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EUROPE'S OPPORTUNITY IN A GLOBALISED WORLD

*Opening Lecture of the International Summer Programme,
University of Vienna, Strobl/St. Wolfgang, Austria, July 15th 2007*

Dear Members of the Faculty,
Dear Students,

It is a great **honour and** pleasure for me to be invited here to **give the opening lecture of this magnificent summer school, on** one of the most fascinating topics of our time – that of globalisation, and the European experience in particular. Many people regard globalisation in a rather restricted sense, as the benefits or disadvantages of international trade. This understanding is much too narrow. The implications and consequences of globalisation go to the core of our socio-economic existence and concern such fundamental issues as economic prosperity on the one hand, and social justice on the other.

In our time, globalisation also means the compression of distance and time in the World economy. And it means the return of nearly one half of the World's population after decades of self-isolation – i.e. the people of China, India and the former Soviet empire – into the global market economy. This represents an enormous change within a very short time period and brings with it certain difficulties. It implies a new specialisation of labour, with many problems of transition, for example rising prices. As a consequence we have begun to experience a growing demand for petroleum oil, for natural gas and other raw materials (metals, timber etc.). This process, unfortunately, carries a growing threat to our global environment.

By far the greatest achievement of globalisation has been the elimination, or at last the reduction, of poverty for about 1 billion people on Earth. Half a century of development aid could not match this result. For those still suffering the deprivation of poverty, the greatest hope of lasting relief is an accelerated forcing of globalisation, combined with appropriate levels of aid, e.g. in the area of health care; Aids may just serve as an example.

Conflicting views on the benefit of economic progress

In my view, there is no fundamental conflict between improving the welfare of mankind, while seeing to it that everyone benefits from the process.

The first is achieved through economic growth, by which we mean the growth of the output and consumption of a country or region. The second is the redistributive task of public finance – all members of society should share in the benefits of progress and in the costs of setbacks. Democracy can only survive or can only be established if there is social cooperation. And, cooperation will only be forthcoming if people feel that they are being treated fairly.

In my view, the attitude of those who believe that prosperity and social justice are incompatible is excessively pessimistic. They believe that economic progress depends on creating exaggerated incentives and, by implication, that greed is the engine of growth. Social fairness is felt to stymie growth by discouraging growth-oriented behaviour. Growth would then produce an oligarchy of the super rich, while the vast majority of the population remains super poor.

An unfortunate side-effect of this pessimistic viewpoint is that it produces a reactionary opposition to economic progress. Sometimes the opponents of globalisation revert to violent measures, which I consider to be unfortunate, as even their valid criticisms get lost in the process.

The Process of Globalisation

Globalisation means that for a given geographic region, be it a group of countries or a group of continents, the individual economies of the region are integrated into one. This occurs when administrative barriers, such as tariffs or exchange controls, are eliminated and technological developments lower, or remove, cost hurdles. The geographic region then behaves very much like the economy of a single country. A “global” economy will exhibit extensive trading links in goods and services – including that most important and rapidly growing service, tourism - as well as a high degree of mobility of labour and especially capital.

Globalisation has experienced a long evolutionary history. Progress has not been continuous. Instead, periods of progress have been punctuated by setbacks, with the latter sometimes lasting for decades, or even centuries. Some of the more vocal critics of globalisation treat it as a “new” and “undesirable” phenomenon; however, the only thing new about globalisation today is the speed of development but not the phenomenon itself. Certainly, since the 1970s the quality, more so than the quantity, of transnational

interaction has changed due to technological revolutions and due to new and sped-up means of communication and transportation.

At a very basic level, globalisation commenced as soon as mankind changed from being individual hunters-gatherers to living in social organisations. The productivity gains arising from the specialisation of labour established the superiority of this form of society, so that there could be no return.

But productivity gains from specialisation presuppose trade, whether between individuals, towns or regions. The larger the region, the greater the scope for specialisation, and the more lucrative the rewards.

The growth of empires, and the Roman Empire in particular, accelerated the process. Political unity fostered closer trading links between otherwise completely separate regions. The durability of the Roman Empire, its legal cultural and linguistic unity, its engineering innovations especially in the spheres of road-building and communications, and the introduction of a monetary standard over so vast an area, all served to foster trade and prosperity.

In the middle ages, the trade routes opened up by explorer-adventurers expanded the trading links between Europe and Asia and, later, between Europe and the Americas. Commerce transferred from land to maritime routes, but the cost of trade remained very high. Thus, cargoes were restricted to goods of high unit value relative to weight, precious metals, spices, tea, silk etc.

The supremacy of mercantilist doctrine (“Colbertism”) in Europe from 1500 to 1750 AD was a significant setback for any notion of globalisation. The prevailing view, that the economic system was a “zero sum game”, meant that any policy measure which might benefit one segment of society necessarily worked to the disadvantage of others, thus discouraging cooperative behaviour in the common interest.

Even more significant was the mercantilist view of the bullionists – i.e. that the wealth of a country was represented by its stock of gold and silver. Thus, a payments deficit should be avoided at all costs, usually by means of restrictions on imports. And, as double-entry bookkeeping – invented and first practised by the Venetian Luca Pacioli – evolved at this time, the tools for monitoring trade balances were to hand. The restrictive perception of self interest promoted by mercantilism resulted in almost continuous warfare and strife between the emerging nation states.

The classical economists and social philosophers, principally Adam Smith and David Hume, heralded a new era of economic liberalism towards the end of the 18th century.

The benefits of free trade and liberalism were enjoyed mainly in the period from 1815 to the beginning of World War I in 1914, with some exceptions. Transportation costs dropped sharply due to the advent of steam power, cheaper transportation and the expansion of the railroad network. Communications improved with the discovery and implementation of telegraphic technology.

Ironically, the United States, like Bismarck's Germany, remained heavily influenced by mercantilist attitudes throughout the 19th century before a liberal "open door" policy had been pursued. The open policy on immigration, although consistent with a pro-globalisation attitude, but was probably motivated by a desire to populate the "New World" with suitable settlers and displace the indigenous population. To this day, a powerful protectionist lobby influences economic political attitudes in the United States. But also in other parts of the world we are confronted with a growing "economic patriotism", or even worse, a "politically-motivated economic nationalism".

The Benefit of Globalisation

The benefits of globalisation, which provide enormous economic benefits through productivity growth arising from specialisation, were expounded by Adam Smith in the late 18th century. The extension by David Ricardo at the beginning of the 19th century refuted the "zero-sum game" view of the mercantilists, and firmly established the competitive economic system with free trade as a "win-win situation", whereby all could benefit. These productivity gains are amplified by technological progress, which leads to a sharp reduction in costs, opening new opportunities for advantageous exchange. And, expenditure on education and research are the main drivers of technological discoveries.

History has emphatically supported the superiority of this view.

The Limitations of Globalisation

The clear advantages which economic theory identifies arising from trade and competition ignore transition effects. Economic theory also presumes a "level playing field" of equal opportunity for all participants. Both of these issues give rise to important reservations, and costs which are not taken into account.

First, when globalisation removes existing barriers to international trade and capital flows, trade will expand along the lines of comparative advantage. What this means is that each country will focus on producing those goods and services in which it enjoys a productivity advantage relative to its competitors. Those goods and services will be exported. The country will reduce the output of those goods in which it experiences a relative productivity disadvantage, and will import its requirements from its competitors.

But, this requires a significant readjustment of production and output and this will not be as frictionless as the theory suggests. Physical capital is typically dedicated to a specific production process and cannot be switched to another use. The same is true of labour skills. Thus, some capital and labour is likely to be unemployed in the transition period, which may be very long, indeed. Where industries are concentrated regionally, it is even possible that entire regions will remain depressed for years, if not indefinitely.

The Level Playing Field: Business Location

A **second** reservation with classical trade theory, and its over-simplified picture of globalisation as a “win-win for all” phenomenon, is based on the view that the world economy is not a “level playing field”. Countries express their individual preferences over a wide range of issues, such as the level of taxation and the provision of public services, location incentives to industry, valuation placed on the environment, exchange rate regimes and so forth.

In answer to the critique that the global economy is not a level playing field, I would pose the question, “should it be?” and: “can it be?”

The Level Playing Field: Ecological Footprints

An important consideration is the manner in which different countries value the environment and charge for its services with respect to the exploitation of resources and the disposal of waste materials.

Entire populations are transposed to make way for hydro-electric power schemes, or other major social infrastructure projects. Companies can pollute land, water and the atmosphere with seeming abandon. These social and environmental costs are still external, though they should have been internalised long ago. Yet, the prices of goods reflect neither these environmental costs nor the shortage of fresh air, clean water and so on.

Social costs are borne by society, not the manufacturer. Combined with low wage costs and other beneficial cost arrangements, private costs of production are at rock bottom. EBITs and profits are very favourable.

The problem with all of this is that the environment is overburdened. When production involves social costs, in this case environmental costs, which are not reflected in the price of a good or service, too much is produced and too much is consumed. Our

ecological footprints get even larger, although they are already too large and should be reduced.

An ecological footprint is the *per capita* “quantity” of the environment, measured in “global hectares”, which can be consumed and is consistent with sustainability. It includes our consumption of energy, water and other resources and also takes account of the waste we require the environment to absorb.

Not only is mankind, on average, consuming well in excess of what is sustainable at present, the World Wildlife Fund estimates the excess at 25%, but the distribution of consumption is very uneven. The ecological footprint of the United States is almost five times the sustainable level, with China it is already much the same. We can see this very clearly when we consider that the United States, with 5% of the global population, accounts for 25% of the global consumption of resources and output of pollution.

Clearly, the commercial organisation of Western society is not sustainable and may not be accepted much longer by the rest of the world. The struggle for resources suggests that significant price and cost increases are in prospect, and unless we can agree on a global distribution of permissible waste, we may make our planet unfit for human habitation.

The strategy for economic survival and success under this increasingly threatening cost pressure can be found in the field of innovation and research. It will only be possible to cope with increasing raw material and oil prices, without a dramatic fall in living standards, if procedures can be found that replace traditional fuels, and if alternative products are developed that require fewer material inputs.

The European Prospect

The role of Europe in the World has changed dramatically in the past century. This period has provided us with some of the worst experiences of our entire history, although good has invariably followed evil. The renowned British historian Eric Hobsbawm in his seminal work, “History of the 20th Century”, dubbed this era the “Age of Extremes”.

The century opened with many of the great European empires still largely intact. By the end of the century, not a single one would remain. The two cataclysmic World Wars changed the political landscape irreversibly, and also produced a profound change in the minds of men. In particular, it altered our view away from the mercantilist perception of national self interest, and drove home the message that self interest cannot ignore the common interest or the common good.

Arguably the lowest point of the entire century was the fascist and bolshevist regimes which emerged from the chaos of the First World War and the adversity of the Great Depression. The worst of all fascist regimes was without question the "Third Reich", designed to last 1000 years, but which was extinguished under the weight of its own evil in a little over a decade. Never has the World witnessed such disregard for human life and the abuse of minorities, at least not on this scale.

But, out of the ruins came a new beginning, an age of cooperation and tolerance. The reconstruction of Europe necessitated national cooperation on an unprecedented scale, and even between countries which had been adversaries in a murderous war but a few years previously. The Marshall Plan, which provided the funding for reconstruction, was premised upon such cooperation and could not work without it.

The resultant movement towards integration in Europe was very much a "globalisation" phenomenon on a regional basis. Indeed, globalisation in the sense of trans-national cooperation has gone further in Europe than between any other group of countries. Still, there is progress elsewhere as well, visible in the fruits of the work of the WTO, and in the regional Free Trade Areas, such as NAFTA, EFTA, COMESA or GAFTA, which are slowly emerging in a variety of regions.

Globalisation in Europe in terms of integration has brought peace and prosperity. The initial impetus may have been driven by the need for reconstruction and the intention to eliminate conflict through integration and dialogue. But, we now understand that globalisation confers many other benefits as well. For this reason we are actively expanding our political superstructure, the European Union. Membership has increased from 6 member countries as recently as 1970, to 27 member countries today and still more to join. That is a measure of our conviction to spread the fruits of cooperation.

But, we cannot include the entire World in the European Union and there has to be a limit to its geographic scope. But the process of globalisation has to continue until, as the name implies, it encompasses all economies on Earth.

Through growing economic integration, Europe has become a giant whose economic performance even exceeds that of the US. Politically, however, Europe has remained a midget, and from a military point of view, it is a newt. In the global context, Europe can only gain influence if it pools its resources skilfully, and if it brings itself to having a common foreign, security and economic policy. Europe has to promote its integration further; the common market and monetary union have to be merged into a common economic policy. And Europe has to learn to speak with one voice.

Globalisation and Europe's Opportunity

Globalisation, along with the technological improvements it has produced, has forced many changes. The cost of long-distance trade has fallen to such an extent that transportation and communication costs are now an insignificant component of the price of most goods.

The current economic situation also contains some risks. The imbalances in the global economy, particularly the external deficits of the US, and the surpluses of China, other Far East countries as well as of the oil exporting countries, poses a threat to the stability of the financial system. In the United States, the government as well as American households have amassed a huge "mountain of debt" as their deficits are financed by issuing debt securities. At the same time, the surplus countries are accumulating growing levels of foreign exchange reserves, which constitute excessive liquidity in the international financial system. Thus, we see that the group of specialist investment funds, known as hedge funds, and official state funds exercise control over financial resources which amount, approximately, to the GDP of Germany. This financial might would enable them to acquire, at a stroke, most of the companies listed on the German stock exchange.

Although this situation is untenable in the longer run, the risk of a serious and protracted recession in the United States is not something which even that country's most vociferous critics can look forward to with any degree of smug satisfaction. For this reason, the problem is not one to be resolved unilaterally by the USA alone, but will require a concerted multilateral effort.

Conclusion

I hope it is now clear that globalisation is the only way forward if we hope to live in prosperity, justice and in peace. Globalisation involves the in-depth integration of our economies as well as international cooperation and mutual trust in a fair distribution of the resultant prosperity.

Globalisation can be expected to help us attain two goals – a greater degree of global prosperity on the one hand, and a fairer and more rational allocation of resources and distribution of wealth, on the other. I am not saying that globalisation alone can achieve all of that – other measures will be necessary to achieve other related goals, such as the development of poor countries, and international agreement on the optimal rates of exploiting the environment and resources.

Nor am I implying that transition problems can be avoided, and much of my talk has dealt with those problems. In particular, the share of the developed world in production

and consumption will have to decline – here we are speaking roughly about the OECD group of countries – and this is hardly a cheerful prospect. But, just as a rising tide lifts all boats, an increasing World economic cake will make the inevitable redistribution easier to digest.

But make no mistake about one thing; a fairer reallocation of global wealth is coming. The only question is how? We can try to achieve this by means of globally agreed macro-goals, which are then implemented by free-functioning market forces – in other words, by globalisation. History teaches us that the most likely alternative mechanism – is war, combined with repression and genocide!

Europe has shown that globalisation does work. This will be our contribution to the history of the new century. Today, however, Europe is facing a historic decision - whether to become a global player in this power game, or whether to be content with being a mere pawn in the game of the global players.

Let me finish my remarks with a famous quotation. In the novel “The Leopard” by Giovanni Tommaso di Lampedusa, the character Tancredi states: “If we want things to stay as they are, things will have to change. D’you understand?”