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Europe as a power

An INSEAD roundtable discussion with: Thomas Barrett (MBA '78), director of the European Investment Bank; Jean-Paul Bethèze, chief economist of Crédit Agricole and member of the French Prime Minister's Economic Analysis Council; Alice Rivlin, director of the Greater Washington Research Program at The Brookings Institution.

There has been so much 'hype' about the rise of the BRIC countries – Brazil, Russia, India and China – as the new economic powerhouses of this century, that one begins to wonder about the relevance of Europe as an economic power.



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“Is the European economy as relevant as it once was?” asks **Alice Rivlin**. “Yes, absolutely, the citizens of Europe are better off now in an economically integrated Europe than when each country was going it alone. In the US, for example -- where the economy has been integrated for 200 years -- the economy of the state of Michigan is in dire shape, but no one in Michigan believes that they would be better off if Michigan were not part of the Union.”

However, Rivlin points out that if the European Union has done well in terms of inflation control and monetary policy, and building strong financial markets -- which are both key to having a strong economy -- the third key is, which is missing, is responsible fiscal policy. “EU countries must learn to live within their means. Fiscal challenges have yet to be met in Europe” says Rivlin.



“Yes,

Europe is relevant, but relevant for what?” asks **Jean-Paul Betbèze**. “What are we, as Europeans, supposed to do in a new world where one third of global growth is now coming from China and India? The key is to reform ourselves. But we’ve only just started doing that,” adds Betbèze, following the recent election of President Nicolas Sarkozy.

The EU 'Weight Watchers'

Regarding fiscal policy, Betbèze compares the EU to a club of Weight Watchers, “in which the Italians claim they have no scale, and the Germans reply that they’ve been serious about losing weight for

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four years before everyone else joined the club!”

In Betbèze’s analysis, the process of fiscal discipline – or Weight Watching as he calls it -- is like a J-curve in which it is very painful to get results at the beginning, but then progress happens much faster later on.

“There is a first mover advantage for the person who goes on the diet first, who therefore becomes more competitive first”, says Betbèze. “The first dieter – Germany -- reaps all of the benefits from the diet. In France, we must reform our product and labour markets. France and Italy are just at the beginning of the diet. But beware, you have to make reforms for the right reasons in order to be relevant. The EU needs an explicit strategy regarding reform.”

The need for constant reform



Thomas Barrett agrees with Betbèze that the EU “should no longer pursue the policies of the past -- we have a need of constant reform, because of the challenges of globalization.”

But what exactly are the challenges of globalization that could potentially make Europe irrelevant as a macroeconomic power?

“Asia is not just about cheap labour,” argues Rivlin. “Can we compete with an India and a China that now compete with us in the top sectors of the knowledge industry?”

Is Europe just a cow to be milked?

Beyond the threat of competition from China and India in high-tech industries tomorrow, Betbèze argues that China already has a strategy today to acquire assets in rich countries. “Because of anti-China protectionism in the US,” says Betbèze, “China will start buying assets in countries where they are less protected -- in Canada and Europe for example -- and then one day the US also. So, is Europe just a cow to be milked?”

According to Rivlin, one of the reasons that the European economy is less dynamic than the ‘BRIC’

countries, or the US, is because of the rigidity of the labour market in Europe. “US companies can just fire people at will and Europeans think that’s cruel. But US companies are less hesitant to hire people. There is a lot to be said for flexible labour markets. The EU is burdened by heavy regulation.”

But how fair is it to use the labour market as a benchmark for comparing economies when many of the jobs in China, for example, are manufacturing jobs which no longer even exist in Europe? And how important is it for Europe to preserve a strong manufacturing base in its economy?

For Rivlin, the manufacturing issue has already settled once and for all: “We will move away from manufacturing in the developed world and to think otherwise is just an illusion.”

Betbèze thinks the opposition between manufacturing jobs and services jobs is the wrong issue: “We should reduce the wall between industry and services, and realize that industry is a source of services.”

'Don't be afraid of change'

The example of the United Kingdom illustrates how a major European economy can transform itself in a matter of decades from a manufacturing economy to a services-oriented economy -- mainly in financial services today.

For Betbèze, “It’s a story about TINA: There Is No Alternative. In the UK they know this, but not in the EU. In the Weight Watchers club, when you gain kilos you do not see it immediately, so it is quite dangerous, and you pay the price much later, but also much harder. We must go on a diet even, if we don’t know it and don’t see it. We must explain the benefits of the EU, but those benefits are never immediate, and it’s easier to blame Brussels in the short term. I say to European citizens: Don’t be afraid of change. We are too frightened of change. What we must start to say is: What’s frightening is not to change. We as economists must sell the story and sell the explanations.”

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