For the EU Economy and Citizens: There are a number of potential benefits for the European economy overall, including:

(i) **Improved standards of living, increased employment and enhanced job security**, through an increase in the volume and the value of sales of existing products and services, and an increase in sales of new products and services.
(ii) **Increased employment and enhanced job security**, by improving the competitiveness of the EU economy.
(iii) **Increased job satisfaction**, through an improvement in the scale and the scope of jobs.

The obstacles to change

There are still a wide variety of different labour market practices and cultural specificity between companies and countries in Europe. Companies which have successfully introduced new forms of work organisation have made major improvements in their competitiveness.

However, there appear to be a number of powerful obstacles to change, specifically:

(i) *Lack of awareness amongst certain companies of the new forms of work organisation and their benefits.* If managers and employees do not know what is possible, then the forces of change will be weakened.
(ii) ***Negative attitudes among some managers, workers and trade unions inhibiting the adoption of new forms of work organisation.*** These are based on 'traditional' views about the 'correct' relationship between workers and management, as well as on the natural tendency for change to be opposed by those who benefit from the current situation and those who are uncertain about the impact of any change.
(iii) *Barriers* limiting internal employment flexibility in areas like working time, and atypical work; product market regulations and practices reducing competition; collective bargaining arrangements in so far unnecessarily limit the freedom of negotiation at plant level.
(iv) *Practical difficulties in implementing the new forms of work organisation.* It is not easy to introduce innovative ways of working into a company. The 'technology' is complex and must be adapted to each company. In addition, implementation requires major disruption of existing activities. The programme of change must also continue for a number of years before the benefits are won. These major practical difficulties make organisational change unattractive to many companies.
(v) *The financial cost of implementing the new forms of work organisation.* Taking advantage of these new methods of organising work can require major expenditure. Companies must spend money on employee training, the

acquisition of the technology, programme design, and implementation support. In addition, there are opportunity costs arising from diverting management from other activities, as well as from possible short term disruption of sales. If all of these factors are taken into account, the introduction of new forms of organisation within a company is a significant investment, albeit in an intangible asset. Moreover, as with many other investments in intangible assets, it is difficult to quantify the benefits. This leads in some cases to companies believing that they are acting rationally in refusing to incur the costs associated with the introduction of new forms of work organisation.

(vi) ***The inability of companies, particularly SMEs, to introduce new organisational techniques because they lack the capacity and resources to make the necessary changes.*** Deficiencies include: lack of skills among managers and staff, lack of management time, lack of financial resources.

IV.3 Policy Recommendations

There is no single driver of change in work organisation and industrial relations, nor is there a single correct model for change in Europe. Our attempts to bring about reform and President Santer's Confidence Pact, proposed to Council, must start from this awareness.

1. We need to know more. Based on existing material, the Commission must immediately embark on a **comprehensive benchmarking exercise at EU level analysing positive labour market flexibility** initiatives. The test is to identify those that have produced the greatest benefits in terms of job protection, job enrichment and especially job creation. Confirmed by an analysis of what has already been done, if at limited sectoral level primarily in Europe's smaller countries, the social partners can move forward decisively to tackle much needed reforms.

2. We must do better what we do already. Pan-European, **private/public benchmarking of positive labour-market flexibility must also be used to improve current government and private sector training programmes**, their priorities and budgets.

3. We must learn from experience. This **benchmarking must take into account current Commission monitoring of Member State labour policies** (*tableau de bord*) with the aim of identifying not only best practices, but also recommendations to help Europe achieve concrete improvement in positive labour market flexibility.

4. We need to focus our efforts. Europe's employment and training organisations must work in a more efficient way with the social partners. To reduce dilution of energy and financial resources on critical employment, training or quality of

work programmes and issues, **the scope and resources of existing and new institutions**, such as the European Foundation for Working and Living Conditions and the European Industrial Relations Observatory, **should be reviewed and better coordinated.** We must reduce unemployment, but not by having more people studying the subject.

5. We need to look to the future. Commission and Council should entrust to the most appropriate single institution and to a selection of innovative European companies a single **programme to increase job creation initiatives and apprenticeships for young people across the EU**, linking to the existing work in this area, for instance in the ERASMUS programme.

6. We have to be aware of the true cost. A forward looking competitiveness strategy must be geared more toward job creation than job preservation. With the involvement of the social partners, **the Commission should proceed with the cost/benefit analysis of EU social legislation as laid down in the Maastricht Treaty**, highlighting the most successful examples of incentives improving working conditions and industrial relations.

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ENHANCING EUROPEAN COMPETITIVENESS

Fourth Report to

the President of the European Commission,

the Prime Ministers and Heads of State.

December 1996

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PERCY BARNEVIK

10th December, 1996

Dear Mr President

On behalf of the Competitiveness Advisory Group, I am pleased to submit the Fourth and last Report of the Group, focusing on the European Union's position in a globalising world economy.

In the three previous Reports, the Group made several policy recommendations regarding the completion of the Internal Market which is essential for the EU's competitiveness and employment prospects (e.g. Company Statute, TENs, EMU, East-West win/win enlargement, public sector reforms, innovation & financing support for SMEs and labour market reforms).

Within the Group's last mandate, it was felt important to also assess the EU's international trade and investment performance, particularly in the highly competitive growing Asian markets. The Group again formulates practical recommendations and key benchmarks for Europe, regarding both barriers to trade and FDI, particularly for SMEs as well as social and environmental standards.

I take this opportunity to thank you, as well as your colleagues in the European Commission, for the valuable support provided to our Group.

We hope that our policy recommendations will contribute to the progress of the European Confidence Pact for Employment which you launched in January 1996.

Sincerely Yours

Percy Barnevik

Mr. Jacques Santer
President of the
European Commission
Brussels

PAGINA BIANCA

I. EUROPE'S PLACE IN A GLOBALISING WORLD ECONOMY

The global scene

National economies are becoming increasingly open to foreign trade and foreign investment. Falling transportation and communication costs and a more liberal trade regime have led to an unprecedented expansion of trade in developed and developing countries alike. The pattern of world trade is also changing. India, China and Indonesia - virtually half the world population - are opening up. Asia's share of world trade grew from 10.9% in 1983 to 12.8% in 1990, to 18.9% in 1995. Foreign direct investment (FDI) is also a major source of economic integration. According to UNCTAD estimates, the growth rate of FDI 1981 - 1993 was almost double that of exports. Asia also plays a leading role in FDI flows. China alone attracted $34 billion in 1995 - 15% of the world total, against virtually nil in 1980. Another striking figure: in 1994, intrafirm transactions between multinational corporations accounted for more than one third of total exports. Multinational corporations were directly involved in an additional 30% of export flows.

Growing integration is a source of both opportunities and adjustment. It allows firms to operate more effectively. It allows countries to exploit more fully their comparative advantage. It opens new markets and provides broader opportunities for exports and employment. At the same time, growing integration is associated with stronger import competition. In Europe, the fear is that this can come particularly from low-wage countries.

Adjustment becomes necessary: resources must be reallocated from declining to emerging sectors. In the process, new firms are born, others expand, new jobs are created. Some firms downsize, others close, workers are laid off. All this is neither free nor painless. But it is an integral part of the process of growth and structural change. Resisting global integration means protectionism. Protectionism will not save jobs, except in the short-term. In the end, it will only prevent national economies from exploiting new opportunities. Smashing machines did not protect jobs and craft skills from 19th Century technological progress. Likewise, protectionism today offers no defence against global integration.

In an era of increased mobility of capital and technology, competition from low-wage countries could be more significant than in the past. Despite this, evidence suggests that economic integration with developing countries need not have negative impact on wages and employment conditions in industrialised nations. Emerging markets have become an expanding source of export opportunities. Exports *from* South East Asia grew 134%, 1989 - 1995. During the same period, however, imports *into the region* grew 146%. Firms in the European Union have not lagged in taking advantage of these trends. European Union exports to South East Asia growing by no less than 153% in this time frame.

Furthermore, emerging markets progressively compete less and less on low wages. Integration into global trade and investment is associated with extremely rapid growth in wage levels. To give one example, South Korean wages in manufacturing are now 43% of their US counterparts, compared to just 9.5% only ten years ago.

Integration brings substantial benefits to rich and poor countries alike. But the trend towards greater integration is not irreversible. The history of industrial countries in the 1930s and of developing countries post-war illustrates how misconceived trade policies can lead to a dramatic reversal in such a trend. The integration of trade and investment is not inexorably determined, either by the forces of progress or by technological advance. Policy matters. The benefits bestowed by trade will not accrue automatically to economies unless policy-makers resist the pressures for protection, preserving a liberal, multilateral, rule-based trade regime.

Europe's position

Europe appears well placed to take advantage of global integration. It is rich in entrepreneurial talent. It has a strong exporting tradition with world-wide reach. It has a highly skilled labour force, backed by excellence in scientific research. Yet for all this, Europe's performance has been below its full potential, particularly in recent years.

Europe's trade position

Europe has been losing market share in the world export league. While not necessarily a straightforward indication of faltering competitiveness, this is something that should be monitored. In 1995, the Member States of the European Union accounted for 19.4% of total world exports, compared to 21.1% in 1990. In the same five years, Japan's share kept around 12%. The share held by the United States also fell somewhat, from 16.4% to 15.4%.

These years saw the full entry of new exporters into global markets. Europe was penalised too by relatively slow growth in areas - Africa, Central and Eastern Europe, the Middle East - where, for political, geographical and historical reasons, it has a strong presence compared to the US or Japan. The fastest expanding markets - in South East Asia - accounted for only 11.9% of European Union exports, as opposed to 14.4% for the US and 29.6% for Japan. This unfavourable geographical composition of European exports was, to some extent, offset by relatively fast growth in exports toward the more dynamic markets.

But attention to respective market shares should not be overdone. The CAG is more worried by the fact that extra-EU merchandise trade has fallen as a proportion of the Union's GNP from 22.6% in 1983 to 18.6% in 1993. Here could be an indication that the European economy is not integrating as rapidly as it should into the global economy.

Europe's technological position

High technology sectors are characterised by relatively faster export growth. Overall, OECD manufacturing exports increased at an average annual rate of 8% during the 1980s. But high technology exports had a growth rate of 12.5; low R&D sectors 5.7%. With its strong scientific and research tradition, Europe should be better placed in the technology race. Unfortunately, as stressed in our first Report, too much of European research is not translated into industrial applications. The share of European Union patents in both the US and in Europe itself has declined, and this decline is accelerating.

More crucially, Europe's revealed comparative advantage has shifted away from high technology sectors. During the 1980s, only the United Kingdom strengthened its comparative advantage in high technology sectors. Both Germany and France specialise in medium-high technology sectors. For Italy, the pattern of specialisation is biased toward medium-low sectors.

Fear that Europe is losing ground specifically in the most dynamic areas is not unfounded. Nevertheless, we have to be careful not to jump to the wrong conclusions. First, an unfavourable trade balance in high technology goods may simply indicate high imports of such goods. If such imports are then put to productive use, this could indicate a strengthening, rather than a weakening, of Europe's overall competitive position. Second, Europe is still prominent in certain key hi-tech sectors, such as pharmaceuticals, chemicals, aerospace. Third, building a strong position in some high-tech products can be very costly - both directly, in budgetary terms, and indirectly, by raising intermediate input costs for firms and for final users. Policy may indicate other priorities.

Foreign direct investment

FDI plays a paramount role in enabling firms to establish a bridgehead in foreign markets. Moreover, it spurs a rise in exports from the country of origin by fostering demand for intermediate inputs and specialised services.

From 1980 to 1993, Europe held on to its world share of both inward and outward FDI. These figures are, however, misleading. Expansion of FDI in Europe is to a large extent a matter of intra-European flows. Most crucially, European FDI in the dynamic markets in South East Asia is all but negligible. The German share of FDI toward South East Asian markets rose from 1.4% in 1985 to 3.6% in 1990; that of France, from just under 1% to just under 2%. During the same period, the US share soared from 5.2% to 10.3%, the Japanese from 12% to 18.8% (1991-94).

European firms have to invest more in emerging markets to take advantage of their rapid growth. Exporting is not enough. Long term, the successful exporter has to be there, on the ground. He has to participate in the local economy and integrate with it. Improving the effectiveness of public export agencies, particularly in support of small and medium sized enterprises, should be a major priority in public policy.

Responding to the new challenges

The European economy will benefit from today's radically new trading and technological opportunities only if resources are allowed to move smoothly from declining to emerging sectors. We are all well aware that this is not free of social costs. Yet, provision of social protection need not slow down the process of structural change, nor compress our economy into an obsolete industrial mould. Policy must protect people, not jobs. The European social model can and must be reformed to permit freedom to exploit the new opportunities in respect for the social imperative. In this way, the resultant economic benefits can be fairly distributed and we do not risk sacrificing the basis of the European model of society.

A more flexible and assertive European economy cannot be avoided in the new global environment. Global integration demands of us further extension of the Single Market programme and stronger trading links, particularly in areas as yet not covered by the WTO, with partners both near and far. In today's context, regional integration agreements are complementary to global integration.

Crucially, public policy must foster the internationalisation of Europe's small and medium sized enterprises. Besides being a source of employment, in the past our SMEs have been fonts of competitiveness and innovation. They can perform equally well even in the new, more challenging, international environment.

For companies big and small, participation in - and exposure to - international trade and investment enhances competitiveness by stimulating innovation improving operating efficiency and forcing adjustment to structural change. This, in turn, can only benefit Europe through increased employment, higher productivity, wider consumer choice and improved living standards.

II. BENCHMARKS FOR EUROPE: THE DYNAMISM OF ASIA

Many European sectors have benefited from open international trade and investment. These include:

- **the mechanical engineering sector**, which has achieved a globally competitive position through strong export performance;
- **the chemicals sector**, which has used extensive outward investment to achieve a globally competitive position;
- **the car assembly and automotive parts sector**, which has benefited substantially in terms of quality and productivity from inward investment by American and Japanese car assembly companies.

There are, however, principal areas, related to international trade and investment, in which Europe's competitive performance can be improved. In each, Europe is not doing badly, but neither is it doing well. In each, poor or indifferent performance is progressively weakening our position. Globally, the pace is being set in the dynamic markets in Asia. It is to there that comparative assessment must look.

II.1. Institutional barriers to market access within the European Union

The Single Market programme has achieved a great deal to improve market access within the European Union, but much remains to be done. This concerns trade between the Member States and the openness of the Single Market to the outside world. In both, theoretical opening has to be turned into reality. This is particularly the case in infrastructure sectors. All studies indicate that, for business, quality of infrastructure is the key determinant of where to invest, where to create jobs. Barriers to market access in telecommunications, energy (particularly gas and electricity) and financial services are the result of continued restrictions on who may provide today's products and services, and the new ones which are emerging.

- **European Telecommunications Sector:** The main barriers are to effective market access in basic telephony services. *De facto* monopolies are taking the place of *de jure*. As a result, competition is still restricted, leading to lower productivity (between 20% and 50% below that in the USA), higher prices (circa 25% higher than in the US and Japan), less innovation, less choice and lower quality service. This undermines the competitiveness of European companies which rely upon telecommunications as a key input. It also restricts other opportunities for growth by reducing the competitive advantage of Europe's telecommunications companies (and their suppliers) in global markets. It significantly hampers the emergence of the new industries based on information technology.

- **European Energy Sector:** Energy is an important input for Europe's manufacturing industry. However, European manufacturers pay far more for energy than their competitors in the USA. The primary causes are the restrictions on market access and lack of contestability in the gas and electricity sectors, as a result of continued restrictions on market participation. For example:

  - In the electricity generation sector, a recent OECD report revealed that physical output per employee in ten European countries averaged only 38% of that achieved in the USA.

  - In the chemicals sector, calculations by CEFIC suggest that European companies pay up to 45% more for energy than their US competitors. This is a fundamental problem for the global competitiveness of an industry for which energy forms nearly 8% of total input costs for the manufacture of basic chemicals.

- **European Financial Services Sector:** Few of the benefits anticipated from the creation of a single market in financial services have in fact been realised. The main causes are the continued failure of Member States to enact European legislation, the presence of national restrictions which effectively inhibit the activities of new entrants and lack of tax harmonisation.