Bayoumi, Tamim, Laxton, Douglas, Pesenti, Paolo, Benefits and Spillovers of Greater Competition in Europe: A Macroeconomic Assessment, Federal Reserve Bank of New York, Staff Report No. 182, April 2004

[36] Reding, Viviane, The Review 2006 of EU Telecom rules: Strengthening Competition and Completing the Internal Market, Annual Meeting of BITKOM, Brussels, Bibliothčque Solvay, 27 June 2006

[37] Francois, Joseph, F, Schuknecht, Ludger, Trade In Financial Services: Procompetitive Effects And Growth Performance, Centre for Economic Policy Research, Discussion Paper No 2144, December 1999

Early-stage entrepreneurship activity in selected OECD countries, in 2006[38]



The levels are quite different, not least due to differing policies. If the state makes it hard, expensive, bureaucratic and risky to start a business, many people will be more likely to refrain from doing it. Those factors differ substantially between countries. One study compared the levels of entrepreneurship in OECD countries with the degree of economic freedom and found a strong correlation between low levels of economic freedom and thus large state interventions and low levels of entrepreneurship.[39] If a country wants to increase entrepreneurship, it should increase economic freedom and roll back many interventions by the state.

Labour Markets

Many European labour markets have massive amounts of state interventions, which limit free economic exchange and thus competition. They may be of different kinds: regulations, taxes or public activities. They affect hiring and firing practices, workplace rules, safety, and even the kind of language allowed. In various ways, the interventions also decide how, with what, where, and when people work. The interventions affect pricing through taxation and semi-public roles for trade unions, notably collective bargaining. Finally,

[38] Bosma, Niels, Harding, Rebecca, Global Entrepreneurship Monitor, GEM 2006

[39] Björnskov, Christian, Foss, Nicolai J, Ökonomisk Frihed och Ivaerksaetteriaktivitet – En Lande-Undersögelse, CEPOS, 22nd of January 2007

there are a number of mandatory social insurance systems. These are not all harmful or should be abolished – neither is that possible. But excessive interventions create substantial problems.

The United States has more limited state interventions in the labour market, though there are parts of that which are harmful too. A comparison with Europe can still be relevant. Consider that between 1970 and 2003, employment in the U.S. increased by 75 per cent. In France, Germany, and Italy, it increased by 26 per cent.[40] In 2004, only 13 per cent of unemployed workers in the U.S. were unable to find a new job within 12 months; in the EU, the figure was 44 per cent.[41] In the EU, average youth unemployment is 17 per cent. In the US, it is 10 per cent.[42]

But the best comparisons can be made within Europe. Denmark has an employment rate of 76 per cent, but Poland is far lower at 53 per cent. Youth unemployment is above 20 per cent in Greece, Italy, Sweden, France, Belgium, and Finland and below 8 per cent in Ireland, the Netherlands, and Denmark. The degrees of labour freedom, as defined by the World Bank in their Doing Business Reports, are generally higher in countries with high employment and low unemployment.[43]

High taxes on work and high contributions for not working will also create incentives against productive activities. In the US, the income will rise by 30 per cent if you go to a job from being on unemployment benefits, in Estonia the rise is 35 per cent and in Slovakia a very high 57 per cent. But in France, for example, the increase would be a mere 18 per cent and in Sweden only 13 per cent.[44] The state interventions possibly have the aim of improving social conditions, but they harm the very foundations of social progress.

State interventions in various markets – in particular the labour markets – may have the exact intention of restricting competition, because competition is seen as harmful. But if they have the – unintended – consequences of creating vast unemployment, surely the interventions have proven counter-productive? Sometimes, the regulations are motivated by attempts to prevent "social dumping", that is, people competing with lower wages. But countries that liberalized have seen the largest increases in incomes, not least for low-income earners. That is the result of competition.

[40] Gersemann, Olaf, Cowboy Capitalism: European Myths, American Reality, Cato Institute, 2004

[41] Furchtgott-Roth, Diana, What US Labor Laws Can Teach Europe, Financial Times, 11th of August, 2005

[42] European Commission, Eurostat, http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=Yearlies_new_population&root=Yearlies_new_population/C/C4/C42/ccb30992

[43] World Bank, Doing Business, http://www.doingbusiness.org

[44] European Commission, Eurostat, http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=STRIND_EMPLOI&root=STRIND_EMPLOI/emploi/em042

Taxes

In reality, countries don't compete. It is the residents of a country that do; entrepreneurs, investors, working people. What the country and its politicians do is that they set many of the conditions for those that really compete. When discussing "national competitiveness", what is really discussed is the national conditions for a German entrepreneur to compete with an Italian entrepreneur. There are many factors that will determine whether the conditions are good or bad. But just as entrepreneurs need the freedom to compete, countries need the freedom to create competitive conditions for their inhabitants. One of the important factors is taxes; where, how and how much tax is levied by the state.

Governments know fairly well how much a certain tax will damage a particular economic activity; the price elasticity is calculated precisely. They actively attempt to raise taxes on environmentally harmful emissions and tobacco, to make polluting and smoking less attractive. There are numerous studies that have shown the adverse effects of high tax pressures on the economy.[45] The main issue is how harmful the taxes actually are. In today's world, tax bases have become mobile, and several tax rates have started to decrease. The KPMG auditing and accounting company finds the OECD countries to have reduced their corporate taxes by seven percentage units between 1996 and 2003.[46]

Countries today also compete with tax levels in order to create a competitive environment for business, investments and work. One example has been the spread of flat tax rates after Estonia's introduction of flat tax in 1994. There are today 16 flat tax jurisdictions.[47] Fears have again been raised that this is a race to the bottom, and that in the end there would be no tax revenues – and thus has to be stopped somehow. In fact, there are numerous benefits form tax competition. The countries that have decreased tax rates have experienced great benefits, not just in terms of growth and employment, but also in tax revenues. Estonia's revenues have increased every single year since 1994 despite the tax rate being lowered from 26 to 18 per cent. Ireland decreased the corporate tax stepwise from 50 to 12,5 per cent – and the revenue as a share of GDP tripled. The benefits from tax competition can be summarized as follows:

Tax competition brings great benefits, to all society and not just to those who directly take advantage of it. But the greatest benefits go to those countries that work in harmony with global free markets, not those protectionists who try to erect barriers against the

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45 A few examples are: Tanzi, Vito, Zee, Howell, H, Fiscal Policy and Long-Run Growth, IMF 1996, Working Paper 96, Ahmed, Shagil, Temporary and Permanent Government Spending in an Open Economy, Journal of Monetary Economics, March 1986, Fu, Dong, Taylor, Lori L, Yücel, Mine K, Fiscal Policy and Growth, Federal Reserve Bank of Dallas, 2003, Working Paper 0301, Davis, Steven J, Henrekson, Magnus, Tax Effects on Work Activity, Industry Mix and Shadow Economy Size: Evidence From Rich-Country Comparisons, in R Goméz-Salvador et al, Edward Elgar 2005, Abrams, Burton, The Effect of Government Size on the Unemployment Rate, Public Choice, Vol 99, June 1999, Bassanini, Andrea, Scarpetta, Stefano, The Driving Forces of Economic Growth: Panel Data Evidence for the OECD Countries, OECD Economic Studies no 33, OECD 2001, Engen, Eric M, Skinner, Jonathan, Fiscal Policy and Economic Growth, NBER 1992, Working Paper 4223

46 The Economist, A Taxing Battle, 31st of January, 2004

47 Mitchell, Daniel J, Flat World, Flat Taxes, The American, 27th of April 2007

tide. … Tax competition…provides incentives for governments to spend more wisely. By preventing taxes from becoming too high, tax competition boosts economic welfare, productive investment and employment. Low-tax jurisdictions also make global capital markets more efficient.[48]

Attempts – from individual governments, the OECD or the EU – to harmonize taxes or restrict tax competition in other ways, would harm all the countries affected by that regulation. They would find it harder to attract investments, create new jobs and foster entrepreneurship. Other countries in the world – those who still compete with taxes – would benefit.

Welfare Services

When per capita GDP grows and our incomes rise, we may increase savings, private consumption or pay more taxes for public consumption. With more resources for private consumption we may have things like holiday journeys, DVD players, eating out, new clothes, and perhaps a weekend cottage. When we can afford this, demand for more and better welfare services increase; it has been called “the discontent of rising expectations”. To match the growth of quality and quantity in private consumption of goods and services, then, the publicly provided welfare services also have to increase. If these services should continue to be delivered by tax-funded public monopolies, the public sector will grow and taxes rise.

Public monopolies have a number of difficulties. The lack of competition and the attempts to deliver numerous services to everyone has lead to inefficiency. The European Central Bank has analysed public sector efficiency in 23 industrialized countries, and reached the conclusion that, the smaller the public sector, the higher the level of efficiency – and the bigger the pubic sector, the lower the level of efficiency. In other words, the more the public sector is assigned to do, the less efficiently it performs.[49]

Indeed, there are problems in welfare services in European countries today – of different kinds and degrees. The public health care systems find it difficult to produce the right services at the right time, creating waiting lists. Some people pay a second time and leave to other countries in the world to have treatment. Universities are largely part of the tax-funded public sector in Europe and only one Continental European University makes it to the Top 40 in the world – in Zürich, Switzerland.[50] Though these issues are very complex, some of these problems are definitely results of lacking competition. Public monopolies are in essence centrally planned systems, and though there may be good intentions from both those running the systems and those working in them, there are problems.

[48] Teather, Richard, The Benefits of Tax Competition, Institute of Economic Affairs, 2005

[49] Afonso, António, Schuknecht, Ludger & Tanzi, Vito, Public Sector Efficiency : An International Comparison, Frankfurt: European Central Bank, ECP, 2003 (Working Paper 242)

[50] The Times Higher University Rankings, http://www.socialcapitalgateway.org/eng-deprankings.htm

There is evidence that entrepreneurship and competition in health care has increased efficiency and shortened waiting lists.[51] Countries that have introduced school choice – for example by school vouchers, allowing students to choose and thereby introducing competition – have increased education quality.[52] And Universities, not least in the US, that compete and are allowed private funding have a completely different quality.

The possibility of introducing more competition in welfare services lies with national governments. But there is an opportunity in launching policy measures in order to increase trade, and thereby competition, in welfare services. This is increasingly possible, thanks to the emergence of welfare producers in countries like India, as well as the technological development in, for example, health care. A services directive within the EU that included health care and education would have increased competition among European providers, to the benefit of Europeans in general.

[51] OECD, Competition In the Provision of Hospital Services, Directorate for Financial and Enterprise Affairs, Competition Committee, 27th of October 2006

[52] Ahlin, Ĺsa, Does School Competition Matter? Effects of Large-Scale School Choice Reform on Student Performance, Department of Economics, Uppsala University

Global Competition

We Africans no longer want contributions. We would rather have the opportunity to compete, to sell our goods at the market of the West, to get investments and participate more in the global trade.

Yoweri Museveni, President of Uganda

Globalization – what it is and what effects it has – is frequently discussed today. The most basic definition is that the institutions and policies of a free economy are spreading over the world. Barriers to free exchange have been taken away or been decreased. International trade and investments have been increasing sharply. Hundreds of millions of Indians and Chinese have joined the global work force. They have left poverty behind. More people than ever have the opportunity to create a better life for themselves and their children – by starting a business, working and competing.

The fact that countries like China and India gain competence and create healthy business climates implies that they will be able to produce goods and services that they can make available to consumers in the US and Europe. As consumers, we all benefit from the new, better and cheaper products like DVD players or digital cameras. In fact, lower consumer prices are just as important as wage increases, especially for people with low incomes. We all gain from the current booming global economy as well. Wealthier consumers in Asia will demand goods and services from Europe and the US too.

In turn, this enhances global specialization. Currently, quite a few manufacturing, information technology, and service jobs are moving to Southeast Asia. As the productivity of the people in these countries increases, even more high-skilled jobs are likely to depart. It is essential to recognize, however, that rising Asia is not stealing jobs, as in a zero sum game. It is a plus-sum game. This can be instanced with the case of Delta Air, which in 2003 moved 1 000 ticket reservation jobs from the US to India and saved $ 25 million in the process, sufficient to hire 1 200 new workers in the US for more qualified positions.[53]

But Europe has to be competitive to be able to attract investments and jobs in the future, not least those with a high productive value that are thus well-paid. And our labour markets have to be free enough to create new and better jobs that can replace the old jobs. Just as we are much better off today than we were when the majority of the population worked in agriculture, we will be better off as we continue to let manufacturing jobs go. Subsidising old industries or protecting old jobs may in the worst case succeed – and in that case, the new and better will not emerge. Jean-Baptiste Say famously described the consequences of policies of protectionism and state intervention:

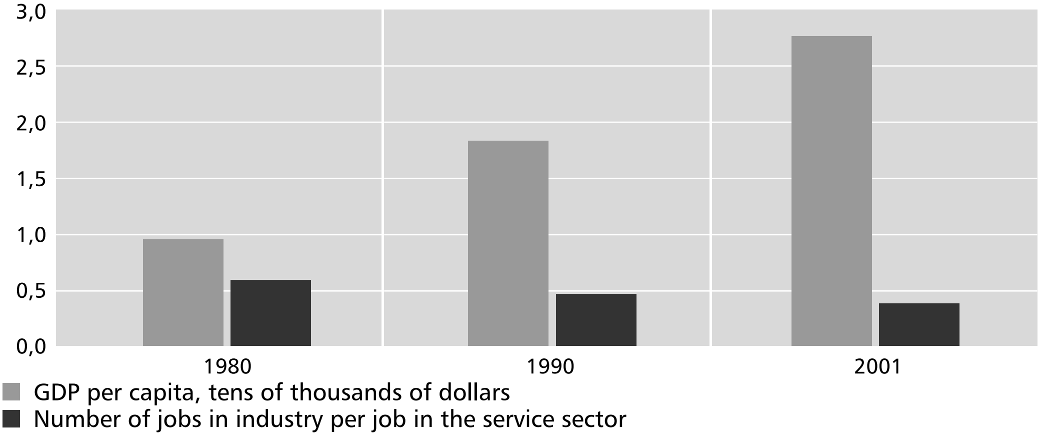
This is precisely the case, when authority grants to a particular class of merchants the exclusive privilege of carrying on a certain branch of trade, the India trade for instance; the price of Indian imports is thereby raised, without any accession to their utility or intrinsic value. This excess of price is nothing more or less than so much money transferred from the pockets of the consumers into those of the privileged traders, whereby the

[53] Drezner, Daniel W., The Outsourcing Bogeyman, Foreign Affairs, Vol. 83, No. 3, May/June 2004

latter are enriched exactly as much as the former are unnecessarily impoverished. In like manner, when a government imposes on wine a tax, which raises to 15 cents the bottle what would otherwise be sold for 10 cents, what does it else, but transfer 5 cents per bottle from the hands of the producers or the consumers of wine to those of the tax-gatherer?[54]

About 70 per cent of the work force in Western Europe today is employed in the service sector. We know now that the larger the share of services is in the economy, the higher the level of GDP per capita and the lower the level of unemployment.[55] For decades, industrial production has continued to rise, but employment in that sector has been decreasing. This reflects the productivity development. In competitive sectors, there is a lot of innovation, and firms constantly improve production – not least with new technology. More people are employed in services jobs, also in the industrial corporations. This is not a development to resist; it should be welcomed and facilitated.

The more services jobs, the wealthier



Competition – national and international – is the driving force for improved production and a society of new jobs and prosperity. Change will by definition always take place, and as more countries and people are part of this development, it speeds up. A challenge for policymakers is how to facilitate the development towards the new. The creative destruction definitely has an element of destruction. People have to get opportunities to switch from the old to the new, which is an issue for education systems and labour markets. That is a more productive political focus than attempts to restrict competition and stop change.

It is a fact that the average European gets older. This is both due to low birth rates in many countries and that we live longer – the latter of course a great success of humanity rather

54 Say, Jean-Baptiste, A Treatise on Political Economy, 1803, http://www.econlib.org/library/Say/sayT1.html#Bk.I,Ch.I

55 World Bank, World Development Indicators 2005, at http://publications.worldbank.org/ecommerce/catalog/product?item_id=631625

than a problem. But it also means that governments cannot stick to the policies and systems of a society where the demographic situation was very different. If we continue to force people to retire at 60 despite them living several healthy decades more, Europe will not be competitive in the future. The taxes to pay for public pensions for so many retired people would take the business climate to the ice age. This also goes for the taxes to pay for public health and elderly care.

Reforms that make retirement age more flexible and introduce more competition in welfare services would defuse what is sometimes referred to as a demographic bomb. This also highlights the need to open up Europe more for immigration. A person coming to Europe, start a business and perhaps hire someone in the future would be a gain for the European society. There are numerous substantial gains from immigration, for immigrants and previous residents alike.[56] Achieving the full gains from immigration however demands that they are able to join the labour market or start a business.

[56] Legrain, Philippe, Immigrants – Your Country Needs Them, Little, Brown Book Group, 2007

The Role of the European Union

You recognize but one rule of commerce; that is (to avail myself of your own terms) to allow free passage and freedom of action to all buyers and sellers whoever they may be.

Francois Quesnay

The European Union – and its predecessors – has undoubtedly played an important role in increasing competition in Europe. By establishing free trade in goods among its members, it countered national protectionism. The extension of the freedom of mobility in principle to capital, services and people further opened up the member states. Economic exchange was facilitated, which contributed to economic growth. This has also increased the interdependence between the member states, and one original intention was that this would benefit peace throughout Europe. Enormous amounts of barriers to competition have been torn down by the work of the EU institutions.

The single market program was launched in 1992, and a number of studies have analysed the effects so far. Trade has increased more than it otherwise would have, which has also boosted competition and thus contributed to a higher level of productivity.[57] EU GDP is estimated to be some 2 percentage points higher today than it would have been without the single market. Furthermore, it has been estimated to have led to the creation of an additional 2,75 million jobs.[58] Following the liberalisations of energy and telecom markets, as part of the EU Lisbon Agenda, consumer prices have decreased.[59] The 2004 EU enlargement also enlarged the single market, further boosting its effects on trade, investments and growth.[60]

The single market has boosted competition in Europe and thus increased European global competitiveness. For the single market, there is a single EU competition policy. There may be reasons to debate some of its implications and analyse its effectiveness. But it has a very important role in curbing national subsidies and protectionist regulations.[61] In global trade, where the EU also has exclusive powers, there is also an immensely important task in working for more openness to trade in the world. The idea of creating a single market across the Atlantic – recently supported by Chancellor Angela Merkel – is one interesting task.

Free trade in goods is established within the EU, but there is a long way to go to achieve a more open and integrated European market in services. Despite the fact that most

57 European Commission, The Macroeconomic effects of the Single Market Programme After 10 Years, 16th of May 2006, http://europa.eu/internal_market/10years/background_en.htm

58 European Commission, A Single Market for the Citizens, 21st of January, 2007

59 European Commission, DG Energy and Transport, http://europa.eu/energy/gas/publications/index_en.htm

60 European Commission, Enlargement, Two Years After: An Economic Evaluation, Bureau of European Policy Advisers, and DG ECFIN, No. 24, May 2006

61 More about the EU Competition Policy, the current situation and needs for the future, in European Commission, Report on Competition Policy 2006, 25th of June, 2007

people today work in the production of services, most of the trade is still in goods. There is a great potential in increasing trade in services – thus increasing competition among service producers in Europe. A recent study compiled 85 examples of protectionist barriers against entry into other European markets for a Swedish service producing company. The barriers may be special national demands for documentation, controls, certifying, taxes, or bureaucracy in general.[62] The approved Services Directive is one step forward, but it is very limited. More needs to be done by the EU, also in the financial services sector.

The EU has, however, also launched policies that have created new barriers to competition in Europe. The agriculture policy is of course the prime example of a policy designed to protect the old producers against change in general and competition in particular. The CAP is costly, reduces productivity and seriously hampers trade – and keeps poor countries in poverty. Another example is the EU working-time directive, creating European limits on working time, closes several opportunities for companies and countries alike to compete. And the recent EU interventions in the telecom markets, capping the prices, will distort competition and indeed may create difficulties for producers to meet certain demands of consumers.

During the last decade, there have also been a number of proposals that the EU should make even more substantial interventions to restrict competition. Harmonising taxes is one returning topic, as well as more labour market regulations. The proposed new Treaty of the EU contains elements that might open up for more restrictions on competition. Such measures would be very harmful indeed – hurting consumers, reducing growth, stopping the new jobs and in general set Europe on a path of decline in the world. And such policies are based on the same old misconceptions of competition as they always have been.

Just as public power on any level – local, national or international – the European Union can either launch policies that increase competition or increase control. The dominating effect of the EU and predecessors historically has been opening up for more competition, but there have been very notable and serious exceptions. In recent years, in particular, there have been many tendencies towards policies against competition. By reversing that development, and having competition as a leading aim, the EU would play a very beneficial role for Europe, reconnecting with the European ideas of entrepreneurship and competition that once set us on the path to prosperity.

[62] Confederation of Swedish Enterprise, 85 exempel pĺ protektionism, June 2006

Summary and Agenda for Competition

The state is the great fictitious entity by which everyone seeks to live at the expense of everyone else.

Frederic Bastiat

In general, the art of government consists in taking as much money as possible from one party of the citizens to give to the other.

Voltaire

Europe was the first part of the world to become wealthy. Today, many other parts have followed and have become at least as wealthy. The origins of European wealth creation can be described as the institutions for a free economy. Entrepreneurship and competition set Europe on a path to prosperity that has led to marvellous results in terms of increased living standards.

During a few decades after World War II, Europe went in the opposite direction, abandoning the successful roots of wealth creation. During the last decades, however, European countries have started to decrease state interventions again, opening up for more competition. But much remains to be done. There would be great gains for Europeans if policies increased competition in product markets, labour markets and welfare services. Opening up for trade, immigration and, above all, entrepreneurship would also increase competition.

Policies of "protection" against competition are counterproductive; everyone will be losers, especially in the long run. Central control is the opposite to freedom and entrepreneurship; they cannot be combined. Protectionist policies are for those that do not believe in their own abilities to compete, and thus attempt to protect previous gains. Europe should have more confidence in its future.

Eastern and Central Europe is a showcase for the world about the significance of competition in a society. When competition was erased by the centrally planned economy, the countries were devastated. As reforms – often rather radical – increased competition and economic freedom in general, the results were astonishing. Eastern and Central Europe are now the most vital parts if Europe, to the benefit of all Europeans.

The EU has historically contributed substantially to increasing competition in Europe. The single market and enlargements increased trade, competition and thus growth. But the EU have also created new barriers. The future direction of the development of the EU is uncertain, indeed that is illustrated by the debates about the new Treaty. But if the EU were to have free competition as a main aim, it would benefit European prosperity very much.

There are a number of policy measures that could increase competition in Europe, which can be launched locally, nationally and European-wide. There is probably not a lack of knowledge about what to do or disbelief in the substantial positive effects of more competition. It is a matter of political direction and determination. President Nicolas Sarkozy has presented a number of reforms in France that would increase competition. The only logical reform strategy is to pursue the same policies for Europe as for France.

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