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Keynote Addresse by

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Good afternoon Mr. Chrobog,
Professor Sinn,
Ladies and Gentlemen:

Economic policy in the face of global markets

Johann Wolfgang von Goethe once wrote:

"There are four things a person should do every day:
listen to a pleasing song,
read a good poem,
look at an excellent painting,
and, if at all possible, speak a few words of reason."

I thought of these things on my way to Munich. As far as the first point is concerned, Munich boasts the Philharmonie concert hall in the Gasteig Cultural Center, for example. With respect to the second, Munich is where Thomas Mann wrote *The Magic Mountain (Der Zauberberg)* – which, although not a poem, surely meets Goethe's requirements. And on the third – the painting: Munich is home to the Alte and Neue Pinakothek art galleries, amongst others. On the fourth point – speaking "words of reason": by now, the Munich Economic Summit has become an established international institution. And, as in the past, so the subject of today's conference "Europe and the New Division of Labor" – is once again a hot topic in the current economic debate.

The challenge of global competition

But what do we really mean by "the new international division of labor"? For me, there are four aspects that deserve to be highlighted. To begin with, production processes can now be broken down into their component parts more than ever before. Secondly, the number of goods and services that can be traded across international borders is increasing rapidly. Thirdly, financial markets around the world are today more closely interwoven than they have ever been before. And fourthly, the individual locations with their economic policies and fiscal and regulatory systems, are competing internationally for investments and savings.

The speed at which international markets are integrating is breathtaking. Many of the current international key data have risen by a factor of two in barely more than a decade, and this applies to more than just total world trade volumes alone. The share of imports from emerging and developing countries contributing to the economic productivity of industrialized countries has also doubled. For instance, China is now our fourth most important importing country, after France, the Netherlands, and the United States. The energy consumption of many emerging countries has also doubled, as it has in China and India. As a consequence, over the next 15 to 20 years, China alone plans to build as many as 40 new nuclear power stations. Finally, the level of foreign direct investment worldwide in relation to global economic product has risen from less than 10 percent to over 20 percent.

However, many of the consequences of an intensified international division of labor are not directly apparent. We may all notice the increase in energy consumption as a result of higher petrol prices. We may also notice that more and more products are imported from emerging countries, as we come across the tag "Made in China" with increasing regularity. But consumers barely notice that a very significant proportion of the international division of labor is accounted for by the manufacture and trade of intermediate inputs. And it's not just multinational corporations that are involved. In Germany, 35 percent of SMEs have foreign suppliers. This is not a sign of weakness in our national economy. On the contrary: making use of international supply chains allows German companies to safeguard their livelihoods, and also to expand.

Notwithstanding the debate surrounding the "bazaar economy," we will soon experience much more tangible effects of the intensified division of labor; with the integration of China, India, and other nations

into the global economy, the global availability of labor is increasing rapidly. Millions of employees are prepared to work in these countries at much lower wages than their counterparts in industrialized countries. What's more, the potential of these workers has often been underestimated; the number of skilled workers in these countries is also increasing. China, for example, has more high school graduates than either the United States or the EU25. Lively investment activity – also from foreign companies – serves to increase the productivity of the workforce in these countries even more. The OECD estimates that, in the future, industrialized countries will be able to outsource around 20 percent of operations to other countries in sectors that require highly developed information and communication technologies. Competition is also becoming tougher in what was once the exclusive domain of the industrialized nations – the production of high-tech products and services.

The question must be asked, however, whether or not in the future we can continue to keep pace with the speed of China's export success. On the one hand, a purely quantitative growth that involves ever-increasing resources in production, but without making any technological progress, must necessarily reach its limits. On the other hand, the imbalances in foreign trade will, sooner or later, induce adjustment processes in the markets, which will again allow trade flows to develop in different directions. Finally, the development of wages in the dynamic hubs of Eastern Asia is progressing just as dynamically as their economic growth itself.

Globalization as an opportunity

Nevertheless, the public perceives globalization trends first and foremost as a threat. Despite this, I find it rather unlikely that emerging national economies should suddenly be identified as unwanted competition that needs to be suppressed. Ultimately, they are only doing what proponents of development policy have been preaching to them to do for decades: they have been resorting to their own strengths and facing up to international competition. A look back into history shows that an intensified international division of labor has, in fact, always been a blessing. A particularly good example of successful integration is the German "Economic Miracle" that followed World War II. Had we then had external foreclosure, a controlled-currency economy, protective tariffs, and no guest workers, our standard of living today might well be no better than it was in Eastern Europe in 1990. And even today, Germany's integration in the global economy may be regarded as an impressive success story.

Despite the rise in the value of the euro against the US dollar by around 40 percent since late 2001, not to mention the appearance of new competitors, Germany has managed to increase its international market share. We occupy an excellent global position, particularly in markets and sectors that show strong growth. This proves that our economy can capitalize particularly well on the benefits of an international division of labor.

In the future, the focus should be on rendering global market opportunities even more accessible. Here, it's worth considering that China and India alone represent 2.3 billion consumers!

Then there are our Eastern European neighbors, who are particularly keen to buy German products. Additionally, there is an as yet ungauged wealth of potential in the service sectors. In this respect, the strengths of the German service economy are often underestimated. Thanks to the high level of education of our skilled workforce and our state-of-the-art communications and transport infrastructure, we are well equipped to compete in open international service markets. We occupy an excellent international position, particularly in industries like logistics, insurances, and information services. Overall, we are the world's third-largest exporter of services, after the United States and Great Britain.

Admittedly, we can't be "world champion" at everything. Goods exports and the FIFA World Cup – that wouldn't be a bad start. Alongside accelerated economic growth, the demand for top-quality, high-grade, high-tech products is also increasing dramatically. This means better employment opportunities and earning potential for highly skilled workers. In this light, the chronic lack of university-trained engineers that we are currently experiencing in Germany should be seen first and foremost as an opportunity for our young people.

Workforce mobility

A further sign that our world is becoming more and more networked is the increasing mobility of the

workforce itself. Here, too, what we are experiencing now is only the forefront of coming developments. By that, I don't just mean the ever more acute migration problems in Europe. In future, the potential and dynamics of a location, and its quality of life, will have a stronger influence on the flow of migration, both outwards and inwards, of skilled workers. Seen in this perspective, the attraction that a country holds for immigrants provides a meaningful site index.

Every now and then, there are indications that Germans are increasingly inclined to emigrate. A few weeks ago, Uli Hoeness, manager of the medium-sized enterprise Bayern München, the Munich soccer club, summed up the issue in a nutshell. On the subject of Michael Ballack, currently Germany's most renowned active soccer player, and his move to Chelsea London, he said:

"It was clear from the outset that Michael didn't go for the sake of a new language and a new culture – he went for the new currency."

As Minister for Economics, I ought to be worried if our best minds – and indeed our best legs – are leaving the country for good. On the other hand, if they just want to spend some time gathering experience abroad, that will be an asset for our country. What Goethe once wrote about his sojourn in Italy may well hold true for Michael Ballack: "People know themselves only insofar as they know the world."

Commitment to the market economy

One thing is certain – there are no simple or conclusive answers to the questions posed by globalization. I make no bones about my own conviction: I believe that competition and open markets in Germany, in the EU and beyond are a central instrument for successfully shaping globalization. Competition allows personal initiative and responsibility to flourish. It provides a fair and reasonable opportunity for economic success on the part of companies and employees alike.

Competition fulfills key functions, especially in a global context: it promotes innovation and the spread of new technologies. I am reminded of the speed at which microelectronics has infiltrated almost all areas of daily life. Moreover, competition has the effect of lowering prices, also in an international context. It's not without good reason that the cost of a domestic telephone call in Germany has fallen by 95 percent in the last eight years. Effective competition means having recourse to alternative suppliers and alternative technologies. The importance of this is manifest in the current energy debate.

Central areas of action for economic policy

Three areas of action are particularly important for economic policy in the age of globalization. The first priority is to create in one's own country the appropriate basic conditions for the economic activity of companies and employees. As long-distance costs fall, especially the cost of transport and communications, the attractiveness of those basic conditions will become increasingly important. In this sense, economic policy *per se* will gain significance as a factor of regional economic policy, while physical considerations such as geographical location will take a back seat. For Germany this means that we must secure and develop the attractiveness of our country for investors and innovations. Admittedly, the tax burden in Germany measured against GNP is not particularly high in international terms. At the same time, it is a cause for concern that our business tax rates are, by international standards, too high. This will be addressed by the business tax reform, to take effect in 2008. By raising VAT in 2007, we will not just be taking a significant step towards consolidation. At the same time, the relief this will bring from non-wage labor costs will also improve employment incentives in the labor market. With the coming health reform, too, we must keep our sights focused on the urgently needed decoupling of statutory health insurance contributions from labor income. Furthermore, we must secure and expand our strengths in the field of capital- and knowledge-based products and services. This is the only way we can continue to afford wage levels that are high by international standards. To this end, we will strategically expand funding for education and research. By the end of this decade, we will increase state and economic spending on this area to 3 percent of GDP, or around $80 billion each year.

We also need to allow companies and employees more freedom in their decision-making. After all, it is they who must ultimately adapt to global competition. That is why the issue of deregulation and reducing bureaucracy deserves special attention.

However, the issue that most requires our attention is the development of the labor market. The central task of economic policy is to give people the opportunity to engage in economic activity in order to allow them to develop and pursue an independent lifestyle. To this end, the well-intentioned approach of the "Hartz" reforms needs to be developed further in certain areas. In so doing, I believe it is important to further strengthen the competition philosophy and the motivating and controlling function of wages. Flexible wages can give people a timely indication of which sectors and regions they should enter into. On the other hand, setting wage levels with rigid wage agreements, or even by legislation, will lead only to higher unemployment. And I remain firm on another point: rigid protection against dismissal, too, is acting as a brake on the inevitable structural changes. We must actively support the mobility and flexibility of employees, and we must promote schemes for skill development, training, and education.

A second field of action for which we must adapt the basic conditions to meet global challenges is that of the European Union. The densely populated and relatively homogenous EU economic environment offers excellent conditions for strengthening the networking of industrial production. This is even more relevant for the service sector. It is thanks to information and communication technologies that the still considerable productivity reserves in this sector can be exploited. To this end we must facilitate access to the national markets. I now wish we had shown a little more courage when it came to the compromise on the EU Services Directive. We must now ensure that consumer and environmental protection concerns do not serve as an excuse for protectionist measures. I intend to use the opportunity of the German EU presidency to lobby for stronger competition within the European networks, in particular in the telecommunication and energy sectors.

Finally, the third area of action consists of shaping global basic conditions for the international division of labor. The most important factor here will be the successful conclusion of the Doha talks. We must achieve the goal of substantially improving market access for goods and services of all participants. Emerging countries and advanced developing countries must make their contribution by significantly reducing applied tariffs and guaranteeing additional market access for service industries.

It is with concern that I observe the increasing tendency to adopt regional free trade zones instead of finding multilateral solutions. It will be to the detriment of medium-sized companies in particular if, depending on the target region for their foreign trade, they must constantly come to terms with different bodies of rules and regulations. With bilateral trade agreements, there is also the additional fear that whoever is the stronger partner will be the one that dictates the terms. In this light, it is small and developing countries that may stand to lose the most if the Doha talks fail. But it is also important that rules that have already come into force under the provisions of the WTO are strictly monitored and adhered to. This is the only way in which fairness in international competition can be guaranteed. This applies, among other things, to the existing rules for the protection of intellectual property. But despite this, I can still see in the future – beyond the Doha talks – plenty of potential for removing the still extensive non-tariff-related obstacles to trade and direct investment.

Limits to state intervention

The intensified international division of labor again raises the question of whether, where, and how much active economic policy we need. It is with a degree of skepticism that I notice that many people are increasingly inclined to call for the state to play a more active role. While the basic conditions are gaining importance in a dynamic international environment, individual measures and national attempts to "go it alone" are becoming demonstrably less effective. Limited public financial resources additionally reduce the room for manoeuvre. And it isn't always clear whether or not private commercial solutions may, in individual cases, be possible, or even preferable. However, I can see a few developments that may make an active economic policy necessary, even in the future. At times, multilateral agreements and institutions are still too unrefined to guarantee fair international competition. The targeted funding of industry and exports in individual countries often leads to a distortion of international competition. And global competitive markets without a globally effective competition watchdog do not yield the best possible economic results. In these instances a compensating intervention by the state may well be appropriate, for example in the area of research and innovation. In this sector, it is important to safeguard key technologies in particular, so that Germany and Europe can remain internationally competitive.

Another very topical issue is the question of a strategy for the supply of energy and raw materials. I consider it justifiable to actively promote the expansion and retention of certain energy sources, in order to be well prepared for any risk scenarios that may arise in the future. And I will actively accompany our enterprises through the sometimes turbulent waters of the global economy. This is where our chambers of foreign trade can make an important contribution, by promoting trade fairs and underwriting export credits and investments. That is what I consider to be a reasonable foreign trade policy.

On the other hand, the growing international tendency towards "economic patriotism" is extremely problematic. This phenomenon, incidentally, is not limited to Europe. Apparently, the United States is also not immune to it, as was evident in the effective resistance to the sale of a Californian oil group to a Chinese company, and the failure of an investor from Dubai, who wanted to take over the operation of a number of American ports. In both cases, the deciding factor was, no doubt, not the quality of the offer, but an objection to the nationality of the bidder. In my opinion, preventing competition in this way has very little to do with patriotism, but a great deal with protectionism. The citizens of our country will be best served if we remain an attractive location that can induce foreign capital, foreign expertise, and intelligent minds to come to our country and work productively here.

Conclusion

I am pleased to see that companies and consumers alike have clearly expressed their optimism in the most recent surveys. If the economic climate as portrayed by the Ifo Index is anything to go by, we are already in the middle of a strong economic recovery. We must support the present upturn by taking the right stance with our economic policy. By means of a clear, comprehensible economic policy that promotes competition, we hope to gain people's confidence, and also their trust that a strengthened international division of labor will lead to greater prosperity for all. Accordingly, I make a direct plea for an in-depth dialogue between politicians, academics, and business. This is, in fact, the aim of the Munich Economic Summit – which is why I would like to thank the BMW Foundation Herbert Quandt for its invitation.

I wish all participants a stimulating discussion, and I hope that afterwards we will all emerge the wiser.