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Taking Advantage of Globalisation: the Role of Education and Reform in Europe

Ladies and Gentlemen,
I would like to thank the Oesterreichische Nationalbank, and in particular Klaus Liebscher, for inviting me to participate in this conference on the role of human capital in the modern economy.

I believe it was a native of this city, Peter Drucker, who back in the 1960s was one of the first to recognise the value of employees that can produce ideas, knowledge, and information. In today's globalised world, the need for a European economy that is built on knowledge and innovation and which makes good use of its human resources is widely recognised. And yet Europe continues to fall short of achieving this requirement.

This morning I would like to outline the benefits that enhancing Europe's human capital can bring, not only in terms of economic growth but also for individual prosperity and a more equal and cohesive society. I will stress that if we want to reap these benefits, we need to embark on a comprehensive strategy of reforms, including a targeted effort to raise the efficiency of public spending on education, research and development (R&D) and innovation.

But to begin with I would like to recall the far reaching changes taking place as a result of globalisation, and the place that the EU is taking at the heart of these developments.

Opportunities and Challenges of Globalisation

When 50 years ago the Treaty of Rome was signed and the EU was born, it was intended to tackle very European challenges, to confront the

difficulties of a continent divided by the Cold War and scarred by memories of the World War II. Today our future as Europeans cannot be built looking inwards, losing the perspective of the global scale of the challenges faced by our societies. Security, climate change, energy, immigration, trade and investment flows are only some examples of the issues where our internal policies are tightly influenced by global developments.

Overall, I believe that globalisation is a positive development that presents many new and significant opportunities. And a strong Europe is, in my view, the only way to capitalise on the new global opportunities of the 21st century.

In the economic front changes are far reaching and unprecedented in pace. It is fair to say that the economic landscape has been fundamentally redrawn over the last two decades, with growth in emerging economies, such as China, India and Brazil, lifting millions of people out of poverty and shifting the pattern of global trade and investment flows.

As the world's largest exporter, the EU benefits directly from the expansion of its world partners. The strength of the EU economy is being supported by a growing demand for European exports and investments from emerging economies. At the same time European consumers are benefiting from having access to cheaper imports and a wider variety of goods and services.

But while globalisation offers a multitude of opportunities for European companies and consumers, fears are running high that adjustment

to the increased competition that globalisation entails is a threat to jobs and wage income.

It is true that the very dynamism brought by globalisation sometimes creates painful dislocations. A shift in consumer demand, the advent of new technology, or new competition leads to the closing of some factories or causes the demand for certain skills to decline.

Nevertheless, even though adjustment can be a costly and uncomfortable business, resorting to protectionism and trying to shield jobs and industries from international competition have greater opportunity costs. A “fortress Europe” is simply not possible in our highly interconnected world; let alone desirable. Trying to hinder the adoption of new technologies, obstruct trade and investment flows or close our borders to migration would do far more harm than good, only serving to reduce economic efficiency, income and employment opportunities in the long run.

In my view, it is in Europe’s interest to turn around the arguments and focus on how we can maximise the opportunities that globalisation offers. And let’s keep in mind that these opportunities are not only economic.

The European Response

In our efforts to secure a bright future for Europe in a global economy we can build of three pillars.

First, Economic and Monetary Union (EMU) provides us with a very solid foundation. The euro acts as an anchor for economic stability, keeping inflation historically low and supporting growth and employment. Indeed, with growth currently above the long term average, unemploy-

ment at its lowest level in 15 years and the EU expected to create 9 million new jobs over the period from 2006 to 2008, our economic prospects are looking bright.

These achievements notwithstanding, it is clear that the euro and EMU as a whole face challenges. Raising potential growth, enhancing adjustment to economic shocks, putting Europe’s fiscal house in order and ensuring a successful enlargement of the euro area will be key issues for the coming years. As monetary union approaches its first decade, and with the benefit of analysis covering a full economic cycle, the Commission will present next year priorities for action to strengthen EMU in the years ahead.

Second, we should take advantage of having the world’s largest internal market. It is a vital tool for helping European companies prepare for, and compete in, the global marketplace. The European Commission is currently seeking to further strengthen the Single Market by establishing priority areas for further integration, such as in the financial services sector, in order to enhance its role as an open and competitive trading bloc in the 21st century.

Third, we should build on the renewed Lisbon Strategy for Growth and Jobs. With its focus on reforms that create employment and raise productivity, the Lisbon strategy represents another key pillar of the EU’s response to globalisation. In December this year the Commission will present its proposal for the review of the Integrated Guidelines for the period from 2008 to 2010. Tackling the challenges of globalisation will remain in my view at the core of our strategy.

Making Better Use of Human Resources

Let me now turn my attention to the importance of improving human capital, a subject that is at the core of today's conference. It is my firm belief that, despite the efforts made so far, this crucial resource – our people – is still underutilised in Europe. In the age of globalisation, nothing will contribute more to our economic success in the future than education and knowledge. Developing our comparative advantage in high-value added activities requires a dynamic framework where innovation and R&D, fostered by excellent education systems, can spur productivity and job creation.

Over the last years all Member States have formulated policies aimed at stimulating private R&D and education. For example, countries such as Austria have introduced or strengthened targeted tax incentives to stimulate R&D spending. Member States have also implemented various measures to upgrade the quality of general education and to increase the use of Information and Communication Technologies (ICT) in education and training. Austria is prioritising the development of international centres of excellence and aims to build a new university centre of excellence.

But despite this good progress the EU is losing attractiveness for R&D investments relative to the U.S.A. and some emerging economies. The battle for knowledge and innovation is only half won and therefore further efforts must be made by each Member State. The EU must remain an attractive location for companies to locate their R&D facilities, and it must be able to train and retain its brightest people.

Tackling Inequality through Opportunity

But enhancing human capital is not just beneficial for economic growth and competitiveness. Better education systems and a skilled workforce can also contribute to the maintenance of an equal and cohesive society. This is a key principle of our European Social Model.

With concerns mounting over the divide between rich and poor, income inequality has become a hot topic of discussion. Some analysis shows that income mobility has fallen since the



1970s and alongside fears about globalisation the voices against inequality are growing.

Equality of opportunity should be at the heart of our societies. And the most effective way of ensuring that economic opportunity is as widely distributed as possible through efficient and effective education systems.

Improved educational achievement of the population increases employability and stimulates social cohesion. Employment rates tend to be correlated with education levels. In 2005, the EU wide average employment rate for the low-skilled was 46%, for the medium-skilled 69%, and for the high-skilled 83%. It is clear that in Europe the prospect of finding a job increases with educational qualification.

At the same time, over past decades, the real wages of workers with more years of formal education have increased more quickly than those of workers with fewer years of formal education. This is possibly due to the fact that technological advances have raised the productivity of highly skilled workers more than that of low skilled employees, causing the real wages of highly skilled workers to increase at a faster rate. Although this is not the only reason to explain income inequality, it is clear that the larger returns provided by education and



skills is an important factor behind the long-term divergences in wages.

Overall, policies that boost our investment in education and training can help reduce inequality while expanding economic opportunity.

A Re-Direction of Public Spending

Let me now turn to the role of government spending. One means of enhancing human capital and facilitating the development of Europe's knowledge economy is through more effective government spending. There is a great deal of scope in the EU for the public sector to channel spending away from inefficient expenditure items towards more growth enhancing budgetary areas such as education and R&D.

Everybody would benefit from a systematic effort to measure the relative efficiency and effectiveness of alternative policy options. After all, higher public spending does not automatically equal high quality public services. In the area of education, for example, recent research by the OECD suggests that there is ample room for efficiency gains. Portugal, Austria and Finland, for example, spend nearly the same amount on education (around 5.6% of GDP), but according to the PISA study differ widely in terms of the performance of their students. I understand that these results have generated a lot of discussion in your country.

It is also important to bear in mind that increased efficiency in public spending will be instrumental in dealing with the increased budgetary pressures associated with ageing populations. As part of strengthening the preventive arm of the Stability and Growth Pact the European Commission will increasingly pay attention over the coming years to the effectiveness and efficiency of public spending and stimulate Member States to exchange best practices in this area.

The Crucial Role of a Broad Reform Strategy

However, improvements in the education system or increased spending in Research and Development will not be sufficient on their own to equip Europe face the challenge of globalisation. They need to be embedded within a broader strategy aimed at supporting the inevitable adjustment process.

Product Market Reforms

In product markets, competitive conditions have continuously changed with the deepening of the Single Market, EU enlargement and the introduction of the euro.

National competition authorities and regulatory bodies have been strengthened in a number of countries, including Austria. Major steps have been taken to liberalise network industries and as result productivity growth has accelerated and relative price levels have declined. Moreover, many Member States – Austria is a good example on that front – are taking measures aimed at reducing the regulation burden and enhancing the business environment, especially for SMEs.

In my view continuous product market reforms should inject a new dynamism into our economies by eliminating excessive and unnecessary regulatory burdens on businesses and by facilitating market entry and exit of firms. The Commission is going to make proposals on how to establish priorities and tackle these issues in its Single Market Review to be present in the autumn.

Labour Market Reform

Increased competition on product markets has been complemented by measures taken in several countries to increase the flexibility of their labour markets. Over the past five years, countries have liberalised employment protection legislation for temporary contracts, reduced the tax wedge to “make work pay” and introduced reforms to public pension systems. Overall, these reforms are delivering results. The utilisation of labour has increased, leading to the

creation of 10 million jobs in the EU since 2000.

But while it is true that labour productivity has accelerated, rising in 2006 for the first time this decade at a faster rate than the U.S., Europe still suffers from low productivity in the services sector, an area which covers 70% of modern economic activity.

And despite the falling rates of unemployment in the EU, the figures for youth unemployment are still unacceptably high. Many Member States, including Austria, could do more to improve the skills of disadvantaged young people. At the same time, not enough is being done to make labour markets more flexible. In many countries, benefit systems still create disincentives to work and the capacity of labour markets to adjust to a changing environment remains insufficient. Labour market reforms should enable workers to move smoothly from declining to expanding activities, thus easing tensions in the adjustment process.

Meeting the broader challenge from globalisation requires reforms that increase flexibility without increasing people’s uncertainty. In my view the experience in many Member States shows that job protection is not essential as long as the job holders are secure that they will find another job. The Danish experience with “flexicurity” is the one that most people talk about but there are other models. There is no “one fits all solution”. Therefore, the Commission will present a Communication on “flexicurity” before the summer setting a framework for promoting job flexibility in combination with employees’ security.

Conclusion

Ladies and Gentlemen, I would like to conclude by saying once again that the increasingly globalised world offers us multiple opportunities, but also creates a number of challenges. A strong and integrated European Union can provide us with the right response, helping us to take advantage of the opportunities and to meet the challenges head-on. In my talk today, I have focused on three key aspects of such a response. Let me recall them.

First, it is important to enhance human capital. Better educated and skilled people are more likely to find their place in the new international division of labour and have a greater capacity to adjust to the challenge of globalisation.

Second, increased investment in human capital does not necessarily imply a rise in public budgets for education and training. In the light of budgetary constraints, we have to use the resources available in the most efficient and effective way. It is a question of value for money.

Third, measures that encourage investment in education and training are most effective when embedded in a comprehensive reform strategy. The Lisbon Strategy for Growth and Jobs provides a broader framework that creates the conditions for increased investment in human capital and a successful response to the globalisation challenge.

Thank you for your attention. 

