

**Responding Actively to the Challenges of Globalisation:
Enhancing Europe's attractiveness as a place to invest and work
Issues for Discussion at the Informal Ecofin Meeting**

Main Messages

- ***Globalization can be a force for the good for all and should be promoted***
- ***For Globalization to be accepted by populations, policies must ensure that fruits of globalization be spread evenly across countries, population groups, skill levels***
- ***While outsourcing and offshoring are rational business strategies to maintain competitiveness, policy action is required to induce investment in Europe, in order to increase jobs and growth***
- ***In times of globalization, ethical behavior by firms becomes even more important, as government intervention capabilities are reduced and international firms' power enhanced***
- ***Ethical behavior, via observance of corporate social responsibility standards must be seen as a European locational asset, attracting investment, because it is a guarantor for sustainable development. It can help to create jobs in Europe***
- ***EU countries should promote CSR and create incentives for firms' adherence to CSR.***

1. Europe in the Emerging New International Division of Labour

In recent years the process of relocation from industrial countries has spread to an ever broader range of regions, sectors and activities, including services. Contrary to widely held views, the share of EU production affected by this process has remained rather limited so far, was largely offset by a reverse process of relocation into the EU and took place predominantly between developed economies rather than between the EU and emerging economies, notwithstanding the spectacular rise of China and India during the last decade.

It follows that in spite of world-wide competition having increased because of "globalization"; the welfare of European citizens continues to be influenced mainly by the volume of production of goods and services within Europe. Income from abroad plays only a minor, though increasing, role. For this reason, the locus of services and industries as places of work (on which also a majority of tax revenues depends) and investment is important.

On balance, up to now the EU as a whole has lived up well to the challenges posed by the increased mobility of productive and finance capital. However, just like with globalisation in general, relocation causes an uneven distribution of gains and adjustment costs. The latter are mainly, but not exclusively, concentrated on low-skilled workers and on regions with a high share of traditional industries as clothing, textiles, shoes, etc. These are also visible and identifiable, while the benefits are diffused over a wider population and often harder to identify.

Globalisation gives firms additional incentives for regulatory arbitrage and evading national standards. It is in the interest of Europe to build on good social relations and ethical behaviour of its firms and managers. Together with quality of life, a productive and well-

educated workforce, excellent infrastructure, a European Trademark of Socially Responsible and Ethical Behaviour could become an additional attraction for investors – and improve the image of globalisation in the eyes of Europeans.

It is to be expected that in the years to come the attractiveness for a broad range of productive activities of China, India and other large and populous countries like Brazil and Russia will further increase. At the same time widespread technical limits to relocation will prevail, even if the distinction between tradable and non-tradable goods is further blurred over time. Further, managerial decisions on the location of investments are the result of a complex set of economic and institutional factors, amongst which *any* single factor plays only a limited role. Europe will need to step up its efforts to remain competitive and enhance its attractiveness as a place to invest and work.

- *Given that the process of relocation is just one aspect of the broader process of globalisation, do you agree that the adequate policy reaction is to support the further development of the comparative advantages of Europe as a business location rather than to slow down or even reverse the process of international trade and capital liberalisation?*
- *Do you agree that non-protectionist policy efforts towards a more equitable distribution of gains from globalisation between enterprises and employees, between skilled and unskilled workers and between regions are key condition for broad public support of a liberal, outward looking EU-economic policy?*

2. Concerted Policy Efforts to strengthen Europe's Competitiveness as a Business Location

Competition induces firms towards specialization and optimization of their firm-specific advantages. Relocation of (parts of) enterprises – in the form of outsourcing or off shoring - is one way to optimize such specific advantages.

There are three major motivations which can lead firms to relocate production abroad: Increased efficiency, acquisition and development of strategic assets and improved access to foreign markets. Cost differences and the quality and availability of factors of production play a key role; important are also costs of complying with governmental regulations, of enforcing contracts, unit labour costs, the quality and costs of infrastructure services and taxes.

The investment decisions of firms wishing to acquire and develop strategic assets is often driven by the scientific and technological infrastructure and resources as well as by the presence of other firms and institutions which may create positive externalities for the investing firm.

The firm will make a decision on whether to offshore (i.e. within the firm structure) or outsource production (outside the firm) depending on the relative costs of control, incentives and contract enforcement. The effects on the investing firm will be different.

While de-localisation can enhance a firm's competitive potential, Europe as a whole must make sure that it remains an attractive location both for investment decisions of European firms, but also in order to attract outside investors. For outside investors, it would be to Europe's advantage to become/remain the destination of mainly outsourcing investment, since this would enhance Europe's autonomy relative to headquarter decisions. On the other hand, off shoring investments tie European firms more closely into the supply chains of the investors.

While outsourcing and off shoring are rational firm strategies to remain competitive, policy makers must make sure that Europe remains attractive as a location to invest.

- *Do you agree that promoting research, innovation and education and, more generally, to promote optimal conditions for industrial restructuring/innovation are among the most important policy areas necessary to preserve and develop European competitiveness in a sufficiently broad range of areas and tasks?*
- *Do you agree that completing the Single Market constitutes also an important stimulating element to promote the formation of competitive intra-European value chains, and therefore an important element to promote Europe as a business location?*
- *Do you agree that a pervasive streamlining of the regulatory environment, with a view to minimizing compliance costs, but without compromising regulatory policy goals in the areas of environmental, consumer and labour protection and competition policy is of major importance to improve the cost competitiveness of Europe and that we therefore have to join efforts to secure a lasting success of the ongoing better regulation initiative?*
- *Do you agree that productivity-enhancing measures rather than cutting wages form the appropriate strategy for a European industrial policy, as the latter would stimulate a specialisation pattern neither desirable nor sustainable in the longer run?*

3. Socially Responsible Conduct as Ethical Necessity and Locational Advantage

Increased capital mobility, brought about by technical progress, notably in the areas of ICT and transport but also by liberalizing capital movements both within Europe and on a global scale has amplified the room of manoeuvre for both enterprises and portfolio investors, while that of national governments for intervention has decreased.

The unleashing of market forces, the intensified world-wide search for yield has been accompanied at times by a number of features which had a negative impact on the public debate. These include, among others, ethical questions of dealing with countries with human rights violations, cases of abuse of market power, questionable labour practices, accounting applications, corporate and managerial greed, positive profit performance followed by labour shedding, among others. These developments have given the market economy and globalisation a bad name in the eyes of many of our citizens. This perception threatens to undermine the acceptability of our economic and social model and leads to populist and/or backward-looking policy conclusions.

The public needs assurances that politics take action to make sure that enterprises behave in socially responsible ways, that they apply high ethical standards both within their firms and vis-à-vis the societies in which they function and on whose support they depend.

The numerous voluntary attempts at voluntary Codes of Conduct of Socially Responsible Behaviour by the UN, OECD and EU are important steps in this direction and have been complemented by a new EC initiative by Commissioner Verheugen towards forming a European Alliance for CSR, with the aim to make Europe a Pole of Excellence on CSR.

While this initiative sets laudable and welcome standards for corporate behaviour, it does not adequately address the much-discussed problem of the concurrence of high profits and reductions in the labour force, as well as the inadequate investment by enterprises in Europe – with the consequence of high unemployment.

- *Do you agree that European enterprises should be encouraged to stronger commitment to CSR? Do you agree that this could represent a locational advantage and act as a lever to attract more investment to Europe?*

- *Do you agree that CSR commitments should go beyond intra-firm labour practices and environmental standards and also contain benchmarks for employment maintenance and job creation and guidelines for managerial remuneration, relative to those of the workers, such that confidence in our market system is strengthened?*
- *Do you agree that the EU should promote such a CoC (e.g. widen the main topics of its Alliance for CSR to include macroeconomic effects of enterprise behaviour) and use it as rewarding complying enterprises with special commendations (e.g. "CSR seal of approval")? Do you see other ways in which politics could address these citizens concerns?*