Europe 1992: Issues and Opportunities

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During the whole postwar period, Western Europe has been moving in fits and starts toward more intimate forms of economic cohesion that transcend the traditional relationships between individual nation states. Some visionaries have even promulgated ideas of eventual political union.

In the last two years, however, the fundamental political and military environments within which the European Community has been evolving economically have been dramatically – and apparently irreversibly – altered. In a direction that is exactly contrary to the expectations of communist theory, the economic and political systems of the former so-called communist „bloc“ have collapsed under the weights of their own incompetence and moral bankruptcy. While these events fulfill in one sense the wildest hopes of democrats in Western Europe and elsewhere, they also raise a host of new issues that the European Community – and its business associates around the world – must confront.

The Challenge of Cohesive Action

The most severe test that the European Community now faces, overshadowing for the moment questions about implementation of the Single European Act, is the ability of its members to define and put into action common policies with respect to their relations with the rest of the world – including the rest of Europe. This challenge is made far more complex by the dramatic events of the past two years. Political and economic union do not have to proceed in lock step, but neither do they develop in isolation from each other. The politics of responding to the challenges, threats, and opportunities posed by the collapse of the Soviet hegemony over most of Central and Eastern Europe and the uncertain future of the former Soviet Union itself place very severe additional strains on the relationships among the Community's existing members.

For example, the internal strife in Yugoslavia triggers very different interests, fears, and hopes in Greece – which has a border and ethnic links with the Yugoslav province of Macedonia – from those in Germany, which historically has had a very strong influence over Croatia and Slovenia, two provinces that are trying to break away from the Yugoslav federation and from Serbia in particular. Similarly, there was little evidence of concerted European policy or action in the recent war with Iraq. Each country reached its own decisions about whether and how to support U.S. actions. Nor have Community members achieved consistently coherent policies on such critical issues as defense, security, foreign policy, or immigration.

However, only initiatives taken and implemented at the European level have a chance of containing the disruptive forces of racial, ethnic, and religious strife that have been brought to the surface by the collapse of the prevailing power centers in Central and Eastern Europe and the former Soviet Union. Without such initiatives there can be no hope of creating an environment that permits healthy economic development.

Furthermore, the sheer economic weight of Europe, and the attractiveness of European markets to suppliers of a wide range of goods and services, have meant that the rest of the world increasingly expects coherence in European policies and actions. The success of the rich Western European economies and their interdependence generate a strong motivation for additional political and institutional relationships at the European level that will promote this cohesion. Without such relationships, it seems inevitable that sooner or later Europe will come to resemble an economic region and trading bloc that is dominated by Germany, rather than a community that is inspired by a diversity of overlapping interests and influences.

Critical though it is, the need for European political cohesion should not be permitted to eclipse equally important issues of economic viability and competitiveness.

The Competitiveness Problem

The reshaping of the European political landscape presents some new opportunities as well as perils to many European and non-European businesses. The assessment of these opportunities demands a clear perspective that goes beyond today's headlines. Despite all the attention being paid to the reconstruction of Central and Eastern Europe and the economic future of the former Soviet Union, the rich Western European countries remain by far the most interesting and attractive markets for most businesses, whether European or non-European. But even within these Western European countries, there is justifiable concern about the underlying competitiveness of European companies in several key industries.

During 1990-1991, the trade deficit of the European Community with Japan has risen substantially and has come to rival that of the United States. In the automotive industry, for example, prestigious, high-quality products from Mercedes to BMW face strong competition from the relatively new Japanese luxury car models such as Toyota's Lexus and Nissan's Infiniti. Like the Americans before them, Europeans are seeking to limit penetration of their domestic car markets by the Japanese with the help of „voluntary“ limits on Japanese car sales. When practiced in the United States, this strategy had the effect of allowing the Japanese manufacturers to secure higher margins

on their U.S. sales without apparently enabling the U.S. manufacturers to stop – let alone roll back – the rise in Japanese market share.

In the electronics sector, European semiconductor companies show little sign of being able to improve their share even of European markets, let alone of extra-European ones. Furthermore, the record of the indigenous European computer industry does not inspire confidence that it will be able to nurture successful, major global competitors in the long run. In consumer electronics, the two major European players – Philips and Thomson – are having to fight very hard to maintain their positions against the leading Japanese and other Asian vendors in determined efforts to avoid the fate of the U.S. consumer electronics industry, whose players have all but disappeared as independent entities.

In telecommunications, at least, the European position is relatively strong. Companies such as Alcatel Alsthom, Ericsson, and Siemens figure prominently among the global leaders in terms of both market share and technological prowess. Even in this sector, however, there is some cause for concern. European countries are relatively weak in the high-growth segment of data communications equipment where the United States is both entrepreneurial and dynamic. European firms are dwarfed by the enormous strengths of Japanese manufacturers in the consumer electronics markets. The latter area is particularly portentous because the development, manufacturing, and marketing skills required for consumer electronics are increasingly transferable to markets using a growing variety of telecommunications terminal equipment.

The real lesson of the weakening of the European electronics and automobile sectors, as compared to the competitive strengths of some other European industrial and commercial sectors, is that companies that remain very dependent on single national markets rather than European and broader markets are ultimately self-defeating. Unfortunately, several leading European companies in the automobile and electronics sectors fall into this category. Strong remnants of mercantilistic thinking and practice in Europe have distracted these companies from developing their long-term competitiveness.

Despite these concerns, there is much room for optimism. In industries as diverse as food, chemicals, pharmaceuticals, industrial and farm equipment, petroleum refining, and publishing and printing, Europeans can point to companies such as BASF, SmithKline Beecham, Nestle, Asea Brown Boveri, Royal Dutch Shell, and Bertelsmann as examples of businesses that appear to be at least as well placed as any U.S., Japanese, or other rivals. Indeed, many are extremely well positioned for continued success in their chosen fields of endeavor. European companies in these industries have shown themselves to be capable of cosmopolitan thinking on a European and indeed a global scale. And across these and other industries, the pattern of European companies is extremely variegated with regard to competitiveness, the relative influences of laissez faire thinking and government regulation, and market shares in regions outside Europe.

One danger for European firms, however, is regional isolationism. An excessive concentration on the new situation in Europe may lead to neglect of both the opportunities and the competitive forces in North America and Japan, as well as in rapidly developing countries around the world.

The political, financial, and emotional ties within the new European realm are very strong, and it is natural that Western European firms should seek to exploit opportunities to the east. It is also natural for them to rely on traditional ties with their own governments and on their expertise in dealing with marketplaces that are heavily influenced by politics. But if in so doing European firms neglect to pay close attention to the evolving competitive strategies of formidable rivals from North America and Asia, or to develop their own strategies for operating in these rich markets, then their long-term competitiveness in several major industrial sectors may weaken.

The European Edge

In pursuing competitive advantage, Europeans have a special edge relative to both the United States and Japan: an extraordinary diversity of skills and expertise. Within Europe, there are many centers of excellence, from the Italian flair for design of apparel and automobiles to the financial strengths of the United Kingdom, the high-speed land transport system of the French, and the methodical training methods and manufacturing productivity of the Germans (to name but a few). The economic and business challenge is to enable all these diverse centers to become productive across Europe, rather than primarily on a national scale.

Furthermore, Europeans have shown themselves to be remarkably resilient and adaptable in responding to and helping to shape new political, social, and economic environments. It is at least plausible that the recent astonishing events in Europe will stimulate Europeans to develop initiatives that effectively support the long-term competitiveness of European industry and commerce. Such initiatives presumably would combine individual efforts with communal obligations and responsibilities. For example, Sweden's approach of linking unemployment compensation to training might be emulated throughout Europe.

In this context, Europe differs in several fundamental respects from the United States and Japan. For example, Europeans have certain advantages over the United States in traditions of social responsibility. The latter country, in an intriguing contrast to the European experience, is running up against the limits of sheer entrepreneurship, which fails to pay sufficient attention to the values of cooperation and mutual responsibility, particularly in fields such as education and health care. In the long run, these social activities are as critical to competitiveness and economic prosperity as other, more obvious factors, such as capital investment and R&D budgets.

Nor, indeed, are Europeans necessarily less well equipped than the Japanese to prosper in future economic and business endeavors. The formidable manufacturing and financial strengths of the Japanese, their assiduous collection of technical and market information on a global scale, and their ability and willingness to invest for the long term are coupled with a very fragmentary and impoverished set of interactions with the rest of the world in other than financial and economic spheres. The homogeneity of Japanese society, while a strength in many respects, is also a weakness when it comes to dealing with a very heterogeneous world. To the extent that the ability of a country or group of countries to influence events in their interest depends on a reputation for using power with integrity and disinterestedness, and not just on economic and military strength, then Europe, for all its limitations, still enjoys some significant strengths that Japan lacks.

One area in which European businesses possess clear geographical and cultural advantages is investment in Central and Eastern Europe. But here all comers must proceed with considerable caution.

Investing in Central and Eastern Europe

Opportunities abound for investing in Central and Eastern Europe. There is vast need for the development of communications, transport, and other parts of the fabric of modern economies. Inevitably, however, much that glitters is not gold. Black market economies do not necessarily possess the qualities required for the healthy operations of modern entrepreneurial economies. Major short-term (it is to be hoped) dislocation and pain may have to be endured before sound economic structures can be put into place. In the former East Germany, it is estimated that production fell by about 40 percent in the first year of unification. Even in Hungary, which has a head start on its neighbors in developing a more competitive market-type economy, potential pitfalls abound, as evidenced by the bankruptcy of Videoton, with whom the French-owned computer vendor Groupe Bull had developed a partnership.

For some time to come, much business in Central and Eastern Europe will fall into the high-risk but potentially high-return category. Not all businesses in these countries can be saved by Western partners with injections of capital and technology. A great deal of the economic infrastructure is still developing, from trained people to the basic framework of recognized accounting, tax, and legal practices. This framework will be evolving in parallel with – rather than prior to – the execution of major contracts. The selection of local people and organizations with whom to work is far from simple. However well intentioned, some local industrial establishments will not be able to make the transition to a modern, competitive economy.

One major risk of investing in Central and Eastern European economies is the impact of prolonged economic and political chaos within the former Soviet Union. For example, even the well-developed Finnish economy has experienced significant difficulties in 1991 as a result of the inability of the Soviet economy to absorb Finnish exports. These exports can be paid for only by hard currency generated by Soviet exports of oil and other valuable commodities, which have fallen off substantially. Eastern and Central European economies are even more vulnerable than Finland to problems in the former Soviet Union, at least during a period of transition to modern economic structures. In 1988, exports of most of the Eastern European countries to the Soviet Union represented 25 to 60 percent of their production. These exports are not usually competitive in alternative Western markets. Furthermore, these countries have been very dependent upon Soviet oil for their energy needs.

Another major category of risk is the possibility of political and therefore economic disruption within Central and Eastern Europe itself. Yugoslavia is an obvious case in point, and other countries are not immune. A break-up of Czechoslovakia is not inconceivable, nor is fighting as a result of disputes arising from the treatment of ethnic minorities such as Hungarians in Romania. Businesses making substantial investments of people or other resources in these regions should develop contingency plans in the event that some of these worst-case scenarios materialize.

Nevertheless, for Western European and other firms with patience, determination, and a strong vision of what Eastern and Central European economies could become over a 10- to 20-year period, the prospects are enticing. Western European firms in particular should be in a good position to benefit from future growth and prosperity in these economies, thanks both to pan-European sentiments and the leading roles that Western European governments and financial institutions are playing in helping the economies of Eastern Europe get to their feet.

A Model for the Twenty-First Century?

As the twentieth century ends, events and forces in Europe are still promising to exert a powerful influence upon global history and economic development. The tremendous sufferings the world has undergone during this century arose largely because of conflicts that were inspired by competing ideas and spheres of influence that originated in Europe. An optimist might hope not only that the most vicious and destructive of these conflicts have largely run their course, but that Europe itself, around the core of the European Community, might be showing the way into the twenty-first century by establishing in its own spheres new relationships among diverse political, economic, social, and linguistic groupings. These relationships might serve as models for the evolution of the organization of human society beyond the nation state, which has proved stubbornly persistent in this century despite the expectations and ideals of the socialists and communists of the late nineteenth century.

It has been observed that modern national governments may be too large and remote to be able to cope with local issues, while at the same time they are too parochial to cope with global challenges. For all its economic and political success – and the diverse origins of its inhabitants – the United States is less likely to serve as a useful model for future economic and political unions than the European Community. The historical experience of the United States, and its growth and expansion by immigration, are so unique that it is hard to see how other parts of the world would be able to grow organically the kinds of political and institutional relationships that prevail in that country.

In contrast, the very diversity of languages, cultures, and histories within Europe make it more likely that institutions and procedures successfully implemented there to realize common economic, social, and political goals may be applicable elsewhere in the very heterogeneous world in which we live. To quote the European Round Table of Industrialists *(Reshaping Europe)*, „The pretense that the Community can satisfactorily deal with economic subjects while leaving the management of all other foreign affairs in other hands has become an anachronism."

If such should prove to be the case, then 1992 may become in retrospect as important for the future of Europe – and the rest of the world – as 1492.

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