UNITED NATIONS UNIVERSITY

UNU-MERIT

ANALYSIS

Europe in the Global Race for Investments:
Defining the roles of Governments and Multinationals

A REFLECTION ON KEY ISSUES RAISED AT THE RECENT FDI CONFERENCE:
Investing in Europe's Regions and Cities. Public and Private Partners for Growth and Jobs.

By Sergey Filippov

Competition for foreign direct investment (FDI) has intensified over the recent times. The superiority of the Triad (USA, Western Europe, Japan) is being increasingly challenged by the emerging markets such as BRIC[1], as well as East European economies (new EU Member States). Faced with this new reality, governments rethink their policies. In this paper I elaborate on the complexity of relationship between multinational companies (MNCs) and governments, and bring Europe's investment attractiveness in the spotlight. I argue that a further European integration and simplification of regulatory environment are the key prerequisites for Europe's success in the global competition.

One of the most amazing phenomena attached to globalization and FDI flows is the revival of interest for the role of localities, based on the idea of eroding sovereignty of centralised nation-state in favour of both supra-national and sub-national institutions.

This is the reason why on October 9-12, I participated in an annual conference *Open Days 2006. European Week of Cities and Regions* organized in the city of Brussels by the European Commission and the Committee of Regions, under the topic *"Investing in Europe's Regions and Cities. Public and Private Partners for Growth and Jobs"*. The conference brought together European policy-makers, officials from European regions and cities, top executes of key high-tech MNCs and scholars. The discussions touched upon a variety of

---

[1] An abbreviation coined by Jim O'Neill of Goldman Sachs 5 years ago to denote four economies with the strong economic growth: Brazil, Russia, India, China. His recent forecast suggests that the aggregate GDP of these four countries will surpass the aggregate GDP of G7 by 2035. Furthermore, he argues that Mexico can be added to this club making it "BRIMC". And some other authors suggested to use the term "BRICS" (BRIC + South Africa).
More info: "Les "Bric" tiennent leurs promesses". Le Figaro. 23.10.2006:
http://www.lefigaro.fr/eco-entreprises/20061023.FIG000000280_les_bric_tiennent_leurs_promesses.html

issues, from public-private partnerships for infrastructural projects to R&D strategies of multinational companies.

The latter issue is of particular interest to me, as my PhD research project, conducted under the supervision of Prof. Dr. Geert Duysters and Dr. Ionara Costa, is focused at the interplay between the increasing internationalisation of corporate R&D (specifically, R&D-oriented FDI) and the national policy-making in the European context. The understanding of the fact that I live in Maastricht, a city where the EU Treaty was signed in February 1992, makes the research inspiring and exciting.

The conference gave me a unique opportunity to complement my academic vision on the topic with views of practitioners (both officials and executives). In this brief report I highlight the main outcomes of the conference and my reflections upon them, and raise several issues for debate.

Divergent goals of governments and multinationals

It is natural that goals and motivations of governments and multinational companies are by definition, quite different. To put it in a very simplistic way, whereas a government strives to increase social welfare, a firm seeks profit maximization. Though this idea is almost axiomatic, there still seems to be a lot of misunderstanding about it. Some political leaders adopt rose-coloured glasses in their approach to MNCs: *"….We have excellent quality of life in the region. Come to us and create jobs..."* Mr. François Barrault, President of British Telecom BT International, had a clear message for policymakers (both at the national and regional level) about avoiding unrealistic expectations of what MNCs could bring to the table. *"If you want to attract us [MNCs], you need to understand how we work, you need to walk in our shoes….We are not a social club. We are not here to create jobs".*

It follows then that the challenge facing policymakers is twofold. In the first place, they need to understand how business operates in order to provide incentives for MNC to invest to a particular location. At the same time, the sheer presence of an MNC may not result in concrete benefits for the host economy. It is a government's role to create the conditions that would help the country to reap the full benefits of the multinational's presence (i.e. to maximize the benefits and minimize the costs of inward FDI).

We live in a globalizing world with MNCs as major economic actors. Even though the goals of governments and multinationals differ, hardly any national economy can prosper without inward FDI. Thus the issue of investment attractiveness is gaining importance. Countries of the European continent are among the top FDI destinations but facing severe competition.

Europe's investment climate

It is widely acknowledged that despite Europe's leading position in terms of inward FDI, the continent is losing to its principal competitor, the USA, and increasingly so, to the emerging economies, BRIC in particular. Dr. Edward G. Krubasik, President of Orgalime, former Executive Vice President of Siemens AG, presented a basic typology of global markets: Europe is a large mature market ("size"), BRIC / Asia has explosive economic growth ("growth"), and the USA combines a large mature market with growth ("size + growth"); naturally, *ceteris paribus,* multinationals would prefer to go for size of the economy and economic growth at the same time, to "the lead market".

Problems undermining Europe's competitiveness and inhibiting growth are well-known and include, *inter alia*, productivity falling behind (London is the only European region or city where the productivity matches the US level); failure to capitalize on the application of ICT,; rigidity of labour markets; and losing in the competition for R&D-related FDI and highly-skilled migrants.

The most alarming development is the so-called "European paradox", i.e. the commonly held view that Europe is good in (academic) science but falling behind in technology. This has led to a gap in terms of European technological performance relative to the US. The same goes about the start-up businesses in the high-tech sector. As it has been accentuated, there is no "European Google", "European YouTube" or "European Wikipedia", small and medium enterprises (SMEs) which turned into high-tech multinationals. "YouTube", a company founded in February 2005 in a garage in California, has recently got a price tag of $1.65bn when Google agreed to buy it. Google itself, born in September 1998, has reached a market capitalization of $130bn. In many instances, success of US business can be explained by the entrepreneurial spirit of Americans, that is not always the case in Europe. "[In Europe] *There is a stigma attached to failure* [inhibiting entrepreneurship]*"*, as Mr. Craig R. Barrett, chairman of the board of Intel Corporation, put it at the conference.

What can be done to make Europe more innovative and hereby improve its investment climate? There is a vast body of academic literature and policy reports on the issue[2] - including a significant contribution from work at UNU-MERIT[3] on the types of policies that can support such innovation at all levels..

Multinationals demand "more Europe" and "less Brussels"

The kinds of policy support required by MNCs can differ quite significantly from that of smaller enterprises (for whom factors such as easy access to venture capital, cost of patents, etc are critical).Top executives at the conference underlined two types of policy interventions that MNCs consider critical for their operations: (1) further integration of the European Single Market, and (2) streamlining of regulations, making the climate more "business-friendly". On their part, governments are increasingly aware that they have "*to do something*".

With regard to the first issue, the European market remains greatly fragmented despite fifty years of European integration. In several instances national markets and industries continue to enjoy strong government protection. This increases the costs of doing business, especially in comparison to such integrated markets as the US and China.

Presenting the 2006 edition of Ernst & Young's European Attractiveness Survey[4] Mr. Marc Lhermitte, reported that the USA and China topped the list, at 41% each. Germany and India were ranked second (18% each)[5]. However, if comparisons are made at the aggregate level - looking not at separate countries but regional blocks - Europe fares much better. According to the same survey, Western Europe ranks first in terms of investment attractiveness (68%), Eastern Europe is the second (52%), then USA/Canada (48%), followed by China (41%) and India (18%)[6]. Thus the issue of further market integration seems a natural way to increase Europe's investment attractiveness. But debates on this issue are currently of much more political, than economic nature (e.g. perceived threats to *L'économie sociale de marché / Soziale Marktwirtschaft)*.

Concerning the calls for streamlining the existing regulations, there seems to be a political determination, at both national and European levels. In an open letter published in the *Financial Times* on 09/10/06 the Dutch Minister of Finance and his Danish counterpart, stated that "E*uropean businesses suffer from unnecessary red tape,*", and called on the European institutions to follow the example set by Denmark and the Netherlands and simplify their regulations.

[2] For example, EC (2006) "Creating an Innovative Europe". Report of the Independent Expert Group on R&D and Innovation appointed following the Hampton Court Summit and chaired by Mr. Esko Aho (http://ec.europa.eu/invest-in-research/pdf/download_en/aho_report.pdf);
EC (2004). Facing the challenge. The Lisbon strategy for growth and employment. Report from the High Level Group chaired by Mr. Wim Kok (http://ec.europa.eu/growthandjobs/pdf/kok_report_en.pdf)
[3] http://www.merit.unu.edu/research/index.htm
[4] Ernst & Young (2006). *European Attractiveness Survey 2006. Globalisation Act II: Team Europe Defends its Goals.* Studio EY.
[5] Total is superior to 100% - 3 possible choices.
[6] Total is superior to 100% - 3 possible choices.

In an interview published in the same newspaper the following day Günter Verheugen, the EU Enterprise Commissioner, echoed these sentiments. *"There is a view that the more regulations you have, the more rules you have, the more Europe you have. I don't share this view".* He revealed that the administrative costs of Community legislation alone costs firms up to €600bn annually! Chancellor Angela Merkel has indicated that cutting red tape and boosting innovation will be among the top priorities when Germany takes over the EU presidency in January 2007.

The calls for further European integration are borne out of pragmatic considerations. The message was clear: MNCs (and specifically, the European ones) need and demand a large liberalized and integrated market. It is up to the governments to respond.

Integrated Market and Growth

In a globalizing world, international competition for resources and capital is mounting. Europe, as an economic bloc, has all the potential to compete successfully at international level. In order to do so, governments must understand the way business works and become more "business-friendly," while continuing to protect the welfare of their citizens.

While MNCs wish to operate in a liberalized and integrated European market, this represents only one side of the coin. Continued economic growth is the other. In the meantime growth is also high on the European political agenda[7]. Improving infrastructure, boosting innovations, investing in R&D, attracting FDI in knowledge-based activities will stimulate growth. Positive signs are starting to appear. After extremely slow growth, the EU's rate of growth is expected to increase in the next couple of years. *"We have a solid foundation for future growth in Europe," said* Mr. Jean-Bernard Guerrée, a co-founder of Avisé Partners. "*I keep a lot of optimism about Europe. Europe as a continent is a force",* echoed Mr. Patrick Gounelle, President of Ernst & Young France & Southern Europe.

****

DISCLAIMER:

The opinions expressed in this article are personal and do not represent the official position of UNU-MERIT, UNU or Maastricht University.

The reference to a company and its activities should not be construed as an endorsement of the company or its activities.

[7] "Growth and Jobs Strategy": http://ec.europa.eu/growthandjobs