

## On European Strengths to Master Global Challenges

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Ladies and Gentlemen:

In this short speech I would like to address two main issues which in my view are crucial to the future development of Europe. One regards the great challenges which we are facing nowadays in a world characterized by globalization and by the process of transformation from industrialized to science- or knowledge-based economies. The other regards the specific strengths of Europe to master these two great challenges, their detection and the understanding of their economic and political potentials to spur economic growth and to create new jobs in Europe. Exactly these two goals lie in the centre of the Lisbon Strategy of the European Union, on which we are mainly focusing in this forum.

In the following I will present my ideas on the basis of five central theses. Each of these theses will be formulated first, and then be elaborated analytically and – as far as possible – corroborated empirically.

Let me begin with my first thesis:

Each historical era has its specific economic challenges.

And in each era there emerge champions that manage to find the best solutions to the challenges that are typical of these different eras.

Looking back at the economic developments in the previous decades, we find strong support of this thesis.

In the 1950s and 1960s, and to some extent also in the 1970s, the "world champion" of economic growth was Germany, its growth dynamics became known as the German *Wirtschaftswunder*. The economic challenges of these days have mainly been determined by the reconstruction of a destroyed country, and later by balance of payment problems and especially by the oil crises. Those challenges gave an edge to countries like Germany that had

at the firm level the entrepreneurial spirit combined with a strong working force and at the political level the right mixture of institutions to set free the necessary energies which brought up growth and employment and coordinated wage and price settlements. A close relationship between the banking sector and the business sector, apprenticeship programs, workers' representatives in board of directors, powerful unions and an extensive social welfare system seemed to be the right prerequisites for economic success in those decades, just contrary to nowadays.

In the 1980s the "champion" in terms of economic success was Japan with lifetime employment and pay by seniority. These specific and at the same time human features gave Japanese firms the organisational and competitive power to catch up with western companies and to conquer the international markets. In the particular case of Japan as well, it seems that the very factors that have once lead to strong economic growth nowadays constitute the highest barriers to economic success and dynamics in Japan.

Throughout the 1990s the United States was the country with the greatest economic performance, because it was able to give an answer to the major problem of these days, namely by creating high employment levels and by implementing new technologies into production processes and in this way by spurring high productivity and economic growth. But eventually, the formula for success of the USA has taken its toll. At least, the US economy presently is in a difficult situation. A situation that started with the bursting of the financial bubble in the year 2000 and that is characterized by high private and public indebtedness as well as by a growing trade deficit.

But, related to the issues we are dealing with in this forum, what can we learn from these examples?

First, the great economic challenges that come along with different eras change over time. Second, the location and the formulas for success of economic champions change over time as well, depending on the ability of firms and regions to establish the conditions for market success and economic growth. Third, there exist no general economic and political rules in the sense that these would always pave the way to economic success. Instead, it is required to

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meet the existing economic challenges and to react timely to the ongoing structural changes with pragmatism and experience. Besides these abilities one also needs to be fortunate in some way or the other in order to succeed.

But, what are the economic challenges we are facing right now? And, given these challenges, what are the attributes of an economy that aims to become a "champion"?

To answer these questions, my second thesis is:

Our present main economic challenges are twofold. The first regards an increasing globalization of economic activities. The second regards the profound changes of economic, social, cultural and technological structures in western economies. These changes signify a deep transformation process of these economies from industrialized to science- or knowledge-based economies.

For more than a decade, large parts of our economic processes are determined by a phenomenon that is meanwhile commonly expressed by the term "globalization". "Globalization" affects many economic regions on different levels of economic activity. In this process of globalization, continents and economic regions have been continuously approaching, not only by means of modern information and communication technologies but also by means of globally spanning networks and value chains of multinational enterprises. In addition to these developments, many of the formerly centrally planned economies in Eastern Europe are in a transformation process away from once stagnating and rigid economies towards dynamic market economies. Moreover, two economies with large populations and extremely low labour costs, namely China and India, have appeared as new "global players" on the international economic arena.

The second great challenge, the transformation process towards science-based economies, has to be considered as being equally dramatic. It proceeds with high dynamics and affects all fields of social and economic life. Especially its economic consequences are manifold and already today they bring about profound changes of the foundations for and the conditions of economic success. Knowledge has developed into a central factor which in the future not only will determine the shape and the development of financial, services and commodity markets, but also the production processes and the organization structures in business firms.

Especially the development and application of technological know-how as well as the ability to generate and commercialize innovations will strongly affect the competitiveness of companies and entire regions. Price-competition changes into technological competition, based on innovations. This kind of competition has its own rules and requires new formulae for success. Traditional economic theory still fails to deal with this kind of competition and the economic principles behind it.

My third thesis therefore is:

The two greatest challenges of our time – globalization and the transformation to knowledge-based economies – cannot be resolved by a single country alone in Europe. Only the EU as a whole provides a suitable institutional framework within which its members can co-operatively handle these challenges.

If it proceeds as rapidly as it does today, globalization will lead to a more intense international competition of business firms and of entire economic regions than ever before. The technological change towards knowledge-based economies, which advances as rapidly as the process of globalization, requires large investments in education, research and development activities. These investments are necessary on the level of business firms as well as on the macroeconomic level. National firms of normal size and, respectively, smaller countries will not be able to make such large investments. Only large countries, such as the USA and in the near future China and India have the size to handle such great changes. The argument of country size, especially in terms of the number of customers in an internal market together with the argument of firm size will affect the ability to compete on global markets. If size advantages in production, in the commercialization of new products and technologies as well as in distribution have ever been important for economic growth and development in the past, as the case of the USA has shown, its relevance has even grown within the previous years.

Through its various enlargements in the past, the EU now has the necessary population size and the necessary production and market capacities to compete with other globally oriented economic regions. Due to its size, the EU can now offer great opportunities to the business firms in its member countries in order to act and succeed as "global players" on international markets.

Besides size, the advantages of a common market and a liberal political frame are further necessary conditions for economic success. An economic union alone which is still characterized by high cultural and language barriers, different consumption patterns, diverse capital markets and low international mobility of the work force will not be able to meet the requirements for economic success. What is needed is an integrated Europe that is ready and able to harmonize. This applies not only to the markets for goods and services, and the financial sector, but also to the education and science system, the legal system as well as to the rules for patenting and standardization. In all these fields there apparently exist several significant weaknesses that need to be overcome in the future.

This leads me to my fourth thesis:

Looking at the process of globalization and considering the pace of technological advances, the conceptual background of the EU as well as its strategic orientation have to be modified. To bring about these modifications, the Lisbon Strategy is an appropriate approach, provided it will be realized efficiently.

Since its foundation, and apart from the creation of a common market, the goal to "achieve greater equality across Europe in productivity and income" constitutes the central objective of the EU. By means of several structural and cohesion funds, this objective has been realized quite successfully. But success in the past can develop into a burden for the accomplishment of present tasks, as the examples of Germany, Japan and the USA have demonstrated. From this background, the definition of the Lisbon Strategy and especially the objective to turn the EU into the "most competitive and dynamic knowledge-based economic region in the world by the year 2010" can only be approved. It can be approved because the Lisbon target exactly takes account of the challenges of globalization and technological change that the EU is already confronted with.

Unfortunately, the implementation of the Lisbon target has proceeded quite sluggishly and insufficiently, as the recently issued "Sapir Report" and the "Kok Report" confirm precisely. In essence, both reports sharply criticize the lacking political will of both the EU administration and of the governments of the EU member countries to develop and implement concrete political action along the lines of the Lisbon target. Apparently, the new President of

the European Commission, José Manuel Barroso, is pursuing this aim much more vigorously than his predecessors once were doing. However, how could or how should the realisation of the Lisbon target be performed?

Concerning this big question my fifth thesis is as follows:

To realize the Lisbon Strategy, the European Union has to concentrate on its strengths, it has to bundle them and support them by political measures. The main strengths of the EU lie (a) in its diversity on national and regional levels, (b) in the willingness of its member countries to co-operate and (c) in the deep solidarity of the richer members with poorer countries.

One of the crucial findings of Schumpeterian Theory is that the existence of "variety" or "heterogeneity" is an essential precondition for growth and for the augmentation of welfare in capitalistic economies. That applies to firms as well as to nations or regions. Variety lays the fundament for a successful division of labour and for novelties in society and economy. It is therefore essentially responsible for change and progress in all fields of human living.

Having this in mind, we can say that there is no other economic area on earth which is as distinguished by variety or diversity as Europe. Recognizing and using the economic potential of its variety could become one of the most important tasks for European decision-makers in the future. This is true for firms as well as for nations or regions.

For firms, it offers an economic area almost without any national barriers or other obstacles. This area presents countries with cheap labour costs in the East as well as high-technology centers in the heart of the continent. Depending on its needs and its business strategy it becomes possible for a firm to create value chains that can bundle and organize the specific strengths of the individual member states and of individual regions – without having to consider high transaction costs. While research and development activities are carried out in one region that is well endowed with highly qualified personnel and with technological know how, scale intensive goods are manufactured in another region where production costs are relatively low.

Variety also enables competition on the national political level. A simple tax system operating with a low flat rate for enterprises and households, such as the one that has lately been introduced in Slovakia, shows its positive effects also in the nearby countries of the EU, in

Austria and the Czech Republic – maybe also soon in Germany – and forces them to introduce similar reforms. There are many more examples in all political fields, such as public education with Finland as the model country, the social sector with Sweden, or the field of labour economics with Denmark as the standard-setting EU members.

However, its regional variety can be viewed as being the main advantage of the European Union as an economic region. Up to now, EU politics has primarily looked at the immense differences in per capita income and social welfare among individual member states or regions and has classified them as the main problem of the EU that had to be eliminated by adequate measures, mainly by financial transfers and a policy of financial redistribution. However, from a point of view in which growth and technological change come into the main focus, one may find entirely new insights.

Not only the OECD has rightly identified local and regional conditions as being amongst the driving forces of present economic development. Also, the European Commission has stated in a recently released report that in the past decades changes in modern production technology had lead to a situation where regional particularities increasingly gain importance. Not "great politics" might improve the conditions of producers and consumers. Rather, on the regional level firms can do much more to improve growth and welfare. The keyword reads "creation of regional clusters". According to Porter, such a cluster is defined by firms and institutions which lie geographically close by and which are linked together and in this way build up a specific industry. They share the same technologies, consumer markets or a common pool of employees in a co-operative as well as in a competitive manner. Thereby, they become more productive and prepare the basis for new firms and consequently also for more growth and employment.

The significance of this "new regionalism" might seem quite natural for federal states such as Germany, for instance, but for many Europeans it is new; for some supporters of a central state, like France or Spain, it might even be subversive.

However, the success of regional clusters or innovation networks in modern technologies like life sciences or ICT, where firms, universities, laboratories and local authorities closely co-operate, apparently confirms the concept of regionalism. The Basque country, for instance,

which for a long time had suffered from a declining heavy industry, has developed into one of the richest regions in Spain. Out of the former industrial ruins new clusters grew: nowadays such branches as the automotive supply industry, machine tool manufacturing or the telecom industry are flourishing. The region is growing much faster than the EU average. Similar developments can be observed around the Oere-Sund in Sweden and Denmark, where in the so-called "Medicon Valley" the pharmaceutical industry is prospering, or in the region around Munich, where biotechnology found one of its European centers.

It is always the combination of scientific institutes, infrastructure, the right political conditions and an adequate workforce which in the end constitutes a new industry. This industry is able to establish a regional network and, without deleting the necessary competition, will strengthen regional growth and, as a natural consequence, also the growth of nations and that of the EU.

But, on the regional level as well, geographic borders become much more flux in the present era of globalization. Like on the level of business enterprises, it is indispensable for regions to identify specific strengths and to build necessary linkages with other regions, comparable to multinational firms which have to resort to the strategy of "global business management", being based on the view that market success is strongly determined by the willingness to cooperate and to create strategic networks, regions and even entire nations now have to be embedded in a similar framework of co-operation. In this respect, namely the creation of mutually beneficial and at the same time flexible networks of regions, Europe faces great challenges for its future integration. It has to provide an institutional framework for and to set off a new kind of EU-specific "co-operative competition of federalist-like regions". This could generate a form of fruitful and harmonic living together in Europe that allows for the combination and the bundling of national and regional strengths, but that also makes it possible to compensate for national and regional weaknesses.

"Solidarity", understood in this way, rather has the meaning of financial compensation for existing disparities in economic performance and welfare levels within the EU, as it until now has been the central target of European policy making. Solidarity of the richer with the poorer countries and regions in the EU gets a far more complex character. It implies a political concept and a strategy which allows to notify the specific strengths and weaknesses of

different regions and nations and to react to them in a manner of cooperative competition. The main idea behind that is not to equalize the existing differences solely by means of financial redistribution, but on the contrary to foster and financially subsidize their specific strengths.

Via such a program, characterized by the idea of clustering and networking and based on a “regional system of cooperative competition”, a process may be initiated which in the end can help all countries involved, the richer as well as the poorer ones. Even the EU as a whole may, on the basis of the Lisbon agenda, gain the leadership compared to other economic regions in the global competition.

In this context financial support programs of the richer members will soon lose the character of mere transfer payments. Instead they can be considered as a kind of “venture capital” for future investments, which can induce a self-performing process of prosperity.

From such a perspective the principle task of the EU and its institutions is to serve as a catalyst and to push, coordinate and evaluate the process of regional development.