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**Upheaval in the World Economy – Challenges and Opportunities
for Europe**

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SUMMARY

Europe as the largest world's trader has benefited most from the opening up of the world economy to global competition. What Europe needs is a strategy of continuous adaptation to changes in the world economy. Changes remain inevitable and sometimes they are disruptive. But globalisation is not a disaster for Europe, it has brought European consumers enormous benefits, allowing them to enjoy rising standards of living even at low levels of real growth in the economy. The European policy response to the challenges in the world economy should be threefold. First, what is needed is major improvements in Europe's capacity to compete through investment in education, research and increased flexibility in the economy. Second, the nature of today's key drivers of competitiveness makes growth coming from below, from the mobilisation of local capital an essential element of the policy response. Third, as firms today break production processes into steps that can be performed in any location to reduce costs, Europe – instead of competing only – can also cooperate with China.

Ladies and gentlemen

It is a great pleasure for me to speak once again at the European Forum Alpbach. This is a reflection both on the quality of the participants and on the environment in which this symposium is held annually. We all need to thank the founders back in 1945 for their choice of Alpbach.

And let me say that I will probably add to my own ten commandments a new one today: never speak after Theo Sommer. It is quite a challenge now to speak after his wide-ranging keynote address. I would like to make a few remarks on the implications of the 'upheaval' in the world economy on the policies of our Member States and of the European Union.

Reading the European press one gets the impression that the growing importance of countries like China and India in the world economy is a disaster for Europe. Politicians talk about delocalisation and its catastrophic impact on jobs in Europe; there is even some talk of punishing companies which move capacity abroad. Coming from Poland, I am particularly sensitive to the arguments one hears about unfair competition from the new Member States of the Union.

I am sure it will not come as a surprise to you if I claim that the opening up of the world economy to global competition has been one of the major factors stimulating world economic growth, as productivity has risen around the world. The success of a series of trade liberalising rounds in the World Trade Organisation has been a major benefit for the European Union – the world's largest trader. This is the reason why we are not happy with the present situation in the Doha Development Round and why we would like to move the negotiations forward.

If we ask ourselves from where these economic gains have resulted the answer is that they come from a new pattern of economic activity. The new pattern of comparative advantage has meant that certain activities, especially in manufacturing industry, have declined in Europe as they developed in China, India or elsewhere. Such a new pattern of comparative advantages has also emerged in Europe after the 2004 enlargement.

It is worth pointing out that these changes are not new but are part of the continuous adaptation of production to changes in the world economy. Just outside Brussels there is a village called Hoeilaart, which prior to the opening up of agricultural markets in Europe, specialised in the production of grapes for the Belgian market. This industry, employing many of the villagers, was eliminated by competition from southern Europe. Is Hoeilaart now an impoverished place? No of course not! It is a prosperous suburb of Brussels.

I have been given a very limited time slot, but I cannot refrain from sharing with you my favourite quotation about structural change. In his famous letter the Governor of New York wrote to President Andrew Jackson in 1829:

'The canal system of this country is being threatened by the spread of a new form of transportation known as 'railroads'If canal boats are supplanted by railroads serious unemployment will result. Captains, cooks, drivers, hostlers, repairmen and lock-tenders will be left without means of livelihood.As you may well know Mr. President, 'railroad' carriages are pulled at the enormous speed of 15 miles per hour by 'engines' which, in addition to endangering life and limb of passengers, roar and snort their way through the countryside, setting fire to crops, scaring the livestock and frightening women and children. The Almighty certainly never intended that people should travel at such breakneck speed.'

The railroads were built and America is the world's economic powerhouse with high growth rates and low unemployment.

Change remains inevitable but it is true that it can be disruptive. The rise of China and other major manufacturing centres has certainly led to the relocation of industrial capacity out of Europe. Even within Europe there has been a very limited relocation of plant from the old member states to the new. In employment terms, manufacturing, and indeed agriculture, now play relatively far smaller roles in our economies. It is partly a result of the rise of the service sector, partly it is following the rapid rise in productivity in those sectors. It is true that some employment in manufacturing has been 'lost' to the east.

At the same time, the rise of China, India and other formerly agricultural countries as industrial powers has led to an increased competition for

resources. Increasing prices for oil, metal ores and other raw materials can be partly attributed to the enormous increase in demand from these new industrial powers. And I dare say that if China was still a backward agricultural country we would probably not be paying over \$70 per barrel for oil.

But again I am sure you will not be shocked if I claim that in Europe the debate on globalisation does not provide for enough room to the argument that it has brought us enormous benefits. We, as European consumers, are paying extremely low prices for labour intensive products, such as textiles and many basic electrical products, which we used to produce ourselves but at vastly higher cost. This is one of the reasons that inflation has been able to be kept at historically low levels in the Union over the last decade. This has allowed consumers to enjoy rising standards of living, even at relatively low levels of real growth in the economy. One could say that the average Chinese worker has been subsidising the average European consumer over the last decade and a half.

The new industrial powers are not only suppliers of cheap imports. They are also major markets for our sophisticated industrial and service exports. And these markets will go on expanding into the medium- and long-term future.

But even if we wanted to, could we do anything to try to prevent 'delocalisation' and raw material price inflation? Well we could of course close our economies to imports from these countries and renege on our WTO commitments; but we all know that we would be the ones who suffered most in such a situation. Closing one's markets, if one is the world champion in exports, does not appear to be a very sensible strategy.

So the question is: can we compete? Well there is no way that we can compete on labour costs in basic manufacturing with China. What capacity remains in the Union in these sectors will be delivering extremely high

productivity, producing unmatched quality or living behind some very specialised trade barrier. Our labour force is frequently guaranteed an appropriate standard of living, through the maintenance of legal minimum wage levels and very high standards of health and safety legislation. So no wonder that no one is seeking to re-establish basic low productivity sectors in Europe through weakening our social safeguards.

We can and do compete successfully in advanced manufacturing and in the provision of services – and indeed in agriculture and food industries - but that is another story! But in many of these areas we are or will be very soon short of skilled labour to staff expanding businesses. Even in my country Poland, there are serious labour shortages in several key sectors, in spite of an unemployment level of around 15%.

Of course the conclusion of this argument is that we in Europe will find it ever more difficult to employ unskilled labour, and shortages of highly skilled and educated labour will hold back our development. If this is a valid analysis, it has major implications for education and training policies, for research and development, for labour market policies, for migration policy and also for regional policy, my portfolio in the Commission.

So what should the policy response be? I want to make two points here: a general point, and a point related to regional policy.

First the general point. To a greater extent than ever before, the Commission and Member States are emphasising the need for the Union, on the one hand, to invest in education, training, research and development and on the other to increase flexibility in the economy. The consequences of not doing this would be a slow decline, reducing our influence and power in the world and increasing internal pressure on the internal market and the monetary union.

It is this awareness that led the European Commission chaired by President Barroso to relaunch the Lisbon agenda for economic reform with a clear focus on growth, jobs and competitiveness, and to make this the centrepiece of this Commission's policy. While many of the levers for bringing about change lie with the Member States, this relaunched policy involves them in a much more structured process of priority setting, reporting and exchange of best practice.

Let me mention five basic elements of this strategy.

First, increased emphasis on research and development is a major part of the Lisbon Strategy. Our aim is to raise spending on R & D to 3% of our GDP by 2010 from under 2% currently. Even though measuring R & D expenditure is a difficult area, especially in the service sector, it is clear that our expenditure is far below this level, and far below the levels in the US and Japan.

Second, greater investment in education and training is also vital, not just to ensure that our citizens find jobs in the expanding high-value added sectors of the economy but also to avoid social tensions caused by high unemployment levels. It is also important for the integration of some migrant groups, which are threatened with exclusion from the main-stream through poor educational preparation for life in a fast changing labour market. With a better educated workforce and easy access to training and continuous education, we will be better able to adjust to the ever more rapidly changing technological basis of the economy and evolving demand patterns. We have set ourselves a target of 2% of GDP invested in higher education by 2010. This is an ambitious objective, up from 1.3% today, but one which is widely accepted to be essential.

Third, this adjustment will also require the labour market to be more flexible than it is at present. Labour market flexibility is another key aim of the

Commission's Growth and Jobs Agenda. Interestingly we see that where the official labour market regulation seems better adapted, new patterns of employment are developing. In some countries this takes the form of labour supply companies which flexibly provide labour to other companies, elsewhere temporary contracts are being used on a large scale. Part-time work is now a very significant part of total employment. This new labour market requires regulation to avoid exploitation. It also poses significant challenges for social security and pensions. Nevertheless flexibility holds advantages both for the employer and the employee. Above all it allows higher levels of employment to be achieved in our economies.

Fourth – the importance of risk-taking and entrepreneurial energy. They are major components of our future success in this upheaval in the world economy, and in view of demographic trends in Europe. We therefore need to unlock the business potential of our SMEs. We need to reduce significantly the administrative burden that they face; we need to facilitate the setting up of businesses, and we need to make entrepreneurial education more widely available in our school curricula.

Let me turn now to regional policy. One of my key priorities as European Commissioner has been to ensure that regional policy is at the heart of the growth, jobs and competitiveness agenda. I am convinced that it has an essential role to play in triggering solutions to the problems we face, and in allowing us to rise to the challenges of globalisation. Why is this?

First, it is increasingly evident that many of the key drivers of increased competitiveness that I have just mentioned – research, knowledge, innovation processes, support for SMEs, are better understood and more quickly set in motion at the local level. It is at the regional and local level that we find the essential knowledge for identifying problems and appropriate solutions

Second, in order to drive innovation, we need partnerships between universities, firms and financial institutions; networks to disseminate good practices; and involvement of public bodies as catalysts or as providers of innovative services. Again this is best done at local level – top-down strategies are not sufficient.

And finally, if we ensure that all the relevant players are involved in policy design and implementation, the sense of ownership which results greatly increases the chances that these policies will be implemented effectively and efficiently.

That is why in the reform of regional policy an emphasis has been put on the following key elements.

- There is a more strategic approach which aims at integrating the growth strategies at European, national, regional and local level. This comes with reinforced subsidiarity to ensure that the right players are involved at all levels.
- We have increased budgetary concentration on the priorities of R&D and innovation, entrepreneurship, human capital, ICTs, as well as accessibility of the region.
- We are aiming for a greater leverage effect – making our money go further - by introducing new instruments to mobilise private investment and financial expertise alongside the public assistance.
- And for the first time in the history of Europe's regional policy we are involving key financial institutions – the European Investment Bank, European Bank for Reconstruction and Development, European Investment Fund) to expand the available financial resources, to

improve the quality of projects, and to introduce a new management culture.

On this basis we are now working closely with the Member States to ensure that the significant amount of regional policy funding which is available for the next 7 years – more than €350 billion – is invested in ways which will help us to adapt to rapidly evolving global environment.

(Ladies and Gentlemen)

In my view the Union is at a critical point in its development. If we use the opportunities presented by the 'upheaval in the world economy', we can look forward to rising prosperity and high employment levels. We will be better able to defend our fundamental values, which include solidarity between citizens of the Union, between member states and their regions, and solidarity with the developing world. Our influence in foreign policy will be greater and we will therefore be better able to expand the area throughout which our basic values prevail, increasing both external and internal security.

I am an optimist so I will spare you my analysis of the situation in Europe in twenty years time if we miss this opportunity. But improving, in a sustainable way, our capacity to compete is only a half of the policy response. The second half is about cooperation. We must forget about the traditional distinction between the core and the periphery. Today firms are breaking their production processes into discrete steps and performing each step in any location that reduces costs. International production chains, development of global supply chains bring substantial productivity gains. We can easily discover that Brussels and China are close enough to build bridges.

Only if the Union remains a dynamic centre of the world economy it will be a place where its citizens can continue to enjoy its unique quality of life.

Thank you.