



Telefónica Conference The International Economy: What Role for the European Union?

**Boosting Investment in Europe:
A Tale of Structural Challenges**

**Remarks by Angel Gurría,
Secretary-General
OECD**

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Ladies and Gentlemen,

It is a great pleasure to participate in this Conference on the International Role of European Business and its Benefits for Society. And I am particularly pleased to be part of this distinguished panel to address the role of the European Union in the international economy. In these difficult times of financial uncertainty and economic slowdown, we must not lose sight of our long term challenges. I congratulate Telefónica for organising this Conference.

It is a bit more than fifty years that the Treaty of Rome was signed. In five decades, Europe has transformed itself from a Continent in virtually permanent war into a region of growing prosperity. With a larger GDP than the United States and leading companies in most industries, it is now the world's largest exporter and the main source and receptor of foreign direct investment (FDI). In other words, one of the world's main economic engines.

However, the European project has faced important challenges during the past few years, and the region is still facing important economic structural challenges that impede the full development of its enormous potential. Let me touch very briefly on some of these challenges to try to stimulate our discussions.

1. More integration

First things first: European economic integration seems to have slowed down in recent years. This is affecting the European Union's competitiveness and investment opportunities. The single market has delivered major benefits for EU citizens. And we can say that this process is moving forward. But it seems to be slowing down. The lion's share of the improvement in trade, investment and price convergence occurred in the 1990s. Less progress has been registered since then.

The economic integration process needs a fresh impetus; especially now. A competitive and dynamic internal market is necessary to pull the European economy out of recession and to foster investment and long term growth and prosperity. It is essential to help achieve the objectives of the Lisbon Strategy for Growth and Jobs. It is also important for the smooth functioning of the euro area.

The service sector is the main area that requires further progress in the internal market. Service markets are still segmented, with trade among member countries amounting to less than 5% of GDP.ⁱ This contributes to low productivity growth in the sector, but it also affects the dynamism of Europe's major industries.

The services directive will help by providing more legal certainty, reducing administrative barriers and boosting co-operation among member states. The challenge will be on its implementation.

2. More competition

Europe has made considerable progress in liberalizing its product markets, but it remains more heavily regulated than the average OECD economy.

European network industries need major reforms to become more competitive and attractive to foreign investment. Further market opening is needed, for example, in key sectors like electricity, gas, transport, ports, postal services and telecoms, where regulators have not placed sufficient pressure on some incumbents, or market regulation has not yet been effective. According to OECD recent studies, the potential gains from network reform are estimated to be 1.5 to 2% of GDP at least.ⁱⁱ

What can be done to strengthen competition? I am not in a position to provide you with a specific remedy list for the various European countries. But I can at least set out some broad policy recommendations that emerge from our work.

First of all, Europeans should not go for the single quick fix. It is not useful to spend public money to boost this or that sector, or this or that champion in the hope it will result in improved competitiveness and growth. What is needed is a coherent set of policies that work together to deliver a stable macroeconomic environment and well-functioning labour, product and, as the past year has driven home to us so forcefully, financial markets.

Removing little-noticed obstacles to competition and impediments to entrepreneurial activity may do more to create a favourable investment and business environment than promoting headline grabbing schemes. If greater competition in the euro area could drive down price-cost margins to US levels, output would rise by 8.6% and hours worked by 4.5%.ⁱⁱⁱ

3. More innovation

To become attractive investment platforms and get the most out of globalisation, countries need to move up the value added chain. This requires innovative research-based economies. While the European Union is making progress in some areas of the Lisbon Strategy, to become “the most competitive and dynamic knowledge-driven economy by 2010”, it is falling short of this vision, lagging behind the United States and Japan on most indicators of innovation performance.

The ICT gap has been shrinking and the EU is a world leader in some areas such as aerospace, mobile phones and parts of the engineering industry. However, the gap in

business R&D expenditure has not shrunk and there is evidence that firms in the United States get higher returns from their R&D expenditure. Besides, Europe's system of patent protection is cumbersome and expensive. An inventor must apply for a patent in every country where he or she wants to protect it. The cost of applying for and maintaining a patent is up to 13 times higher than in the United States or Japan, mainly because of translation costs.iv

Modern economies are built with ideas and knowledge, as much as with capital and labour. The major continental European countries have well-trained workforces but their potential is being held back by weaknesses in tertiary education institutions. Most of southern and eastern Europe needs to improve educational outcomes and the way in which they support private-sector R&D. Some must also stimulate entrepreneurs by stripping away the barriers to firm creation.

4. Better financial regulation

As the current crisis has revealed, European financial markets have experienced a remarkable regional integration process. The introduction of the euro has created broader and deeper capital markets for debt securities and equity financing, and new policies have helped to bring down barriers to the provision of financial services across borders and create new common payments infrastructures.

More integrated and developed financial markets in Europe have contributed to economic growth and fostered resilience as larger and more diversified financial systems are better placed to absorb economic shocks. However, it may also open up additional channels for the transmission of financial shocks, including across borders. Moreover, several new financial products have contributed to more risk taking.

The European single capital market continues to be heavily reliant on cooperation between national regulators working within differing supervisory structures, having different responsibilities, instruments and powers. Against this background, it is necessary to continue efforts to ensure a level playing field, to enhance the sharing of information between regulators and supervisors and to align the incentives of national authorities with the cross-border impact of their institutions.

Concluding

These are just a few recommendations that can help the European Union seize its immense investment potential and increase its role in the global economy. Of course, there are other important factors that hamper Europe's trade and investment potential: like taxation issues, greater labour mobility, stronger regional cohesion, farm subsidies and promoting greener energies. I could go on talking about our work with the European countries on these areas, but I have to stop here and let Wolfgang lead the discussions.

Just let me end by reminding you that being open to trade and investment is one of the most important steps Europe can take to raise its living standards over the long term. Recent studies project that at least one fifth of Europe's post-war income gains can be attributed to globalisation. With the world's financial markets in turmoil, it will be important not to back-pedal on open and competitive markets. This would prove very costly for Europe and for the whole world.

Thank you very much.

ⁱ OECD Economic Surveys European Union, Volume 2007/11, September 2007, p.10

ⁱⁱ Idem, p. 11

ⁱⁱⁱ Idem, p. 24

^{iv} Idem, p.43