



Revitalising European Growth

by Michael P. Wareing, CEO, KPMG International

Charles Darwin warned that “ignorance more frequently begets confidence than does knowledge”. Indeed, a little knowledge can be a dangerous thing. The debate on how and whether European growth can be revitalized is clouded by overconfident statements that disguise complexity.

In 2000, the Lisbon Agenda confidently committed to turning the EU into “the world’s most competitive, knowledge-based economy by 2010” with a long shopping list of targets. By the half way point Denmark has done best, Poland and Malta worst.

Some people believe that revitalizing growth would be realized by Europe in the institutional sense - that the Commission, the Council, the Parliament would lead and drive through the changes needed. But the principal movers and shakers remain the national states themselves. National political leaders have become highly skilled at blaming the EU for their own shortcomings. The true scorecard focuses on what the individual member states have or have not achieved.

Institutional Europe can help. A good example is the Markets in Financial Instruments Directive (MiFID) due to be adopted by all member states next year and implemented by firms by November 1st 2007.

But at the end of the day everything turns on individual countries, individual companies and, yes, individuals!

Then there is the assumption that Europe means the EU and specifically the EU-15. The truth is more complex. Growth in Europe, for example, depends hugely on Russian energy supplies. How secure will these be? What infrastructure investment will be needed to deliver Russian energy reliably to Europe in this century? What will be the impact of the 10 new member states in the EU? And later, what will be the impact of Ukraine and Turkey? If the spectre of the Polish plumber was able to play such a role in France’s referendum on the European Constitution, what role will the Ukrainian coalminer, or the Turkish farmer have on the future debate on revitalizing European Growth?

An even more damaging example of ignorance confusing rational analysis is the alleged division between old and new Europe - Anglo-Saxon capitalism versus the Franco-German social model, or even globalization vs fortress Europe!

The Polish plumber symbolized French fears about jobs. The German magazine “Der Spiegel” has found that 73% of Germans expect EU enlargement to destroy jobs in Germany itself. And there is no doubt that with hourly average labour costs in EU-10 much lower than those in EU-15, East and Central Europeans will compete successfully for jobs in the EU-15 and West European companies will create new jobs and transfer old jobs to East and Central Europe. But Europe’s real low cost competition comes from India and China.

Educational standards in the new member states are very high. People are highly motivated as well. Growth rates in EU-10 are significantly higher than those of EU-15 with an overall real GDP average growth of 3.6% from 2000 to 2004 compared with 2% for EU-15. The new Europe should help the EU to compete better globally, to add value, to revitalize growth.

“Old” Europe is doing much better than the propagandists on both sides acknowledge. Business confidence in Germany is at a 15 year high. French business confidence is at a 5 year high. Germany is the world’s leading exporter and the 3% pay deal agreed between employers and unions in the key engineering industry could boost consumer confidence. In France there is much talk of gloom and a recent poll showed that only a third of the respondents, asked whether France would benefit from freer international trade, thought so. Yet France in the last decade was the EU’s single biggest beneficiary of FDI.

There are big structural challenges in France and Germany but business is doing very well. Europe is very rich, very well endowed with 380 million consumers and a GDP of Euro 10 trillion.

“Racing to the bottom” won’t happen. “Old” Europe will not have to dismantle its social model to compete with low tax, benefit deprived East Europeans, nor will Europe abandon workers rights in order to compete with Chinese labour. East Europeans will demand gradually improving social benefit, as indeed the Chinese are already doing. The right direction is to “race to the top”, capturing and adding value. Flexible labour reforms, taxation levels that incentivise, but raise enough for a civilized society, all will play a part. The essential dimension is growth and the last 5 years, 2000 - 2005, have taught us to disbelieve the certainties and strive harder for the achievement.