

ALL IS NOT WELL IN EUROLAND

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The great experiment to homogenize the monetary, tax and trade policies of the 300 million souls of Europe is struggling forward. On a recent trip to Germany and Ireland, we personally experienced a pervasive, but necessarily temporary, campaign to escape a central law of economics: the Law of One Price.

The law of one price simply states that in the long run identical goods cannot sell at different prices, after adjusting for differences in the costs of taxes and transportation. In establishing the euro as a single currency across the European community, Germany and the rest are rediscovering its perils. The sharp price increase incurred by translating from deutsche marks to Euros will result either in a sharp drop in the quantity demanded, or in a wrenching downward ratchet of all German

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prices. A vendor of internationally traded goods cannot price above the market and, in the long run, neither can local restaurateurs or service providers.

Having lived in Germany just three years ago, we were shocked at how expensive the country had become, even for auslanders like ourselves. Rather than posting prices consistent with the exchange rate, many vendors and restaurateurs seem merely to have transcribed their prices from deutsche marks to Euros—a nearly 100 percent markup. No wonder that Germans have dubbed the new currency the “teuro,” from teuer—expensive.

Those price dislocations are slowing Germany’s economic recovery. For the past six years, Germany has had either the slowest growth or second-slowest growth in Europe. Exports are up—now more than a third of GDP—and prosperity is down. Put another way, Germany is exporting capital through its trade account surplus—a disinvesting economy.

Adding to the mess is a myriad of laws to “protect” consumers from “excess competition”—low prices! This same thicket of laws protects workers from being laid off and German companies from being acquired. Price-comparison ads, for instance, are verboten. RyanAir, the Irish-based version of SouthWest Airlines, openly flouts this law, selling out every plane and gladly paying its fines. Under an “anti-discount” law, German companies are free to raise prices but cannot lower them without government approval. Or paying another fine.

Higher prices means fewer goods sold and more unemployment. At 10.4 percent, Germany’s jobless rate is almost double the U.S. figure. Shops are empty and restaurants are only frequented by the expense account crowd. Retail sales continue to stagnate after six years of no real growth.

Not all the news is dire. Last year corporate taxes on retained earnings were cut from 40 percent to 25 percent; corporate capital gains are tax-free. By 2005, phased-in reductions will bring the top personal income tax rate from 51 percent to 42 per-

cent. But the “teuro” and excess regulation continue to punish the overall economy. Prices and quantities will adjust as they always do. But the adjustment for consumers will be slower and more painful—thanks to all those wonderful “consumer protection” laws.

In Ireland we found a very different story. As we know, the Irish bow to no one, and Dublin has refused demands from Brussels to “harmonize”—hike—its tax rates. But for how long? Our Irish business contacts fear a reversal of the supply-side policies that have made the country one of Europe’s few successes. Ireland’s annual GDP growth since 1995 has been 9.4 percent, compared with the European Union’s 2.6 percent average. The Eurocrats cannot bear side-by-side comparison of Irish prosperity with the Continent’s stagnation. But the future of the European economy may depend on Dublin’s resolve in continuing to resist the pressure to “harmonize.” And if the Euro’s spread portends a suicide club of steadily ratcheting taxes, the prospects for the who world economy will deteriorate.

Irish consumers fare far better than their “protected” German counterparts. But they, too, face a wrenching confrontation with economic realities long denied. Unlike Germany, Ireland actively discouraged vendors from raising prices with the introduction of the Euro. Prices were rounded up but not hiked. But revealed in the move to a single currency was the reality that an Irish potato—the national staple!—costs three times its German equivalent. Protests have begun, and arbitrage and the law of one price are already starting to work.

Living with the Euro turns out to be more revealing than a lot of people expected. The contrast between supply-side Ireland and hidebound Germany offers lessons for the U.S. economy as well, as we see the president imposing new onerous taxes on U.S. consumers of steel while purporting to reduce the taxes across the board. The U.S., too, will have its own day of reckoning with the inexorable law of one price. ■