

European economy 2008: Challenges of a globalized world

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The 2008 report by the European Economic Advisory Group shows that Europe is increasingly more dependent on the world's other economies.

The European economy will be increasingly defined by its interdependency on the world's other economies, which are currently immersed in a fierce growth race. This is one of the conclusions of the 2008 report on the European economy by the European Economic Advisory Group (EEAG), of which [IESE Prof. Xavier Vives](#) is a member.

[The report](#) reviews the main factors behind the strengths and weaknesses of the European economy, including the weight of the U.S. economy, the future of industry and global warming.

In spite of the mortgage crisis in the United States, the world economy in 2007 saw major development. World GDP grew 5 percent for the fourth consecutive year, though the risk of a slowdown increased due to the turmoil in the financial markets and the slowdown of the American economy.

Meanwhile, the European Union registered 3 percent growth in 2007 thanks to the momentum of Germany, Spain and the United Kingdom. The cost competitiveness of European countries was seriously diminished by exchange rates. Nevertheless, net exports fueled the growth of GDP in the eurozone.

At the national level, Spain's strong internal demand - particularly in sectors other than real estate - was its most important growth factor, although last year's real wage increase was

minimal.

The credit crisis caused a loss of confidence in the European Union's production capacity. That, along with the appreciation of the euro and the consequent decline in U.S. imports, has led to plummeting growth for the European Union. The situation has been further aggravated by the slow expansion of investment in Europe during the first half of 2008.

In any case, the report's authors predict that the production gap will remain positive and that employment will increase. Private consumption will increase at the same rate as last year due to high inflation.

Globalization and employment

According to the authors, the risk of unemployment deriving from globalization could be due to the lack of flexibility in the European labor markets. They put forward six arguments for how globalization could add more flexibility to the job market while benefiting employment.

1. Buying manufactured products from low-wage economies translates into reduced costs, which generates positive scale effects in internal employment demand.
2. Greater integration of trade means greater competitive pressure and greater sensitivity to price in the demand for products.
3. Greater sensitivity to price in the demand for products also leads indirectly to increased sensitivity to wages in the demand for labor.
4. The potential threat of businesses contracting out their production and closing their national production facilities gives their owners increased leverage for negotiating with labor unions.
5. By reducing the market power of national companies, the income to be distributed between owners and labor unions also becomes reduced. This, in turn, reduces the benefits of collective bargaining for workers, which could partly diminish the importance of labor unions.
6. Trade with low-wage economies has been profitable in terms of exchange for advanced economies, which translates into increases in the relationship between export and import prices.

Globalization and industrial policy

Apprehension about globalization and deindustrialization has created new needs for intervention in industrial policy. The backdrop is the appearance of new international actors such as China and India, as well as greater worldwide competition, which calls for a major restructuring of the advanced economies.

The Lisbon Strategy, developed by the European Union member states, declares that the primary role of industrial policy at the E.U. level is to proactively provide the adequate framework for corporate development and innovation with a view to making the E.U. attractive for industrial investment and job creation, taking into account the fact that most companies are small- and medium-sized businesses.

A broad interpretation of the industrial policy would include macroeconomic policies (e.g., antimonopoly, innovation and internationalization policies), the creation of extensive infrastructures (for transportation, telecommunications, education, science and research) and aid for companies based in the sector.

The report's authors believe that the most important challenge of industrial policy in the European Union is to promote the competitiveness of its companies and the productivity of the economy in order to improve social well-being.

To do so, necessary steps would include:

- providing adequate incentives to companies for getting in and out of the market;
- helping them reach a strategic position in the international market;
- contributing to an efficient restructuring of declining industries;
- increasing positive external effects;
- contributing to the coordination of investment;
- correcting capital market imperfections.

Global warming

Until now, the debate on public policies in the face of climate change has focused on cutting the demand for fossil fuels. It has been implicitly accepted that decreasing demand would automatically lead to lower consumption of these fuels and thus a reduction in CO₂ emissions in the atmosphere.

However, the measures for reducing consumption carried out by some Western countries will

not produce results unless those in control of the solid fuel resources start to limit their supply. If not, the world's energy prices will drop so far that other countries will consume and burn the same amounts not demanded by the "green" countries.

Moreover, the measures requested by governments that ratified the Kyoto Protocol have little in common with the policies that are actually effective in reducing global warming.

One useful measure would be to retain, on a world level, the capital gains taxes deriving from the closure of tax havens. Consequently, there would be fewer investment alternatives for the owners of these resources, which would increase the profitability of not extracting fossil fuels.

The economics of climate change and nonrenewable resources go hand in hand. In broad terms, the problem of global warming consists of transporting the underground carbon deposits to the atmosphere, with useful oxidation between the two.

Unfortunately, most of the proposed policies ignore this undercurrent and aim to reduce the demand for carbon without taking into account the price of that product or the reactions of supply.

Thus, there is a risk of creating measures that actually increase the extraction of fossil fuels, as opposed to reducing them.

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