PECOB
Portal on Central Eastern and Balkan Europe

EU COMPETITIVENESS IN A GLOBALIZED WORLD

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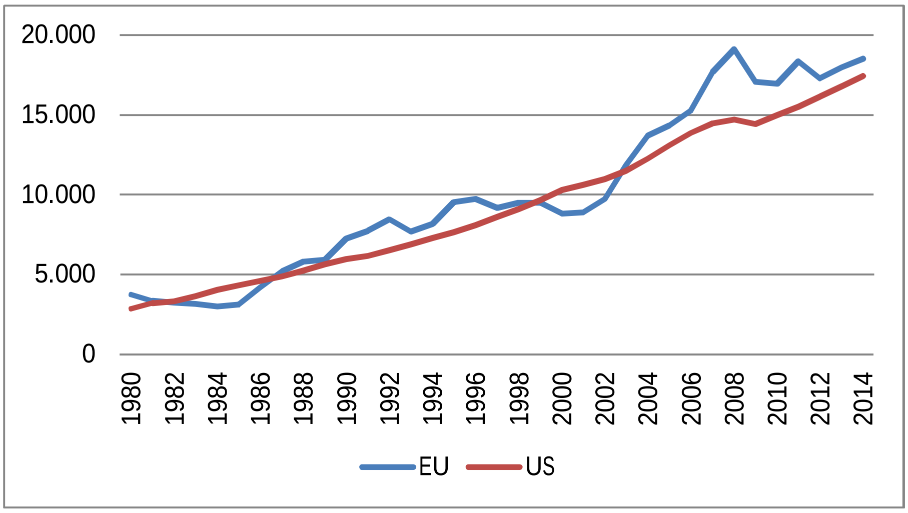
Globalization has been an attribute of international relations for centuries, if not millennia, yet its economic dimension may have truly materialized only with major advances in information technology, in particular the internet phenomenon. According to the International Monetary Fund, the term ‘has come into common usage since the 1980s, reflecting technological advances that have made it easier and quicker to complete international transactions—both trade and financial flows’ (IMF 2000). And for most of this period it was the European Union (or forerunning it European Communities) which dominated the global economy in terms of output size, exceeding that of the US for 27 out of last 35 years, including consecutively since 2003 (see Figure 1). One can thus say that the EU has been a locomotive of globalization, to a great extent setting its rules and overseeing their implementation through a plethora of international organizations, both public ones and NGOs. But the economic power of the EU may be not so much a reflection of its size as a market, as of its competitiveness potential. To be sure, it was Europe where modern industrial civilization has originated, and it was Europe which pioneered on the way to the post-industrial economic order.

Figure 1. EU/US GDP at current prices, thousand bn USD



Source: IMF 2015

Despite fundamental structural problems and differences among its members, the Union holds enormous competitive power, which can be verified not just by its GDP volume, but also in international competitiveness comparisons of its individual members. For instance, in the latest edition of an influential Swiss-made ranking (which will be touched upon in more detail later in the analysis) none of the 28 EU members scored less than 4 index points (i.p.) on a scale from 1 to 7, while their simple average of 4.74 would place the EU in a hypothetic 28th place among 144 countries, somewhere between China (28th with 4.89 i.p.) and Estonia (29th with 4.71 i.p.) (Schwab 2015, p.14). Similarly strong seemed EU industrial competitiveness according to a recent report by the Vienna-based United Nations Industrial Development Organization: by a simple average of its members' values it would stand 23rd among 133 (see Table 1).

Table 1. Competitiveness rankings of EU member states

	WEF 2015 / 144	*IMD 2014 / 60*	*UNIDO 2013 / 133*
Austria	21 (5.16)	22 (73.699)	16 (0.2436)
Belgium	18 (5.18)	28 (66.595)	9 (0.3114)
Bulgaria	54 (4.37)	56 (45.784)	59 (0.0460)
Croatia	77 (4.13)	59 (38.974)	50 (0.0603)
Cyprus	58 (4.31)	-	-
Czech Republic	37 (4.53)	33 (62.213)	20 (0.1931)
Denmark	13 (5.29)	9 (84.040)	24 (0.1705)
Estonia	29 (4.71)	30 (64.383)	52 (0.0583)
Finland	4 (5.50)	18 (78.159)	18 (0.2220)
France	23 (5.08)	27 (67.941)	10 (0.3095)
Germany	5 (5.49)	6 (85.872)	2 (0.5176)
Greece	81 (4.04)	57 (42.244)	49 (0.0653)
Hungary	60 (4.28)	48 (52.505)	29 (0.1402)
Ireland	25 (4.98)	15 (80.360)	15 (0.2695)
Italy	49 (4.42)	46 (52.871)	11 (0.2945)
Latvia	42 (4.50)	35 (61.848)	68 (0.0367)
Lithuania	41 (4.51)	34 (62.014)	47 (0.0674)
Luxembourg	19 (5.17)	11 (82.164)	42 (0.0761)
Malta	47 (4.45)	-	61 (0.0452)
Netherlands	8 (5.45)	14 (81.144)	12 (0.2896)
Poland	43 (4.48)	36 (61.767)	25 (0.1696)
Portugal	36 (4.54)	43 (54.403)	34 (0.1043)
Romania	59 (4.30)	47 (52.841)	46 (0.0675)
Slovakia	75 (4.15)	45 (53.302)	27 (0.1562)
Slovenia	70 (4.22)	55 (46.245)	32 (0.1152)
Spain	35 (4.55)	39 (57.913)	19 (0.1979)
Sweden	10 (5.41)	5 (85.833)	13 (0.2850)
United Kingdom	9 (5.41)	16 (79.814)	14 (0.2782)
AVERAGE	28 (4.74)	29 (64.4203)	23 (0.1744)

Sources: Schwab 2015; IMD 2014; UNIDO 2013

Notes: / - number of countries covered; in brackets – respective index points

Undoubtedly, the global financial crisis that began in 2008 has had a significant adverse impact on the EU competitiveness. Above all, it has laid bare the fundamental problem of the European economic integration in its current form – the divergence between the North and the South (sometimes referred to as the “core” and the “periphery” respectively). It was supposed to be smoothened by various policies, including structural, regional and monetary ones, but was instead exacerbated after the crisis. This divergence means that competitiveness within the common market is not uniform, which certainly prevents raising the level of the overall EU competitiveness vis-à-vis other global economic players – the US, Japan, and the leading emerging markets (so called BRICS – Brazil, Russia, India, China and South Africa), as well as the Gulf states, Indonesia, Argentina, etc. It also implies that the European Union cannot have a one-for-all policy approach to tackling its competitive challenges, which would be the case for any nation state.

By contrast, the highly sophisticated nature of the European integration project sometimes creates competitive dilemmas that are not easy to solve without the necessary political will and public support, and the monetary union (EMU) is one of the best examples here. Meant to raise the EU competitiveness in global trade and finance by lowering transaction costs related to currency exchange and political risks associated with national macroeconomic policies, the single currency turned out to be a mixed blessing in the absence of other policy arrangements, notably a common fiscal policy and the banking union. Yet while the latter problem has been largely tackled (Weidenholzer 2015), the prospects for the former are still rather bleak despite its apparent benefits (Allard et al 2013).

In its early stages, the euro did help to improve macroeconomic stability and reduce credit costs for the peripheral countries, thus boosting their spending power and living standards, but once the credit crunch exposed the South’s structural weaknesses, it has become a problem (appropriately exemplified by the continuing Greek woes). No longer could these countries use devaluation as a quick fix to their external imbalances, having to resort instead to more politically unpopular measures such as, inter alia, budget cuts and layoffs. As a result, economic growth has stumbled, unemployment has soared, living standards have fallen and mass protests have become commonplace in many European cities, not just Athens (Jolly 2015).

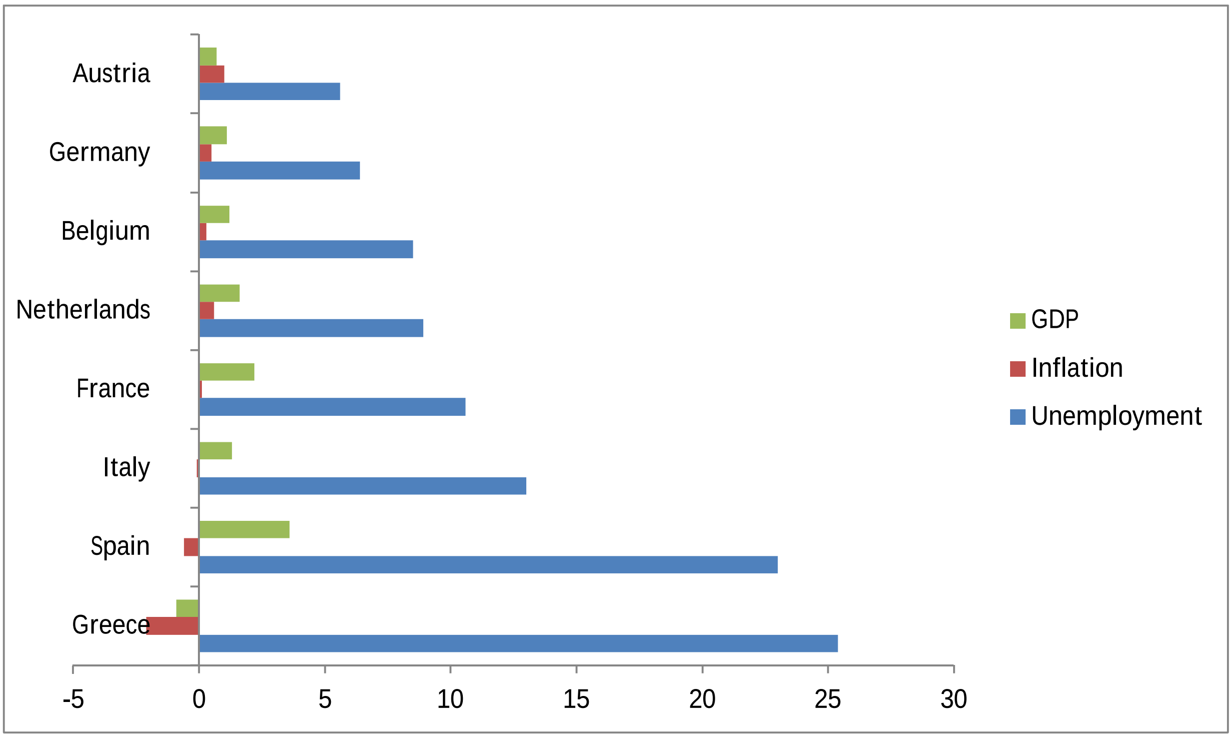
Obviously, this should have been foreseen by the EMU founders, as yet in 1961 Robert Mundell, a Canadian economist who in 1999 received a Nobel prize for his work on optimum currency areas, highlighted the prerequisites of the latter as follows:

‘In a currency area comprising many regions and a single currency, the pace of inflation is set by the willingness of central authorities to allow unemployment in deficit regions... Unemployment could be avoided... if central banks agreed that the burden of international adjustment should fall on surplus countries, which would then inflate until unemployment in deficit countries is eliminated... A currency area cannot prevent both unemployment and inflation among its members' (Mundell 1961, p.659).

To paraphrase Mundell's words in the current EU context, it would be fair to say that unemployment in the South/periphery could be avoided if the European Central Bank agreed that the "burden of adjustment" in form of higher inflation would fall on Germany and other North/core countries. Such a solution, though, seems impossible for several reasons. The prime one among them may be the so-called "Berlin consensus" – a set of economic ideas essentially based on "ordoliberalism" of Walter Eucken and other prominent post-war German economists (Economist 2015a, p.21). According to James Rickards, an American author of several books on global economics, it 'consists of seven pillars: promotion of exports through innovation and technology; low corporate tax rates; low inflation; investment in productive infrastructure; cooperative labor-management relations; globally competitive unit labor costs and labor mobility; positive business climate' (Rickards 2014, pp.121-7). And then there is a shadow of the recent enlargement: Brussels and North/core leaders may be unwilling to show any examples of bad economic discipline to a dozen of post-communist countries who have just adopted the principles of capitalism, yet nevertheless have competitiveness issues that are evident not just in the aforementioned rankings, but on the streets of many East European cities and in the region's recent electoral outcomes (Lyman 2015, p.3).

Reading the most recent economic data, one can nevertheless get an impression that the euro area is undergoing "adjustment" according to Mundell's thinking: North/core countries have higher inflation than those in the South/periphery, yet that does not seem to have any visible effect on unemployment (see Figure 2). Similarly, the difference in growth dynamics may seem considerable, especially in case of Spain, but taken in historical perspective it is hardly significant (and unconvincing to Spanish voters who have set on track of eroding "the country's bipartisan system" by supporting "leftists" (Minder 2015, p.1).

Figure 2. GDP, inflation and unemployment dynamics in selected euro area countries, May 2015 latest data



Source: Economist 2015b

There can hardly be an easy solution to EU's competitiveness problems – it is very unlikely that South/periphery countries will get rid of the euro or leave the Union altogether to regain greater macroeconomic independence and flexibility. Even in Greece, arguably the worst-affected member, there is still a strong support for the euro, on par with the average for the single currency area – 63 and 67 per cent respectively, according to a Eurobarometer survey in autumn 2014 (Eurobarometer 2014, p.25). A more likely scenario is that they will continue to meet the demands of their creditors, cutting budgets, depressing investment and upsetting the electorates. How long it will last is not clear, but it is quite clear that such a scenario is not likely to lead to a sustainable long-term increase of the overall EU competitiveness.

Competitiveness may appear easy to understand as an economic concept yet its contents are quite intricate. On the macro- level, it is not just about exchange rates, wages and inflation – culture, history, geography, geopolitics, and, of course, institutions, both physical (infrastructure) and social (regulations and laws, culture, education, public health) are just as important. Likewise, on the micro- level it is not just about prices and quality that firms win and sustain their competitiveness – management, marketing (and public relations too), logistics, as well as many other factors are in play. And needless to say that either macro- or micro- dimensions of competitiveness should be viewed separate from each other, particularly by policy-makers and experts assisting them, otherwise policies they develop will inevitably be suboptimal and short-lived (an enlightening discussion on the topic can be found in, inter alia, De Grauwe 2010).

The complex nature of competitiveness seems to be well understood by the pioneers and current masters of the respective research, already mentioned in the present paper – the World Economic Forum (WEF) and the International Institute for Management Development (IMD). For example, the annual WEF Global Competitiveness Index draws on 114 indicators distributed in 12 so-called "pillars" (institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labour market efficiency, financial market development, technological readiness, market size, business sophistication and innovation) (WEF 2014). Even more extended seems to be the methodology used by the other established authority in the field – the IMD World Competitiveness Center, which has ranked 60 countries on more than 300 criteria for the past 25 years (IMD 2014). The methodology employed by the European Central Bank (ECB) also involves several hundred indicators to measure competitiveness of the EU members (Benkovskis et al 2014).

This means that nowadays competitiveness should not viewed a something that can be solved simply by currency devaluation, wage cuts or any other simple measures (ideas that are often heard in discussions about Europe's competitiveness). For example, as far as wages are concerned, some economists argue that even with high unemployment, typical for many EU countries, especially from its South/periphery, it would not be realistic to expect substantial wage cuts in some sort of macroeconomic adjustment:

'So if there were really a large excess supply of labour, shouldn't we be seeing wages plummeting? And the answer is no – wages (and many prices) don't behave like that. It's an interesting question why, one that has to be answered in terms of psychology and sociology, but it's simply a fact that actual cuts in nominal wages happen only rarely and under great pressure' (Krugman 2012).

The fact that even the ECB, a chief macroeconomic body of the Union, established a specific Competitiveness Research Network and acknowledged the importance of institutions by devising its own Institutional Competitiveness Index, highlights the complex nature of EU competitiveness challenges. As argued by the ECB's economists Stefan Huemer, Beatrice Scheubel and Florian Walch, imbalances in the EU and the euro area, detrimental to their global competitiveness, are not just about convergence or catching up – they are about institutions, and to be efficient, any subsequent "rebalancing" would require substantial improvement in public policy (Huemer et al 2013).

Globalization has made ever more salient the EU competitiveness challenges while it keeps transforming the economic playing field of the world at a speed many European countries find hard to adjust to. One of such transformations involves industry – nearly half of global manufacturing is already done in Asia, with China accounting for the bulk of it. In 1990, Europe had a share of global manufacturing output similar to that of Asia today, but by 2013 it shrank by more than a half, being only slightly bigger than that of China alone (Economist 2015c, p.61). The other one concerns finance – the reform of the IMF and consequently of the whole global financial order has long been acknowledged overdue, and recent twists and turns around the China-led Asian Infrastructure Development Bank is just one example here (FT 2015, p.8). Even with agriculture, which has long enjoyed a special treatment under the EU's Common Agriculture Policy, there are powerful forces (not least demographic ones) at work that may eventually make Europeans accept the need for more competition and technology in the sector. The lack of progress in negotiations about a new WTO global deal demonstrates that developing economies may not be willing to tolerate more of the same economic rules safeguarding, inter alia, vital EU interests, and will insist on universal access for their agricultural produce in exchange for opening up their service sectors (Beattie 2008).

More than twenty years ago Paul Krugman, the US Nobel laureate in economics, published his famous article titled "Competitiveness is a dangerous obsession", in which he argued that governments should not emulate companies and waste resources on policies to improve national competitiveness (Krugman 1994). Whether Krugman was right or not is still subject to academic debate, but EU policy-makers should be probably better off ignoring his advice and using the opportunities created by the global financial crisis to devise and implement efficient measures at boosting the Union's competitiveness in the age of "hyperglobalization" (Donnan 2015, p.6).

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