International Business Environment

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CASE STUDIES
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Text 1.  Case 1 - Global Recovery: a long way to go


The global recession is coming to an end, but the ingredients of a lasting recovery are still missing.

With luck, the global slump has reached its trough. Asia’s economies are looking rosier, buoyed by a spectacular rebound in China, where output grew at an annualised rate of some 16% between April and June. Even in America and the euro area, GDP is likely to stop shrinking during the summer. Trade, having fallen precipitately, is levelling off. And, as firms rebuild their stocks, global growth over the next few months could be surprisingly robust.

That is a welcome prospect. But it is not the all-clear. For this “recovery” has fragile foundations. The boost from restocking will be temporary. And a big source of demand—government stimulus—is unsustainable. Across the globe governments have, rightly, stepped in to counter the economic slump. In America an increase of 12 percentage points in the budget deficit has cushioned the slump in private spending. Around 75% of China’s growth this year will be state-directed, either through public spending or officially induced lending.

Governments can prop up economies temporarily, but rising budget deficits are not a route to sustainable growth. Eventually burgeoning debt will limit the room for fiscal manoeuvre, and politicians may balk at renewed stimulus long before then. Worries about the budget deficit are already weighing on political debate in Washington. A solid global recovery demands healthy and balanced growth in private demand. Unfortunately, that still seems far off. Before the financial crash, global demand was horribly skewed. It was far too reliant on spending from increasingly indebted American consumers: witness the country’s gaping current-account deficit, which reached almost 6% of GDP in 2006.

The crisis—particularly the credit crunch and the destruction of more than $13 trillion of household wealth—has wrecked the American shopping machine and changed the nature of the world’s imbalances. As consumer spending has slumped, the external imbalances have shrivelled. America’s current-account deficit this year is likely to be less than 3% of GDP. On the other side of the ledger, China’s surplus is on course to fall by half from its 2007 peak, of 11% of GDP, by 2010. [...] Rebalancing via recession is hardly to be recommended. Worse, even as imbalances between countries have unwound, those within them have worsened, as governments have stepped in. Chinese and German consumers are not spending more; the Chinese and German governments are. The task is to right these internal imbalances without recreating the external ones. The solution is well known: consumers in China and other emerging economies, and in thrifty rich countries like Germany, must become bigger engines of demand, while the former bubble economies, such as America, must continue the shift towards saving and exports.

How hard will this be? [...] The detailed to-do list differs from one country to the next, but three broad requirements stand out: a change of mindset for many policymakers; greater macroeconomic co-ordination than hitherto; and bolder microeconomic reforms.

The shift in mindset is most necessary in surplus economies. Too many German leaders seem to take the economy’s export orientation as immutable. Few even grasp the need to nudge it towards domestic spending. China’s authorities want to shift towards consumption, but are reluctant to pull
the obvious lever: allowing the yuan to strengthen faster. Macroeconomic co-ordination will be necessary, especially to ensure that the fiscal tightening which must follow the stimulus does not strangle the recovery. While central bankers are laying out their exit strategies from monetary looseness in detail, few finance ministers have done anything similar on the fiscal side. In the big economies they claim they will cut their deficits substantially in 2011, but there are few details, even on the appropriate mix of tax reforms and spending cuts.

The hardest part, however, will be the microeconomic reforms required to smooth the macroeconomic adjustments. China’s leaders need to boost household income (for instance by encouraging more labour-intensive growth and forcing state enterprises to pay fatter dividends) as well as improve health-care and pension provision so that people feel less need to save. Japan and Germany both have to encourage investment in services, by freeing markets from health care to education. America must counter the rigidities that have arisen after its asset bust. Millions of people with negative equity in their homes, for instance, cannot move to get a new job.

The to-do list is a long one, the risk of missteps is high, and it will take years to complete. That is why the world economy is not yet out of the woods.

Text 2. Case 1 - Economic vandalism

Sep 17th 2009, The Economist print edition

A protectionist move that is bad politics, bad economics, bad diplomacy and hurts America. Did we miss anything?

You can be fairly sure that when a government slips an announcement out at nine o’clock on a Friday night, it is not proud of what it is doing. That is one of the only things that makes sense about Barack Obama’s decision to break a commitment he, along with other G20 leaders, reaffirmed last April: to avoid protectionist measures at a time of great economic peril. In every other way the president’s decision to slap a 35% tariff on imported Chinese tyres looks like a colossal blunder, confirming his critics’ worst fears about the president’s inability to stand up to his party’s special interests and stick to the centre ground he promised to occupy in office.

This newspaper endorsed Mr Obama at last year’s election in part because he had surrounded himself with enough intelligent centrists. We also said that the eventual success of his presidency would be based on two things: resuscitating the world economy; and bringing the new emerging powers into the Western order. He has now hurt both objectives.

Last year the fear was that Mr Obama would give in to enormous protectionist pressure from Congress. By introducing the levy, Mr Obama has pandered to a single union, one that does not even represent a majority of American tyre-industry workers, and he has done so against the interests of everyone else (see article). America’s tyre-makers, who have more or less given up making low-end tyres at home in favour of importing them (often from joint-ventures in guess where) declined to support the application for import “relief”. Consumers will have to pay more. The motor and garage trades will be harmed. And no one can seriously imagine that any American tyre-making job will be saved; firms will simply import cheap tyres from other low-cost places like India and Brazil.

One might argue that these tariffs don’t matter much. They apply, after all, only to imports worth a couple of billion dollars last year, hardly the stuff of a great trade war. China is incandescent with rage; but China is a master of theatrical overreaction. Its actual response so far has been the minor one of announcing an anti-dumping investigation into American chicken and car-parts exports. The whole affair might blow over, much as did the furore surrounding George Bush’s selective steel tariffs...
(much worse ones than Mr Obama’s on tyres) back in 2002. Presidents, after all, sometimes have to throw a bit of red meat to their supporters: Mr Obama needs to keep the unions on side to help his health-reform bill.

That view seems naive. It is not just that workers in all sorts of other industries that have suffered at the hands of Chinese competitors will now be emboldened to seek the same kind of protection from a president who has given in to the unions at the first opportunity. The tyre decision needs to be set into the context of a string of ominously protectionist policies which started within weeks of the inauguration with a nasty set of “Buy America” provisions for public-works contracts. The president watered these down a bit, but was not brave enough to veto. Next, the president stayed silent as Congress shut down a project that was meant to lead to the opening of the border to Mexican trucks, something promised in the NAFTA agreement of 1994. Besides these sins of commission sit the sins of omission: the president has done nothing at all to advance the three free-trade packages that are pending in Congress, with Colombia, Panama and South Korea, three solid American allies who deserve much better. And much more serious than that, because it affects the whole world, is his failure to put anything worthwhile on the table to help revive the moribund Doha round of trade talks. Mr Bush’s tariffs, like the Reagan-era export restraints on Japanese cars and semiconductors, came from a president who was fundamentally committed to free trade. Mr Obama’s, it seems, do not.

America is needed to lead. The global trading system has many enemies, but in recent times the man in the White House could be counted as its main champion. As the driver of the world’s great opening, America has gained hugely in terms of power and prestige, but the extraordinary burst of growth that globalisation has triggered has also lifted hundreds of millions out of poverty over the past few decades and brought lower prices to consumers everywhere. The global recession threatens to undo some of that, as country after country is tempted to subsidise here and protect there. World trade is likely to slump by 10% in 2009, and a report from the Geneva-based World Trade Alliance claimed this week that, on average, a G20 member has broken the no-protectionism pledge once every three days since it was made. For Mr Obama now to take up the no-protection cause at the G20’s forthcoming meeting in Pittsburgh would, alas, be laughable. But if America does not set an example, no one else is likely to.

Nor is the potential fallout from Mr Obama’s wrongheaded decision limited to trade. Evidence of a weak president being pushed leftward might cause investors to worry whether he will prove similarly feeble when it comes to reining in the vast deficits he is now racking up; and that might spook the buyers of bonds that finance all those deficits. Looming large among these, of course, are the Chinese. Deteriorating trade relations between the world’s number one debtor and its number one creditor are enough to keep any banker awake at night.

And America needs China for a lot more than T-bonds. Any hope of securing a climate-change agreement at Copenhagen in December on a successor treaty to Kyoto will require close cooperation between America and China. So does the work of negotiating with North Korea on its nuclear weapons. And as for Iran, where America is keen to seek a fresh round of UN sanctions in the hope of forcing it to scrap its nuclear programme, China holds a power of veto at the Security Council. Under the relevant trade laws, Mr Obama had the absolute discretion not to impose the recommended tyre tariffs on the grounds of overall economic interest or national security. Given everything that is at stake, his decision not to exercise it amounts to an act of vandalism.
Case 1 - Playing with fire

Sep 17th 2009 | WASHINGTON, DC AND BEIJING
From The Economist print edition

By succumbing to domestic pressures, America has started an alarming trade row with China.

In raw economic terms Barack Obama’s imposition of tariffs on Chinese tyres hardly registers. The number of jobs affected is barely a rounding error in measurements of the mighty American workforce. The cost to consumers is also slight. But in geopolitical terms, it is a whopper. Mr Obama’s most overtly protectionist decision so far has triggered a predictably angry reaction from China, which threatened to retaliate against American chickens and car parts and to haul America before the World Trade Organisation. The Global Times, a newspaper that often reflects the views of hardline nationalists in China, ran a front-page headline saying “America has erred before the world.”

The tit-for-tat dispute casts a pall over the G20 meeting in Pittsburgh on September 24th and 25th where Mr Obama will play host to Hu Jintao, China’s president. Warnings of a trade war have multiplied. There have even been comparisons to America’s infamous Smoot-Hawley Tariff Act, which deepened the Depression.

Some of this is hyperbole. Smoot-Hawley sharply raised tariffs on thousands of products, not just one. Then, there was no regulating framework for global trade; now both America and China are acting within the WTO, which was created precisely to keep such spats within rules. Every president since Jimmy Carter has sought import restrictions at one time or another, and Mr Obama’s are mild by comparison. “On the broad canvas of presidential trade policy, Obama’s decision is unexceptional,” says Doug Irwin, a trade historian at Dartmouth College. And China’s retaliation so far has been measured.

But the decision does come at a risky time. Protectionist actions, in particular against China, have been multiplying in recent years (see chart), even within the confines of WTO rules. Last November George Bush and in April Mr Obama, on both occasions joined by other leaders of the G20, pledged to “refrain from raising new barriers to investment or to trade in goods and services”; yet new barriers have steadily increased.

Until now Mr Obama has tried to allay fears that he is a bit of a protectionist by abandoning campaign threats to renegotiate the North American Free-Trade Agreement and to punish China for holding down its currency. He has surrounded himself with mainstream, pro-free-trade economists, watered down (though failed to veto) “Buy America” provisions in the fiscal stimulus, and opposed carbon tariffs in the cap-and-trade bill now before Congress. Even now Mr Obama insists he is “committed to pursuing expanded trade and new trade agreements”, and this week he defended his action as nothing more than the enforcement of trade laws.

That, however, is a stretch. Mr Obama had no obligation to act. Under the terms of joining the WTO, China gave other countries the right until 2013 to impose temporary “safeguards” against surges of Chinese imports. In America the relevant law, Section 421 of the Trade Act, does not require proof that China has broken international trade rules against subsidising or dumping goods (ie, selling below cost), only that the domestic industry was disrupted. Once the International Trade Commission, an independent panel, says that such disruption has occurred, it is up to the president to decide whether to impose remedies. Mr Bush declined to do so in the four Section 421 cases that came to him.
Politically, Mr Obama may have felt he had little choice. The United Steelworkers union filed the complaint in April and the law required Mr Obama to decide by September 17th. Having promised repeatedly to enforce trade laws more vigorously than Mr Bush, Mr Obama presumably felt he needed to do something. The economic benefits to those who lobbied for protection, however, are minuscule. Domestic manufacturers have largely abandoned the low-end tyre market. The tariffs, which drop from 35% in the first year to 25% in the third, will mostly divert supply to Mexico, India, Indonesia and Brazil, says Tom Prusa, a Rutgers economist who has done work for tyre companies.

China also bears some blame. American negotiators were ready to withhold the tariffs if China made concessions, but to no avail. Mr Obama’s defenders note that China would not have gained entry to the WTO without the “safeguard” provisions, which bought political support among its trading partners. And voters and Congress might be less likely to support future trade agreements if the safeguards in existing agreements are never used.

Still, Mr Obama’s imposition of tariffs will tempt more industries and unions to seek similar relief, and he will have to decide whether this decision is a template or an exception. Other countries, fearing a wave of diverted Chinese imports, could copy America’s action. After Mr Bush raised steel tariffs in 2002, half a dozen other countries followed. Under the terms on which China entered the WTO, others can impose safeguards simply because America has. The European Union, however, would struggle to master enough support among its member states.

China itself faces a delicate balancing act. On September 15th more than 300 of the Communist Party’s top officials began a four-day annual meeting in Beijing where, among other things, they are expected to decide whether to give President Hu’s presumed successor, Vice-President Xi Jinping, a further boost by making him a deputy commander-in-chief of the armed forces. Succession politics could be complicated by high-level disputes over how to respond to the Americans. And Mr Hu will not want a breakdown of commercial ties with America ahead of the G20 and Mr Obama’s visit to China in November.

But nor can he let Mr Obama entirely off the hook. Having announced an investigation into America’s alleged dumping, it will be hard to back away. Indeed, the spat will awaken unpleasant memories of the controversy over China’s accession to the WTO. China agreed to the safeguards clause in 2001 with gritted teeth, in part because its reformists saw WTO entry as a useful tool for encouraging market-oriented reforms. China’s prime minister at the time, Zhu Rongji, was subjected to harsh criticism from conservatives at home for pressing so hard for WTO entry. Times are more difficult now than they were back then, so expect a few more fireworks.

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Text 4.  Case 1 - China and US head for trade war

*China could face censure at the World Trade Organisation after the US and Europe lodged a joint complaint over its restrictions on raw materials exports*

*Heather Stewart guardian.co.uk, Tuesday 23 June 2009*

*Checking aluminium cans in Texas*

*China has put restrictions on exports of the aluminium ore bauxite as well as zinc and magnesium*

*Gary Gladstone/Corbis*

Europe and the United States announced last night co-ordinated action against China for busting World Trade Organisation (WTO) rules by restricting exports of essential raw materials, raising fears of a damaging east-west trade war in the depths of the global recession. Ron Kirk, the US trade representative, accused Beijing of putting a "giant thumb on the scale" by restricting exports of commodities including silicon, coke and zinc, to give Chinese
manufacturers an unfair advantage over their international rivals. "It's our job to make sure we remove that thumb from that scale," he said in Washington. "Today's action is proof of our commitment to level the playing field in this area."

The US, with Europe, announced that it would start formal "dispute resolution consultations" at the WTO in Geneva, claiming China has breached the rules of the international marketplace. At a press conference in Washington, Kirk said: "We will enforce the rights of American manufacturers, farmers, ranchers, services providers, and workers using the rules-based global trading system." Baroness Ashton, Europe's trade commissioner, said: "The Chinese restrictions on raw materials distort competition and increase global prices, making things even more difficult for our companies in this economic downturn. I hope that we can find an amicable solution to this issue through the consultation process."

China imposes restrictions, including minimum export prices and tariffs of up to 70%, on a range of raw materials of which it is a major producer. The EU claims these not only break general WTO rules on world trade, but specific promises China made when it joined the organisation in 2001, becoming a fully fledged player in global markets. The US said China produced 336m tonnes of coke in 2008 but only exported 12m tonnes. The raw materials are used in a range of key products, from steel to semiconductors. Brussels said manufacturers and processors in Europe were at risk of going bust if the flow of exports from China was not restarted. With oil prices rising rapidly, western governments including Britain have become concerned that higher commodity costs could choke off the fragile economic recovery, and they suspect China of deliberately stockpiling materials – in contravention of WTO rules on free trade.

If countries cannot reach agreement under consultation, which can take up to 60 days, the WTO will appoint a panel to examine the case and decide whether China is at fault. If Beijing then refused to comply, Europe and the US could be given permission to impose trade sanctions. US officials said they would, "press vigorously for redress". Taking China to the WTO marks a sharp deterioration in relations between the world's largest trading powers. Sources in Geneva said: "In terms of trade disputes, it doesn't get bigger than this." Gerard Lyons, chief economist at Standard Chartered, said there was probably "an element of brinkmanship" involved but the tough economic climate made any trade dispute alarming. "Everyone, policy-makers and markets, is a lot more sensitive to any indication of protectionism issues, given the economic environment," he said. "It's not a good situation."

G20 leaders pledged to resist protectionism at the London summit in April, but the US was infuriated by Beijing's inclusion of a "Buy Chinese" clause in its huge fiscal stimulus programme (although the US had a similar clause in its own stimulus), to ensure the money is spent at home. Democrats in Congress have led an increasingly vocal campaign accusing China of controlling its currency to gain an unfair advantage over its competitors. In his battle for the White House, Obama promised to defend US rustbelt manufacturers against cut-price competition, and the mass layoffs since the global recession have increased the pressure for action. Barack Obama's treasury secretary, Tim Geithner, sparked an angry response from Beijing in January, when an official document accused China of being a "currency manipulator" and deliberately depressing the value of the yuan – though the language was later toned down.

With the Doha round of world trade talks at a standstill, the cooling of relations will underline fears that the march of globalisation has been halted. The White House appears reluctant to restart negotiations. Duncan Green, head of policy at Oxfam, said: "The danger is that this is how the Doha round ends – not with a bang but with a dispute settlement mechanism." Kick-started Begun in 2001 in Qatar, in the wake of the terrorist attacks on New York, the Doha round was meant to give developing countries a fair stake in the global trading system, but negotiations collapsed in Geneva last summer, when India and the US could not agree on how much protection should be given to poor farmers.
Text 5. Case 2 - Chinese light-bulb imports spark EU controversy


Published: Wednesday 29 August 2007

A row is brewing over a proposal by UK Trade Commissioner Peter Mandelson to scrap EU anti-dumping duties of up to 66% on energy-efficient light bulbs imported from China, as his German counterpart, in charge of industry, Günter Verheugen, attempts to block the move.

EU trade chief Peter Mandelson is pushing for the punitive tariff to be lifted completely – a move that could see the price paid by consumers cut by around two thirds. He has the support of a majority of European producers, including the Dutch electronics group Philips, which outsources the manufacturing of its power-saving bulbs to China. But German industry Commissioner Günter Verheugen is opposed to the move, claiming that it could cause job losses for Germany's national light-bulb manufacturer Osram, as below-cost imports from China flow into the EU. He is expected to call for a compromise in the form of a two-year extension of duties.

Earlier in July, a spokesperson for Mandelson dismissed such claims, saying that it was purely "a question of commercial competition between two European companies" and that "Osram is seeking to continue anti-dumping measures because they hit Philips proportionately harder". However, according to the Foreign Trade Association (FTA), an umbrella group of importers and retailers in Europe, Verheugen could have the support of a number of his colleagues, such as Commission President José Manuel Barroso and Energy Commissioner Andris Piebalgs.

FTA Legal Advisor Stuart Newman pointed to the "absurdity" of maintaining tariffs at a time when the EU is attempting to increase the use of green technologies in order to achieve its dual goal of cutting energy use and CO2 emissions by 20% by 2020. Lighting accounts for around 14% of electricity use in the EU and experts say that replacing traditional light bulbs with power-saving ones could offset CO2 emissions by 25 million tonnes per year. Furthermore, the Commission is currently looking to phase out ordinary light bulbs completely (EurActiv 06/06/07) and European manufacturers are thought to be unable to meet total demand in this growing market. "We cannot believe that it is in the interests either of European industry or of consumers to continue these measures," Newman told EurActiv.

But the issue is also seen as a test case for the future of the EU's anti-dumping policy, currently under review (EurActiv 08/12/06). A number of EU nations fear that it could be used as a precedent in future cases for the EU to give more weight to the interests of companies producing or sourcing goods in countries with cheap labour costs, such as China, than to those with production based in Europe – a move that manufacturing countries such as Spain, Italy and a number of new member states are likely to resist.

Text 6. Case 2 - EU faces legal challenge over Chinese light bulb duties


Published: Tuesday 16 October 2007

EU ministers have approved a Commission decision to extend anti-dumping duties on imports of energy-saving light bulbs from China, despite protests from environmentalists and a number of leading European companies.
Foreign ministers gave the green light to a Commission proposal to prolong for one more year anti-dumping tariffs of up to 66% that have been imposed on bulbs originating in China, Pakistan, the Philippines and Vietnam since 2001. The decision followed an investigation carried out by the Commission, which found that it is in the interest of the Community to retain the measures in order to allow companies to adjust to changing market conditions. Germany's national light-bulb manufacturer Osram, in particular, had been complaining that low-cost imports from China would cause large job losses in the EU's largest economy (EurActiv 29/08/07).

However, a number of European companies, including Dutch electronics group Philips and Swedish retailer IKEA, who import large quantities of power-saving bulbs from China, have criticised the move. And an Italian lighting firm, Targetti Sankey, has announced that it would be challenging the Commission's decision in court on the basis that its investigation was flawed. If it wins its case, not only would the extension be declared void, but importers could also be entitled to "claim back from the EU hundreds of millions of euros in duties paid since 2001", according to Targetti lawyer Maurizio Gambardella.

The Foreign Trade Association (FTA), an umbrella group of importers and retailers in Europe, supported the challenge: "We cannot believe that it is in the interests either of European industry or of consumers to continue these measures," said legal advisor Stuart Newman, pointing to the EU's attempts to increase the use of green technologies and phase out the use of ordinary light bulbs completely (EurActiv 06/06/07).

The Targetti case also has the support of green groups, who insist that the decision is "seriously inconsistent" with EU targets to improve energy efficiency and fight climate change, because it will deter consumers from making a shift to more efficient lamps that could save 23 million tonnes of CO2 each year.

However, many EU nations saw the issue as a test case for the future of the EU's anti-dumping policy, currently under review (EurActiv 08/12/06), fearing that it could be used as a precedent to give more weight to the interests of companies producing or sourcing goods in countries with cheap labour costs, such as China, than to those whose production is based in Europe.

Background:

The EU, like most other importing economies, operates a system of trade defence instruments (TDIs). These instruments - anti-dumping, anti-subsidy and safeguard measures - allow the EU to defend its producers against the following kinds of distortions in competition that are harmful to the European economy:

"Dumping" – where third-country companies export goods at below production-cost prices, as the EU claimed was the case regarding imports of shoes from China and Vietnam (EurActiv 24/03/06);

"Subsidisation" – where non-EU exporters benefit from internationally illegal subsidies allowing them to produce a good excessively cheaply; as in the EU case against South Korea for unfair subsidisation of the semi-conductor producer Hynix, and;

"Large and sudden surges of imports of goods into the EU" putting European industries at risk; as was the case when WTO limits on imports of textiles from China to the EU were removed, causing a sudden flood of Chinese clothes to enter the EU (EurActiv 18/05/05).

During the ten years that the EU has operated its current trade-defence system, the global economy has changed significantly, with business and workers' interests increasingly linked to production outside the EU. The rise of China as an export power has underlined a split within the EU between those that are reaping the benefits of cheap imports and those that are under pressure from heightened competition.

These conflicting interests and divisions among EU countries have made it increasingly difficult to define what constitutes "Community interest". Trade Commissioner Peter Mandelson has, already twice this year in disputes over imports of Chinese textiles and leather shoes, found himself stuck between free marketeers such as Britain, Germany and Sweden – which said that imposing TDI in these...
cases was protectionist and would raise prices for consumers – and manufacturing countries such as Italy, France, Spain and Poland, which claimed that imports of under-priced Asian goods were putting their industries at risk and threatening thousands of jobs (EurActiv 04/10/06).

In order to avoid such situations in the future, the Commission, on 6 December 2006, launched a full-scale review of its trade-defence system, with a Green Paper that asks questions such as whether the criteria for using TDIs need to be toned down, whether other measures could be used, and whether the interests of importers and consumers should be given more consideration in investigations.

Text 7. Case 3 - Cadbury's board agrees £12bn sale to Kraft

Dan Roberts, business editor The Guardian, Tuesday 19 January 2010 Article history

Today's bid is an increase on Kraft's previous offer of around 770p, which Cadbury's chairman had described as 'derisory'.

Cadbury will accept defeat in its battle to stay independent today by recommending a £12bn takeover from US rival Kraft that threatens to reignite a fierce debate about the vulnerability of British industry. The 186-year-old chocolate maker decided to throw in the towel late last night after a large foreign shareholder joined hedge funds in indicating it would accept an improved offer from Kraft, and the prospect of a rival bid from Hershey faded. Cadbury's board, led by chairman Roger Carr, will announce its decision to recommend the revised 850p-a-share bid to all shareholders through a statement to the stock exchange this morning, according to sources close to the company. Although a board recommendation is not binding, it is highly unusual for a company to resist a hostile takeover once its management has capitulated.

The confectionery giant joins a list of British industrial names to have fallen to foreign takeovers in similar circumstances in recent years. More than 50 leading companies have gone, including BAA, Boots, Cazenove, Corus, ICI, Jaguar Land Rover, P&O, Pilkington and Scottish Power. Until now Cadbury had fought a public campaign to preserve its independence, attracting support from Lord Mandelson, the business secretary, who warned Kraft to expect "huge opposition" from the government if it wanted to make a "fast buck" by buying Cadbury. His intervention is understood to have rattled Kraft's chief executive, Irene Rosenfeld, who recently met shareholders in London, but the US company chose to negotiate a raised offer after calculating that the political risk was manageable. Cadbury unions have warned that up to 30,000 jobs would be put at risk by the deal as Kraft would be weighed down by some £22bn in debt. Kraft has a record of aggressive cost-cutting, and the union Unite said that between 2004 and 2008 it shed 19,000 jobs and closed 35 sites to help reduce its debt. [...]

The circumstances of the defeat are likely to reopen a debate about the role of hedge funds and other investors during takeovers. Lord Myners, the City minister, has been vocal in his criticism of short-termism among institutional fund managers. Cadbury was the first big test of a supposed new mood after the financial crash and raised strong emotions because of its history as a progressive employer, supporter of fair trade and proponent of good corporate governance. Nevertheless, its management's actions appear to have followed a well-worn path in such situations. Carr cut his teeth as chief executive of Williams, an industrial conglomerate also sold overseas, and worked with Sir Nigel Rudd, who recommended the sale of Boots two years ago. [...]

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Text 8.  Case 3 - Kraft and Cadbury - Chocs away

Kraft wins a battle for Britain's Cadbury and will become the world's biggest confectioner

Jan 19th 2010 - From Economist.com

The intervention of a government minister in Kraft's battle to buy Cadbury says much about the strength of British feeling for their favourite chocolate-maker. The American food giant's sweetened offer, too toothsome to turn down, was accepted by Cadbury's board on Tuesday January 19th. Kraft will pay £11.9 billion ($19.4 billion) for Cadbury in cash and shares, some 50% more than the firm's value before the bidding started in September. Yet last week Britain's business secretary, Lord Mandelson, warned a big group of the country's institutional investors—doubtless fixing those from Cadbury with a narrowed eye—against the dangers of short-termism.

A month earlier he had promised Kraft that the British government would scrutinise a foreign buyer to ensure that "respect" was paid to Cadbury's proud heritage. The firm has been catering to the British for 186 years. In a country that cheerfully waves in foreign buyers for its businesses the threat of "huge opposition" from the government was an unusual change of tone. Kraft too received some words of wisdom on its attempted takeover from a senior American, although the advice of Warren Buffet was of a more practical kind. His investment firm, Berkshire Hathaway, is a big shareholder in Kraft. Reckoning that Kraft's shares are undervalued he counselled the firm's bosses not to let their "animal spirits run high" and overpay for Cadbury.

Irene Rosenfeld, Kraft's chief executive, seems to have listened. Shortly before a deadline imposed by British takeover rules, Kraft upped its bid for Cadbury by boosting the cash portion significantly while reducing from 370m to 265m the number of new shares it will issue to complete the deal. Kraft's share price got a well-timed boost last week after the firm forecast that its profits for 2009 would be even better than earlier expected.

Ms Rosenfeld was quick to acknowledge on Tuesday that Kraft has "great respect for Cadbury's brands, heritage and people". Perhaps that will allay Lord Mandelson's fears. Cadbury's unions opposed the move, worried about job cuts, but the firm's board has reasoned that the price is right to bring together the two companies to create the world's biggest confectioner. Earlier the board had insisted that Cadbury was better off alone. Now Cadbury will become part of the "global powerhouse" that Ms Rosenfeld envisages.

The two businesses are strong in different markets. Kraft has little presence in Britain's confectionery market, where Cadbury is strong, but it has thriving businesses in mainland Europe, where Cadbury has made few inroads. Cadbury has a booming chewing-gum business, particularly in Europe and Latin America, an area where Kraft has little expertise. And between them they can make up lost ground in China, where Mars, the world's second-placed sweet-maker when the deal goes through, holds the upper hand. The deal is also set to yield cost savings of $675m a year.

Other potential bidders still have the chance to make a more appealing offer but it seems that Kraft's touted rivals will remain silent. America's Hershey, smaller even than Cadbury, seems unlikely to be able to muster the financial forces to upset Kraft's bid. Nestlé ruled itself out of the running by after buying Kraft's American Pizza business for $3.7 billion early this month. Ms Rosenfeld may yet find the takeover of Cadbury a tricky process. In dealing with potential rivals, satisfying Cadbury's board and soothing Mr Buffet, Kraft's boss has proved she is a deft operator. If Lord Mandelson is harder to assuage she might try sending him a Chocolate Orange.
Text 9.   Case 3 - Kraft to Acquire Cadbury in Deal Worth $19 Billion

By MICHAEL J. de la MERCED and CHRIS V. NICHOLSON

New York Times, January 20, 2010

After months of fiercely resisting any deal, Cadbury agreed on Tuesday to an improved takeover offer from Kraft Foods, worth about $19 billion. For Kraft, the deal offers a chance to expand its footprint in emerging markets and in higher-growth sectors like gum and candy. "It transforms the portfolio, accelerates long-term growth and delivers highly attractive returns," Irene B. Rosenfeld, Kraft’s chairwoman and chief executive, said in a statement.

Cadbury for its part will benefit from the supply chain of a larger company, said Jon Cox, a food and beverage analyst at Kepler Capital Management in Zurich. But the prospect of a takeover of Cadbury, the 186-year-old British company, especially by an American multinational like Kraft, sent shudders throughout Britain and prompted a wave of public protests. The Mail on Sunday, one of the biggest-selling British newspapers, ran a "Keep Cadbury British" campaign. "It's sad to see another British company bought up by a multinational," Mr. Cox said, "but that's finance." Prime Minister Gordon Brown said Tuesday that his government was "determined that the levels of investment that take place in Cadbury in the United Kingdom are maintained" and that "at a time when people are worried about their jobs, that jobs in Cadbury can be secure."

During a conference call Tuesday, Kraft executives reiterated that the company would keep a strong presence in Britain and would be a "net importer" of jobs in the country. The move will also continue the consolidation that has dominated the food business over the last decade. While mergers involving food companies dipped somewhat last year — preliminary data from the Food Institute, a trade organization, showed 58 acquisitions in 2009, versus 130 in 2008 — analysts expect deal-making to pick up again as companies seek greater scale and presence in developing countries. [...] William Neuman contributed reporting.

Text 10.   Case 4 - US steel tariffs: FAQs

US tariffs on imported steel, imposed by the Bush administration, have been found illegal by the WTO. Mark Tran explains their history

Guardian, Tuesday November 11, 2003

Why did the Bush administration impose the tariffs?

The White House said that the duties of up to 30% on imported steel were designed to give the struggling US steel industry a three-year respite from international competition so that it could restructure. The EU, Japan, Brazil, South Korea, Norway, New Zealand and Switzerland responded by lodging a complaint with the World Trade Organisation. The organisation concluded that the tariffs violated international trade rules allowing countries to protect themselves against sudden surges of imports.

Did political factors come into play in Mr Bush’s decision?

Most certainly. The US president, George Bush, needed political support from key states such as Pennsylvania, West Virginia and Ohio, all of which produce steel, in advance of last year’s mid-term elections. He risks alienating steel producers and unions in those states before next year’s presidential elections if he stops the tariffs, which were imposed in March. Ironically, Mr Bush’s economic team, which was divided on the tariffs last year, is now united on dumping them.

Why the change?
Some of the president's advisers, including his top political strategist, Karl Rove, fear that the tariffs may have backfired politically, costing Mr Bush more support in steel-using states such as Michigan and Tennessee than they won him in West Virginia and Pennsylvania. US industries that use steel, such as those manufacturing appliances and cars, have been pressing for a repeal of the tariffs, complaining that higher steel prices are eroding their profits in a generally tough environment for US manufacturing. Last but not least, the tariffs make US claims to free trade sound hollow.

What has been the impact of the tariffs in the US?

It has been less than clear cut. In late September, two reports from the US government agency, the international trade commission, said that the case was muddy and that it was difficult to determine whether the tariffs or changing market conditions were responsible for the problems of steel consumers.

What has the US steel industry been up to?

Since the tariffs were imposed, the US steel industry has invested more than $3bn into a restructuring effort. Smaller companies have either gone bankrupt or been absorbed by larger ones. Steel officials say that the restructuring effort would be undermined if the tariffs were lifted, and have accused the EU of trying to blackmail the US. With an election coming up, Mr Bush will be sensitive to accusations that he backed down under pressure from the EU and others.

What is the state of the world steel industry?

The industry has been in a dire state, with too much capacity. That has been a problem for European as well as US companies. Anglo-Dutch firm Corus, for example, has had to lay off thousands of workers. However, with the global economy picking up, trade experts say that steel shortages could emerge next year, boosting prices and providing respite for producers in the US and elsewhere.

Are there other trade disputes between the US and the EU?

This is the problem. It is not just steel that is bedevilling EU-US trade. The most serious row involves US export subsidies, which the WTO found illegal. In that instance, the WTO has authorised the EU to impose up to $4bn worth of sanctions, which would be by far the largest in WTO history. Brussels, however, has held off on the measures, pending passage in Congress of new tax legislation that would eliminate the subsidies.

What did the WTO decide?

The WTO yesterday said that steel tariffs imposed by President Bush in March last year were illegal. The decision, upholding an earlier ruling, came from the WTO's appeals body, the organisation's highest tribunal, meaning that the decision is final.

Where do we go from here?

The EU has threatened to impose sanctions of up to $2.2bn (£1.5bn) on US imports such as citrus, textile products and Harley-Davidson motorbikes. EU officials said they would go ahead with these sanctions if the US steel duties are still in place five days after the appeals ruling has been formally adopted by the WTO, which will probably be on December 1. The EU measures are designed to inflict maximum pain upon US manufacturers based in "swing states" that will be crucial to Mr Bush's re-election campaign.

Are we heading for a trade war?

The ball is now in Washington's court. For the time being, the White House insists that last year's tariffs were perfectly legal, despite the WTO ruling, which it says it will carefully review. While the EU has set a deadline for its own retaliatory measures, other countries have urged caution. Brazil says it is not time to retaliate, but to establish "to establish a climate for negotiation".
BRUSSELS, Aug. 23, 2002 — European Union officials hinted today that the union might put off retaliating against United States steel tariffs until next year, signaling that Washington may have bought itself some time by greatly narrowing the scope of the disputed tariffs.

The European Commission, the executive body of the union, said today that it welcomed a decision by the Bush administration, announced on Thursday, to exempt 178 more product categories from the protective tariffs it imposed in March, bringing the total number of exempted products to 727. More than half the European steel exports to the United States originally covered by the tariffs, which will last three years and range from 8 percent to 30 percent, have now been exempted, the commission said.

Pascal Lamy, the European commissioner responsible for trade, urged today that the remaining tariffs be withdrawn "soonest, and in any event immediately after the decision of the panel condemning the U.S. measures." He referred to a World Trade Organization panel that is evaluating whether the United States tariffs are permissible under global trade rules. The panel, acting on complaints from the union and from other affected nations including Brazil and South Korea, is widely expected to reject the tariffs sometime next year. "The decision to exclude many E.U. products from the U.S. safeguard measures will help both E.U. exports and those many industries in the U.S. which need high-quality imports from Europe," Mr. Lamy said. "Let us hope that the next step will be action to restructure that part of the U.S. steel industry which has traditionally been behind the adoption of protectionist measures."

Government ministers of the union's 15 member nations are scheduled to decide next month whether to go through with short-term retaliatory tariffs they have threatened to impose on United States goods including textiles from the Carolinas and citrus fruit from Florida — a list chosen for domestic political effect in the United States. The union has postponed the decision several times to allow Washington more time to address its concerns. Officially, the union is still pursuing retaliation under the trade organization's rules. But trade experts took Mr. Lamy's remarks today as a hint that the union and the United States had reached a deal to avert rapid sanctions. "It sounds like he is saying that they are not going to happen," said Richard Weiner, a trade specialist in the Brussels office of the Hogan & Hartson law firm. "It would be hard to imagine the ministers disagreeing with the trade commissioner." Though the remaining steel tariffs still hinder free trade, he said, the latest round of exemptions "have taken the sting out of them."

European steel producers take a dimmer view. The British-Dutch steel maker Corus urged the union to move ahead with measures against the United States. "We see no reason for the E.U. to change its stance," said Mike Hitchcock, a Corus spokesman. About 824,000 tons of Corus steel exports would have been affected by the original tariffs this year, Mr. Hitchcock said; exemptions announced since then gave relief for only 231,000 tons, or 28 percent. Mr. Hitchcock called the latest round of exemptions disappointing. For Arcelor, the top European steel exporter to the United States, the latest round of exemptions gave relief for 70,000 tons a year, bringing the exempted total to about 23 percent of the one million tons originally affected. "Previous exclusions in recent months have been far from enough," said an Arcelor official in Luxembourg, where the company is based. "I imagine our official line would be unchanged after the latest offering from Washington."

United States officials said these would be the last exemptions offered this year, though a new round will be considered between November and next March. "We will press our customers in the United States to push for further exclusions for our products the next time around," Mr. Hitchcock of Corus said.
Text 12. Case 4 - WTO upholds steel duty ruling


The World Trade Organisation (WTO) today put US president George Bush in a tight spot as it ruled that US duties on imported steel from the EU and other countries are illegal. In its final verdict, the WTO appeals panel upheld an earlier ruling against the US in July. Pascal Lamy, the EU trade commissioner said the US had failed to prove that its industry had been harmed by a sudden flood of cheap imports - a condition for imposing such duties under WTO rules. Brussels says it will start retaliating if the US steel duties are still in place five days after today's decision has been formally adopted by the WTO, probably at the end of November. The steel tariff issue is one of several areas of economic contention between the US and the EU. The EU is already preparing sanctions against US exports after winning another WTO verdict over tax break for US exporters such as Boeing. Meanwhile the US has taken the EU to the WTO over a dispute on labelling of genetically modified foods.

The WTO steel decision places Mr Bush in an awkward position. He introduced the steel tariffs last year under pressure from domestic producers, who claimed they were suffering damage from a flood of cheap imports. If he reverses his own policy he risks damaging his political prospects in steel-producing states such as Pennsylvania, West Virginia and Ohio, ahead of next year's presidential vote. The EU has threatened to retaliate with some $2.2bn (£1.3bn) in duties on US goods. To increase political pressure on the White House, many of the products targeted are produced in swing states thought to be crucial to Mr Bush's re-election prospects. Supachai Panitchpakdi, the WTO director-general said he hopes the parties involved will be able to solve the problem without resorting to sanctions. "I'm sure there will be some way out," Mr Supachai said in Beijing. "I expect to see the conciliatory approach that we have seen in the past, and I certainly recommend that approach."

Leaving the EU aside, Japan, South Korea, Norway, Switzerland, China, New Zealand and Brazil have all filed complaints against the US. All of those countries could now retaliate against US imports if the duties are not removed. Mr Bush's decision to impose duties of up to 30% on foreign steel also came under fire from within the US. Car makers, in particular, said the move increased the price of their materials, causing job losses in the industry and making vehicles more expensive. In a sign that the Bush administration is trying to extricate itself from a bind of its own creation, it has been reviewing whether to maintain the duties for the full three-year period, which would run past the elections until March 2005.

Text 13. Case 4 - White House Signals Reverse of Steel Tariffs

By DAVID E. SANGER, NYT, December 1, 2003

WASHINGTON, Nov. 30 — President Bush is expected to announce this week that he will immediately lift most of the tariffs he placed on foreign steel in an effort to protect American industry, bowing to a ruling by the World Trade Organization that his administration had violated global trading rules, industry officials who have been in negotiations with the White House said on Sunday.

The possible announcement, first reported in Monday's issue of The Washington Post, could come on Monday, the officials said, when Mr. Bush is in Michigan to attend an economic event and raise money for the 2004 campaign. But he may wait until after a Tuesday trip to Pittsburgh, where the decision to accede to the trade organization ruling, even if accompanied by an expected threat by Mr. Bush to reimpose tariffs if there is a surge of low-cost foreign steel, will be deeply unpopular among steelworkers and owners of the American steel manufacturers.
The White House has said Mr. Bush may make no decision until a deadline in the middle of December. But industry officials who have been talking to White House economic officials say Mr. Bush's advisers have warned him that there is no way to avoid the billions of dollars in retaliatory tariffs that Europe and Japan have threatened to impose on American goods if the tariffs are not lifted. The Europeans would use retaliatory tariffs to strike at industries in states crucial to the 2004 election, for example, on Florida citrus, motorcycles produced in Pennsylvania and Michigan, and other products in states that Mr. Bush feels he must win in 2004.

One industry official who has been talking to the White House said he expected that Mr. Bush would try to make the best of his defeat by arguing that the main objective of the tariffs has been achieved: the American steel industry has consolidated significantly in the past 18 months, exactly the reorganization that Mr. Bush declared had to happen during the three-year life of the tariffs. Under the trade organization's rules, the tariffs on foreign steel decline every year so that the domestic steel industry would face increasing pressure to become more efficient. "He'll try to declare victory, as best we understand it," the industry official said. "But clearly, this could be politically costly."

Text 14.  Case 5 - European automotive industry: driving east
Feb 8th 2007, From The Economist print edition

The car may be German, but its innards are nearly all from Eastern Europe

Jean-Martin Folz, boss of PSA Peugeot Citroën until this month, caused a stir in the late 1990s when he suggested that the Toyota factory being completed in northern France at that time would be the last car-assembly line to be built in western Europe. BMW subsequently proved him wrong by opening another assembly line in Leipzig, but Mr Folz was not far out. He himself has recently been opening plants in Slovakia and the Czech Republic and sounding the death-knell for a factory in Britain that closed its doors last month. Peugeot is not alone in heading east in search of skilled workers at lower wages. Poland has Fiat, Opel and Volkswagen; Hungary has Audi; Romania and Slovenia have Renault; Slovakia has Volkswagen as well as Peugeot; and the Czechs have enticed Toyota into a joint venture with Peugeot.

Once you consider car parts as well as assembly lines, the rush east becomes a stampede. Peugeot's parts manufacturing arm, Faurecia, has factories in five eastern European countries as well as one in Turkey. Volkswagen adds Ukraine to give it a total of five countries. Bosch, the Stuttgart company that is Europe's leading parts-maker and one of the world's top five, has factories in ten eastern countries.

But is the rush being overdone? A study by Ernst & Young, a firm of consultants, concludes that central and eastern Europe will have a market of around 4.5m cars within five years. That sounds a lot, but it is less than a third of the 16m in western Europe. The new investment in car-assembly plants will give the eastern region a capacity of over 5.5m by 2011, making it a net exporter of vehicles. This will add to the existing overcapacity in the European car industry, currently estimated at approaching 20%.

The pain is going to be felt mostly in those parts of western Europe where up to now cars have been produced relatively cheaply: Spain and Portugal. Already Renault has slashed output at its large Valladolid plant in northern Spain, It does not take a satellite navigation system to see where the European car industry is going.

Text 15.  Case 5 - Car Production Surges in Eastern Europe
By JOHN TAGLIABUE, New York Times, November 25, 2006 Saturday
For Slovakia, the recent inauguration of an $890 million automobile factory was a major event. The prime minister and other government officials attended. French executives from Peugeot Citroen, which built the factory, flew into the tiny town of Trnava, where the sprawling factory is expected to employ up to 3,500 people and churn out as many as 300,000 compact cars a year. After the collapse of Communism in 1989, many foreign carmakers rushed to acquire local carmakers or build their own factories in countries like Slovakia, Poland, Hungary, Romania and the Czech Republic. That relative trickle, though, is now a flood. The money has been pouring in, and the pace and frenzy is prompting talk of Europe's auto industry shifting from west to east.

By 2010, the Czech Republic could nearly double its production over last year, to more than a million cars. Indeed, as a whole, Eastern Europe has become Europe's backyard manufacturing center, and it could be producing 3.4 million cars annually by 2010, a 33 percent jump over 2005, according to forecasts by PricewaterhouseCoopers. Even Russia's production is expected to rise to 1.6 million cars a year from 1.2 million now. That kind of growth can only be envied by more established car making countries: the United States could be making some 12.6 million cars, a 9 percent jump over last year, and Japan about 10.3 million, a mere 2 percent increase from last year. By contrast, Britain is expected to drop to 1.5 million from 1.8 million in 2005. France is expected to stagnate at 3.6 million, compared with 3.5 million last year. Belgium was struck a blow recently when Volkswagen said it was stopping production in a plant near Brussels, eliminating 4,000 jobs. Even before Peugeot opened its Trnava plant, it announced that it was cutting 11,000 jobs, mainly in Western Europe. The move included closing a plant in Ryton, England.

This year, car production in Central and Eastern Europe, excluding Russia, is on track to exceed 2.4 million vehicles, as carmakers from Europe, Asia and the United States pour billions of dollars of fresh investment into local factories. That may be a fraction of the 57.5 million cars made last year in the 20 top automobile-producing nations in 2005. But the explosive growth contrasts starkly to plans by many automakers to scale back employment and thus production in Western Europe and the United States. Within the last year or so, General Motors, Toyota, Volkswagen, Peugeot, Fiat, Suzuki, Hyundai and Kia have announced plans to build or expand assembly plants in the region. "Making a car is not like making a plastic bag," said Sigrid de Vries, the spokeswoman for the Association of European Automobile Manufacturers in Brussels. "You have to be close to the market and flexible, you have to be close to the customer, and this requires a certain reorganization."

The reasons for Central Europe's new wave of growth are complex. For one thing, the region, together with Russia and China, is one of the world's great untapped auto markets. Sluggish auto industries under the old Communist regimes left many families without cars. Local governments championed local automakers, like Skoda in the Czech Republic and Dacia in Romania. They were driven to near ruin under Communism, but some of those automakers were then bought by Western carmakers after 1989, when Volkswagen acquired Skoda and Renault bought Dacia. High gas prices in the West have also encouraged consumers to start shifting from big cars and S.U.V.'s to the kind of compact cars that are a specialty in Eastern Europe. Above all, labor here is the cheapest in the region.

Engineers in Slovakia earn half of what Western engineers make, and assembly line workers one-third to one-fifth, according to Alain Baldeyrou, Peugeot's plant manager in Trnava. If that does not sweeten the region for foreign carmakers, East European governments offer incentives, from financing some of the investment to offering a low flat-and-simple tax on employee wages and corporate profits, as in Slovakia, where all taxes are a simple 19 percent. By 2010, new investment will lift the region's production to just below that of France, which is expected to be making 3.59 million cars that same year, and more than twice that of Britain, where production will drop to 1.49 million, from 1.77 million in 2005. "Central Europe is in the European Union, it has the advantage of a stable economy, and they want the euro," said Matt Pottle, central European automotive director for PricewaterhouseCoopers. He added that this was likely to mean far slower growth in some Western countries that now specialize in small-car production, like France and Spain.
It will also create more manufacturing jobs in the four major Central European countries, where the number has already risen to 284,507 in 2004, the last year for which figures are available, from 235,826 five years earlier; during the same time, such jobs fell slightly to 1,978,338, from 1,991,848 in Western Europe. "Their largest challenge may be potential shortages of qualified labor," Mr. Pottle said, noting that "prices of labor are rising quite rapidly."

Within recent months, European carmakers have introduced a variety of new models that they will assemble in their Eastern European assembly plants. At the recent Paris Auto Show, Renault featured the Logan, a four-door car assembled in Romania, starting at 5,700 euros (about $7,200) in Eastern Europe. "Today, Europe is a price market," said Stephane Lemperier, a Renault executive, where consumers buy based on low prices. When Ford introduces an update of its successful subcompact, the Ka, which is now assembled in Valencia, Spain, the new model will be built at a factory Ford will share with the Italian automaker Fiat in Tichy, in southern Poland, where Fiat will assemble a new version of its popular Cinquecento.

But Eastern Europe is not making just cheap small cars. Volkswagen assembles its Touareg S.U.V. and the big Q7 of its Audi affiliate in Slovakia; Porsche assembles the body of its expensive Cayenne in a factory near Bratislava, and then ships them to Germany for finishing. And the automakers are pulling their suppliers into the region as well. Peugeot officials said that steel coils for the Trnava plant now come from mills in France, Germany and Austria. But they plan to begin using Slovak steel next year after U.S. Steel brings online a $160 million hot-dip galvanizing mill, able to make 385,000 tons of automobile-grade steel sheet a year, in Kosice, in eastern Slovakia. Seats for the Trnava plant are manufactured by Faurecia, a Peugeot-controlled company, at a suppliers' park near the main factory. Slovakia, the Czech Republic and Poland have been vying to attract suppliers for the big new assembly plant Hyundai is building at Novosice in the eastern corner of the Czech Republic, a short drive from Slovakia and Poland.

With many of the countries of Eastern Europe now in the European Union, cars from the region enter Western Europe without duties, essentially erasing the border for the automotive industry. Countries not in the union that are protectionist, like Russia, are also attracting investment of their own. G.M. may be losing money elsewhere, but it expects to almost double its sales in Central and Eastern Europe, including Russia, within the next three years, and to expand its dealer network in the region by 80, to about 480, according to Automotive News Europe. This summer, G.M. opened a plant near St. Petersburg to assemble the Chevrolet Captiva, a midsize S.U.V.; by 2008, G.M. hopes to bring online a $127 million plant nearby to assemble about 25,000 vehicles a year.

The decisions to move assembly plants east raise awkward questions among workers and their labor union representatives in the West. Labor union leaders in Germany, with the backing of leaders in other countries, have been pressing the European Union to limit the kinds of incentives that Eastern European countries offer automakers to settle there. Union leaders are as irate as they are helpless. "It's a deliberate act of vandalism by the company," said James O'Boyle, a union leader at the Ryton plant, just north of Coventry, that is scheduled to close. Peugeot, he said, would lay off about 2,800 workers in Ryton, and though unemployment in the region is low, at about 4 percent, the auto workers would have to settle for inferior jobs. "No doubt people can find jobs, if they take immense cuts in wages and cuts in benefits," Mr. O'Boyle said. "Some people will go on to better things, but they are a minority."

Jean-Martin Folz, Peugeot's chief executive, denied that the closing in Ryton and the expansion in Trnava reflected a repositioning of the industry eastward. "What you are observing is the economic growth of the European Union," he said, "the growth of manufacturing here." Ryton was closed, he said on the edge of the inauguration ceremony, "because it was the least profitable of our factories." The new plant has been a boon to locals, like Stefan Bosnak, Trnava's mayor, who attended the ceremony. He said that unemployment had dropped to about 5 percent from 13 percent three years ago for the region of 70,000 people, which had a reservoir of skilled engineers left over from the
Communist arms industry. Mr. Baldeyrou, the plant manager, said wages were not the critical factor. "The share of salaries in the price of a car is about 15 percent," he said. "Materials form the greater part, not wages." And in the former Communist countries, unions pose few threats for foreign investors. Fewer than half a million of Slovakia's work force of 2.3 million are unionized, and the number is falling.

"People are doing a good job; there are good social benefits," said Ivan Stefanec, a member of Parliament from the region. "So there is no immediate need for unions."

Text 16. Case 5 - Central Europe transformed

Jun 23rd 2005, From The Economist print edition

EU membership has worked magic in central Europe

By culture and language, by history and landscape, the countries that joined the European Union last year offered more of a complement than a contrast to the existing membership. Slovakia, the Czech Republic, Hungary and Slovenia were recognisably still the Habsburg cousins of Austria, if a little countrified by separation. Poland and the Balts echoed an older Hanseatic order. It was only when you asked people what they earned that the real division between the West and the rest became clear. When you crossed the border from Germany into Poland in 2003, average income per head fell by four-fifths, from $27,600 in Germany to $5,400 in Poland. When Romania and Bulgaria join the EU in 2007 or 2008, they will be poorer even than the central Europeans. According to Deutsche Bank, Romania's average income per head in 2005 will be $4,084 and Bulgaria's only $3,735, roughly half Poland's current level.

Figures like this help to explain why the EU has lost so much of its enthusiasm for enlargement, despite the relative success of the 2004 round. It has grown panicky about competition for jobs and investment from the countries it has just embraced. It is reluctant to add to that competition by promising to admit even more low-wage countries later. "The Polish border is 1,800km (1,120 miles) from London but 80km from Berlin," says one German official, asked why Britain has opened its labour market to the eastern newcomers but Germany has not. Germany fears a free flow of Polish workers, and even more of Turkish ones. Turkey's population of almost 70m is about the same as the combined total of all ten countries that joined the EU last year, and it is poorer than any of them. Ukraine, another would-be member, has 47m people, with an income per head of around $1,000 in 2003.

Western Europe's fears are understandable but counterproductive. Low-wage countries next door should be seen more as a resource than a threat: they attract business that would otherwise go to low-wage countries on the other side of the world. But can Europe come to see it that way? The would-be members among the EU's neighbours can only hope so. They have seen their friends and neighbours in central Europe transformed by EU accession. Having failed to catch that first wave of enlargement themselves, they are now praying for a second chance.

The EU's newest members, though much poorer than France or Germany, are already a lot richer than they were immediately after communism's collapse. In 1991, Poland's GDP per head was just $1,998. The EU led the way in central Europe's rehabilitation, helped by America's USAID and other international agencies, giving or lending $18 billion to central Europe in the 1990s. Just as valuable was the work of multinational companies that bought or built operations in central Europe. They set
new standards for wages, training, workplace safety and technology transfer, creating a "meritocracy in which hard work, ethical behaviour and a desire to learn" were properly valued locally for the first time in decades, says Charles Paul Lewis, author of a study on these companies' role in post-communist Europe.

But even this intervention brought deep change only because the central Europeans really wanted to anchor their democracies and raise their long-term living standards, even at the cost of short-term disruption. The accession process gave politicians an alibi for unpopular reform. Civil servants spent so much time in Brussels that they felt as accountable to the European institutions as to their governments at home. Voters wanted the West, if not for themselves then for their children. Soon they will have it. From the viewpoint of the western European countries, the transition in central Europe has worked almost embarrassingly well. By the end of the 1990s, the countries there had reached a level of political and institutional development that made it impossible to refuse them membership of the Union, even though their incomes and wages were still only a small fraction of those in the older member states. Now their economies are continuing to grow at rates shaming the ones that used to be their models (see chart 1 above). This year even the laggard of central Europe, Hungary, is likely to grow more than twice as fast as the euro zone. The Baltic countries look set to grow at more than four times the euro zone's pace.

Extrapolate from that, and the implications are startling. Latvian incomes are currently the lowest in the EU, but if the Latvian and the German economies were to go on growing at last year's rates of 8% and 1.6% respectively, then, all other things being equal, Latvian incomes would overtake German ones in 2032—which is to say, within the working lifetime of a young adult. That should be a thrilling thought for Latvians. It should be a thrilling thought for Germans too, since they would then no longer have to worry about low-wage competition. In reality, however, the thought of becoming poorer than a former Soviet republic is likely to make Germans unhappier still.

The fear of workers flooding in from Poland or Estonia has caused all but three countries in Western Europe to close their labour markets to the new members for up to seven years. This year France and Germany blocked an EU law opening up national markets to services from anywhere in the Union, for fear that self-employed workers would arrive by this route. This French-led move was inexplicable to anybody from a more consumerist society. French trade lobbies gave warning that Polish plumbers would swamp the country, yet they also agreed that France was desperately short of plumbers. The arrival of Polish plumbers, even by the thousand, could only have been a blessing.

The new members have also upset the old with their taste for flat and often low rates of personal income tax and corporate tax, chosen mainly for ease of collection. Other payroll taxes and indirect taxes mean that the overall tax burden in the new member states is still similar to that in the old. But France, Germany and Belgium have accused the newcomers of unfair tax competition, and called for minimum rates for corporate taxes across the Union. Nicolas Sarkozy, when French finance minister last year, suggested cutting EU budget payments to new members that insisted on setting low tax rates.

Investors, by contrast, love the new members for their low wages, high productivity and simple taxes. Build a factory there, and you get EU market access at far less than average EU costs. According to the Boston Consulting Group, if you want to sell refrigerators or cars in Western Europe, it can be cheaper to make them in Poland than in China. A.T. Kearney, another consulting firm, reckons that the acceptance of Ukraine as an EU candidate could quickly triple the recent rate of foreign direct investment there.

But it was not only EU market access, granted progressively to the central European countries through the 1990s, that attracted investors to the region then and continues to attract them today. It was also the expectation that the rule of law and the quality of government would rise towards EU levels as the accession process continued. Firms will build factories in difficult places if they have to, but they much prefer places where contracts can be enforced, property rights are secure, taxes are
predictable, executives feel safe, and workers get basic social services from the state. Conditions like that help to mobilise domestic investment too.

If Ukraine and Turkey are brought inside the EU, they will create, together with Romania and Bulgaria, a low-wage industrial powerhouse in Europe’s back yard, a zone of 150m people able to compete even with China or India (see table 2). That thought might frighten highly paid workers in Germany or France. But it is better for all of Europe if new investment goes to Eastern Europe and not to faraway China or Brazil. More investment and more growth in low-wage Europe generates more demand for goods and services from high-wage Europe. That helped Germany to run a trade surplus with Poland last year, for example.

The EU countries with more to fear from further enlargement should be those in central Europe which are the Union's lowest-cost producers right now. Slovakia has had spectacular success in attracting foreign direct investment, especially from the car industry. Soon it will produce more cars per head of population than any other country in the world. But in five or ten years, says Ivan Miklos, the Slovak finance minister, the country’s competitive advantage in mass production will slowly but permanently decline as Romania, Turkey and Ukraine catch up. Slovakia wants to encourage more high-tech and service industries by improving the education system and the business climate. The Slovaks have it right. Enlargement is globalisation in miniature. If the EU holds its neighbours at bay, it is putting off a shock of adjustment that will get bigger and bigger the longer it is delayed. Germany has 5m unemployed, not so much because old jobs in old industries are vanishing there (though they are) but because an inflexible German labour market deters firms and individuals from creating new jobs in new industries in which German companies are still world-beaters. All the same, tactically it may be a good idea to accept that free movement of labour is incompatible with further EU enlargement, not for economic reasons but for political ones. If rich countries want to block cheap labour, let them do so. Europe has capital mobility to compensate. If workers cannot come looking for the jobs, the jobs will go looking for the workers. The central Europeans’ experience suggests that the more assured Turkey and Ukraine can be of EU membership, the more foreign investment they will get.

If, on the other hand, these countries are kept outside the EU, investors will expect political and economic reform there to be slower and less secure. Investment will be lower, and growth with it. Something of the sort has been visible in Turkey where, despite a customs union with the EU, foreign direct investment has been much lower than in most central European countries relative to the size of the economy—a fifth of the Czech Republic’s level and a third of Poland's between 1994 and 2003. Less investment means fewer jobs at home, lower incomes, less trade and more pressure on workers to find jobs elsewhere. Everyone loses.

**Text 17. Case 6 - ASEAN: business as usual**

From the Economist Intelligence Unit ViewsWire, Mar 3rd 2009

The ASEAN summit produced rhetoric but little action
Among the many regional groupings around the world, the Association of South-East Asian Nations (ASEAN) is one of those whose actions, more often than not, have failed to match their aspirations. This was supposed to change with the adoption of ASEAN's new charter, which came into force on December 15th, 2008. Alas, the first summit of the organisation's national leaders since then—held in Thailand on February 28th-March 1st—showed that it was pretty much business as usual.

Some serious work was done in the Thai resort of Cha-Am Hua Hin, to be sure. Most importantly, ASEAN's ten members, which together encompass a market of 570m people, at last signed a free-trade agreement (FTA) with Australia and New Zealand after almost five years of negotiations. The 12 economies partaking in this FTA wield a combined GDP of US$2.7tn as of 2007 and are expected to see US$48bn in additional trade by 2020. ASEAN already has inked similar deals with China, Japan and South Korea, and now only lacks an agreement with India to round out FTAs with all its major neighbouring economies.

On most other issues it tackled, however, ASEAN reverted to form as a regional talking shop. The gathered leaders made a lot of noise about deepening the integration of their economies to minimise the adverse impacts of the global financial crisis. But they failed to come up with any concrete measures other than praising their finance ministers, who met five days earlier with their counterparts from China, Japan and South Korea to expand an existing regionwide currency-swap arrangement to US$120bn from US$80bn. This mechanism allows any signatory government facing a foreign-currency shortage to borrow from the others to avert a temporary liquidity crunch. All other statements relating to the current crisis were either platitudes or wish-list stuffing. They include: the necessity of proactive and co-ordinated action to restore market confidence; a firm stand against protectionism and ensuring a successful outcome to the Doha global trade negotiations; the need to invest more in infrastructure to promote growth; and a call for urgent reform of the international financial system.

The reason why ASEAN summits produce so little of substance is because of its traditional reluctance to force member countries to abide by collective decisions. Unlike the European Union—which they hold up as an inspiration—ASEAN countries have been famously reluctant to cede any meaningful sovereignty in the name of regional integration. Recognising the problem, ASEAN adopted a formal charter in 2007—its 40-year anniversary—to provide "the legal and institutional framework" for "a more rules-based [and] effective organisation". The ultimate aim of the charter, which still lacks enforcement or voting provisions, is to realise an ASEAN economic community by 2015.

That is unlikely to happen. At the Cha-am summit, evidence of hard decision-making was in short supply. For example, despite a high-minded rejection of protectionism, no steps were taken to stop a number of policies favouring domestic producers or workers that some member countries have adopted in recent months. Even if politicians had more spine, the huge economic disparities among ASEAN's member countries work against closer integration. For export-dependent Malaysia, Singapore and Thailand, it makes better sense to ship more goods to North America and Europe than to their poorer ASEAN cohorts—because the relatively sophisticated products that they produce, such as consumer electronics, are too expensive for Cambodians or Burmese.

Meanwhile, the international-pariah status of Myanmar is a thorn in the side that ASEAN just can't seem to handle to anyone's satisfaction. The leaders again refrained from pressing Myanmar's prime minister on freeing the country's most prominent democracy advocate, Aung San Suu Kyi, from house-arrest. Neither did they tackle head on the plight of the Rohingya refugees, a Muslim people from western Myanmar who have fled repression by that country's junta to Bangladesh and more recently to Thailand, only to be turned back out to the sea by local Thai authorities. Yet by its own reckoning, "one of the most important undertakings to make ASEAN a genuinely people-oriented community" is the grouping's plans to set up a human rights body by the end of the year. But judging by the continued unwillingness to move beyond easy words, the new human rights body will only serve to highlight ASEAN's weakness as a multinational organisation.
A fall in the value of the pound pushes up the cost of imports but was supposed to boost UK exports by making them cheaper on world markets. The weakness of sterling is certainly affecting the cost of living but – as today’s trade figures demonstrate – is having scant impact on Britain’s ability to pay its way in the world. The much-yaernded-for rebalancing of the economy in favour of manufacturing and exports is simply not happening.

The kindest explanation for the increase in the deficit in January is that the bad weather prevented British goods from getting to their overseas destinations. This is not especially convincing; blizzards in January cannot explain why exports in the latest quarter (November 2009 to January 2010) were 3% down on the same period a year earlier, when the global economic downturn was at its most virulent. Another argument is that it will take time for the effects of a cheaper pound to show up. Economists talk about the J-curve effect of a depreciation, whereby the balance of trade deteriorates before improving, because the cost of imports rises immediately but it takes time for exporters to respond. This does not wash either. Sterling has been under pressure for the past two-and-a-half years and has fallen by around 25% against a basket of global currencies. There should have been some response by now.
Rebalancing the economy requires investment and exports to take the place of consumer and government spending. So, if the trade data continues to be poor in February and March that could have an impact on the first-quarter growth figures, which are due out less than a fortnight before what is expected to be polling day. So what is going on? Firstly, more than half of UK visible exports go to the rest of Europe, which is currently the slowest-growing region of the global economy. The value of UK exports to Ireland, in the grip of an economic depression, stood at £1.4bn in January; the value of UK exports to China – growing at an annual rate of 10% – amounted to £500m.

Secondly, there is evidence that UK manufacturers are using the cheaper pound to boost their depressed profit margins rather than to increase export volumes. In theory, a UK-made car that was selling for €10,000 in Germany or France before the crisis should now have a price tag of €7,500 because the depreciation of sterling makes British goods more competitive overseas. In practice, companies are leaving the price of their goods unchanged and increasing their profits by €2,500 on each car. Given the squeeze on manufacturers, this is perhaps understandable and – if it helps companies survive what has been the worst recession of the post-war era – not entirely bad news either. It does mean, though, that exports will not get their expected boost.

Finally, there is the most disquieting explanation of the lot, namely that British industry has been so hollowed out by the four recessions since the mid-1970s that it no longer has the capacity to take full advantage of a weaker pound. All the main political parties accept that this may indeed be the case, which is why there has been a Damascene conversion to activist industrial policies. The report prepared for David Cameron by James Dyson is part of this growing consensus; there is now a belief across the parties that the UK economy is too narrowly focused and that manufacturing has been neglected for far too long. Industry would welcome some tender loving care from Westminster. It might ask, however, why it has taken so long.

Text 19. Case 8 - Latvia's EU handcuffs

Latvia shows the damage that rightwing economic policies can do – with help from the European Union and the IMF

Mark Weisbrot guardian.co.uk, Friday 15 January 2010

The signs of recession are more noticeable to those who live here in Riga, capital of Latvia – restaurants and coffee shops have lost most of their customers, and construction has practically ground to a halt. Emigration has soared. Latvia has set a world-historical record by losing more than 24% of its economy in just two years. The International Monetary Fund (IMF) projects that 2010 will be another bad year, with GDP shrinking by another 4%. The Fund forecasts a fall of 30% from peak to bottom, which would surpass the US’s economic decline during the 1929-1933 downturn of the Great Depression.

Yet Uldis Rutkaste, an economist who is deputy head of the monetary policy department and advisor to the governor of the Latvia’s central bank, told an audience of several hundred people in Riga on Wednesday that the government would continue with its "pro-cyclical fiscal policy." The word "pro-cyclical," which he used, refers to a policy that would be expected to reinforce the downward trend of the economy. This would continue, he said, until wages had fallen further. It is difficult to imagine a government official in the US, western Europe, or indeed most countries of the world making an argument like this in public. But these are “true believers,” and they will stay the course so long as their citizens are willing to accept the punishment.

What is the reasoning behind doing the opposite of what most governments in the world are doing – stimulating their economies with counter-cyclical policies in order to speed recovery from the global recession? And in a country that has suffered the steepest recession in the world? The logic goes like this: Latvia has a fixed exchange rate, with the currency pegged to the euro, and the government
does not want this to change. If this nominal rate of exchange stays fixed (at 70 euro cents for one Lat), then the only way to lower the value of the currency internationally is to do so in "real terms." This means pushing wages and prices down. In other words, Latvian production can become more internationally competitive by lowering prices and wages internally, while keeping the currency's international exchange rate fixed.

While this is theoretically possible, it is extremely difficult in practice – and even if it were to "succeed," the disease is cured by killing the patient. Unemployment in Latvia has passed 22%, and despite its world record decline in GDP, the real exchange rate, as noted recently by the IMF, has barely moved. An overvalued exchange rate hurts a country’s exports by making them more expensive, and encourages imports by making them artificially cheap. But in this case, the direct effect of the overvalued exchange rate on trade is the lesser part of the problem. The bigger problem is that the government’s commitment to the peg makes it extremely difficult or impossible to adopt the policies that would get the economy out of recession. This includes fiscal policy, as noted above: as part of its agreement for a loan from the IMF, the government has agreed to budget cuts and tax hikes amounting to 6.5% of GDP in 2010. As the IMF acknowledges, this will further weaken the economy in 2010.

Then there is monetary policy – in the US the Federal Reserve has cut short-term interest rates to zero and expanded money creation in response to the recession. The Latvian central bank is restricted in using expansionary monetary policy because of fears that this could undermine confidence in the currency peg. This leaves the Latvian government in the unfortunate situation that the three major economic policy tools available to counteract a recession: fiscal, monetary, and exchange rate policy – are either heavily restricted or working against them (pro-cyclical).

Maintaining the fixed, overvalued exchange rate also creates enormous uncertainty that undermines investment and causes capital to leave the country. The IMF projects that an additional €1.5bn will leave the country this year. Investors and depositors in this situation are worried that the currency will be devalued, no matter what the government’s stated commitment. The government has argued that Latvia has no choice but to maintain the peg. The alternative would be worse, they say: a devaluation would send inflation through the roof (because import prices would rise). And since an estimated 85% of the country’s domestic borrowing is denominated in euros, an even bigger fear is that a devaluation would cause a wave of defaults and bankruptcies.

Yet the fear of runaway inflation is exaggerated: inflation in Latvia is negative and falling right now. Thanks to the depression, imports have collapsed to 31% of GDP, from 52% in 2007 – this reduces the inflationary impact of any devaluation. But, most importantly, the greater threat to economic recovery is actually deflation – which, as the IMF has also noted, increases the burden of the country’s spiralling public debt. A devaluation would help resolve those problems. But the problem of loans denominated in foreign currency is a serious one, and would have to be addressed. This could be done by allowing homeowners, for example, to pay back their loans in lats at the current exchange rate – with the government picking up some of the losses. There are ways to make sure that the majority of people do not bear most of the burden of the adjustment, and the government would have to come up with a plan to do this.

It makes no sense to continue to shrink the Latvian economy, with no end in sight to the recession, simply to maintain the pegged exchange rate. Argentina tried this from 1998-2001, also suffering its worst recession ever and pushing 42% of its households into poverty. After the devaluation, the economy contracted for just one more quarter and then began a remarkable recovery, growing more than 60% in the ensuing six years.

By contrast, the IMF projections for Latvia – under assumptions that are looking increasingly over-optimistic – show the economy in 2014 still smaller than it was in 2006. And to make things even worse, these projections show a public debt of 90% of GDP in 2014 – far beyond the 60% limit required by the EU for the country to join the euro. This has been one of the Latvian government’s
main goals, and justifications, for maintaining the peg and putting the country through hell – but this exit strategy looks increasingly unlikely. The IMF has long had a double standard when it comes to macroeconomic policy: for the rich countries it is generally Keynesian, advocating the kinds of counter-cyclical fiscal and monetary policies that the US has adopted during the current recession. Yet for the low-and-middle income countries it has often pushed the opposite policies.

But to be fair, the IMF does not appear to be the driving force behind these decisions – rather it is the European governments, who are putting up most of the loan money for Latvia. In this case the Fund is going along with the EU, even though it appears that its economists can see that these policies are wrong. Of course the Latvian government has also been a strong advocate of keeping the peg but there is a limit to the punishment that Latvians will accept. And of course the EU will not give loans for policies that it finds objectionable. So EU governments are playing a pivotal role here.

These governments have an enormous conflict of interest in this case. Their banks, including those of Austria, Sweden, Belgium, the Netherlands, and France – have hundreds of billions worth of euro-denominated loans to the countries of central and eastern Europe. A devaluation in Latvia could trigger a similar result in Lithuania, Estonia and Bulgaria, and increase defaults on the bad loans that these banks made during bubble years throughout the region. It is most likely for this reason that Europe increased its pledges to the IMF by $175bn last year, with $108bn also coming from the US congress and $100bn from Japan. While they are squeezing Latvia dry right now, and the IMF is pressuring other countries to cut spending, they will have hundreds of billions of taxpayer dollars on hand to bail out European banks if the need arises.

This part of the story is familiar even to Americans who have watched as our largest financial institutions have received top priority from the government – and indeed are doing quite well right now – while millions lose their homes and their jobs. But Latvia is an extreme case, partly because the macro-economic policy is so far to the right, and exhibiting a 19th century level of brutality. The World Bank has complained about the pension cuts that disproportionately hurt Latvia’s poor, and the long-term damage to the educational system from the mandated budget cuts in that area. There really is no excuse for this to continue.

Text 20. Case 9 - Ireland: tiger, tiger, burning bright

Economist; 10/16/2004, Vol. 373 Issue 8397

An economic miracle with many causes

The figures recording Ireland’s transition from Europe’s worst- to its best-performing economy are remarkable. In 1987 Irish GDP per person was 69% of the EU average (adjusted to EU 15); by 2003, it had reached 136%. Unemployment fell from 17% in 1987 to 4% in 2003; and government debt shrank from 112% of GDP to 33% (see chart 2). Annual GDP growth in the decade of the 1990s averaged a tigerish 6.9%; GNP growth, usually a more appropriate measure for Ireland (see box, next page), only slightly less. Perhaps even more impressive, after a downward blip coinciding with the American and, especially, the information-technology (IT) slowdowns in 2001-02, the economy is bouncing back: growth both this year and next is expected to be around 4-5%.

Not surprisingly, this Celtic miracle has been carefully analysed. Many different, and sometimes contradictory, explanations have been proposed, but as usual there is no single cause: it was a combination of different factors at different times.

To get a more complete answer, it also helps to ask a different question altogether. Seen in a historical context, what is striking about Ireland is not that it grew so spectacularly in the 1990s, but that it did so badly in the 1980s, and indeed for a long time before then. At independence in 1922, Ireland was as rich as most European countries, and only a bit poorer than Britain. But by 1960 it had
fallen far behind, and continued to lag the rest of Europe until the late 1980s. On this reading, the emergence of the Celtic Tiger was a belated catch-up after years of underperformance.

There were, nevertheless, a number of special factors that changed Ireland's fortunes after 1987. Here are some, in ascending order of importance:

- **Fiscal and monetary consolidation.** Charles Haughey's Fianna Fail government, crucially supported by the opposition Fine Gael, started to cut spending, taxes and borrowing. Falling interest rates helped to stimulate the economy, and so did a currency devaluation in 1993. The launch of the euro in 1999 gave Ireland, a founder member, the benefit of lower--perhaps unduly low--interest rates.

- **The tax cuts were also a critical component of a new social partnership.** Unlike Britain, where the Thatcher government shifted decisively against corporatism, the Irish resuscitated social dialogue in 1987, with trade unions accepting wage restraint in exchange for more policy influence and tax cuts. Seventeen years on, unions and employers still talk up the advantages of social partnership. Even the tanaiste (deputy prime minister) and leader of the free-market Progressive Democrats, Mary Harney, considers this an important part of Ireland's success.

- **European Union subsidies.** Countries such as Germany, the chief EU paymaster, like to argue that Ireland's miracle was due to huge transfers from Brussels. Yet European money had been pouring into Ireland since 1973, at first to little obvious effect. The expansion of the EU's structural funds after the Maastricht treaty of 1992 was helpful, but even then transfers never exceeded 5% of Irish GDP, a far smaller proportion than, say, west German transfers to east Germany. The most authoritative studies suggest that EU subsidies may have added around 0.5% a year to growth during the 1990s--useful, but modest in the context of average growth of 6.9%.

- **More important than EU money may have been the 1992 programme to create a European single market.** As a big low-cost exporter to Britain and the rest of Europe, Ireland benefited from more open access. EU subsidies also played another indirect part: by requiring a planned capital programme some years ahead, they helped to protect badly needed infrastructure projects from the cuts imposed in response to the fiscal pressures of the 1980s.

- **Ireland's FDI boom.** A number of foreign manufacturers invested during the 1960s, lured by the country's low costs and zero corporate-tax rates. Among them were such high-tech companies as Polaroid and Digital Equipment. But by the 1990s they had pulled out, as did Gateway, a PC maker. By then, after complaints from the EU, the corporate-tax breaks had become less generous (from this year the rate for all companies is 12.5%). But Ireland's Industrial Development Authority (IDA) had become good at attracting desirable companies, and it proceeded to win big FDI projects in such businesses as software, semiconductors, personal computers, pharmaceuticals and medical devices.

- **Education.** One of Ireland's bigger attractions was a ready supply of skilled workers, including scientists, engineers and business-school graduates. As far back as the 1960s, the country had been investing heavily in both secondary and higher education. Dublin's two main universities, but also those at Cork and Galway, and a new one at Limerick, became crucial to the IT, pharmaceutical and health-care companies that invested in those regions.

- **Low personal taxes.** In the 1960s and 1970s, high income-tax rates, and a high tax burden in general, discouraged domestic growth, but from the early 1990s taxes started to come down sharply, giving a big boost to home-grown enterprise. Des O'Malley, who quit Mr Haughey's Fianna Fail party to found the Progressive Democrats in 1985, says that lower income-tax rates were key to the Irish miracle.

- **Demographics.** The baby boom in Ireland lasted longer than in the rest of Europe, and there were fewer elderly pensioners because emigration in the 1950s and 1960s had been so heavy. Where
other European economies were facing a rapidly ageing population, Ireland has been boosted by its youthfulness. Ireland's population has been growing strongly for 13 years now, helped also by an end to the net outflow of people and the start of an inflow.

The biggest contribution to the Irish miracle, however, came from more people working. Until the 1980s, women's participation in the workforce was low by international standards; today it is above average. Conversely, Irish unemployment was high, at around 17% in 1987; today it is 4%. All in all, the labour-force participation rate in Ireland has risen from around 60% in the 1980s to almost 70%. The absolute numbers of those in work rose from 1.2m in 1993 to over 1.8m ten years later. On some estimates, this accounts for half of Ireland's growth in the 1990s. [...] 

The conclusion is stark: much of the Irish miracle (ie, higher output) was attributable to one-off changes (ie, greater input) and not to productivity growth (ie, more efficient use of that input). In effect, an economy that was suffering from 50 years of inefficiency, poor organisation and under-use of inputs (especially female workers) has spent the past 15 years catching up with more efficient, better-organised neighbours. Now it needs to find ways to keep the momentum going. [...] The new EU members will also discover, as Ireland has already done, that the world has become a lot more competitive. Ireland has some useful advantages to help it stay ahead, but it also faces serious short-term problems, such as the state of some public services and a dangerous obsession with property.


By THOMAS L. FRIEDMAN, New York Times June 29, 2005

Here's something you probably didn't know: Ireland today is the richest country in the European Union after Luxembourg.

Yes, the country that for hundreds of years was best known for emigration, tragic poets, famines, civil wars and leprechauns today has a per capita G.D.P. higher than that of Germany, France and Britain. How Ireland went from the sick man of Europe to the rich man in less than a generation is an amazing story. It tells you a lot about Europe today: all the innovation is happening on the periphery by those countries embracing globalization in their own ways - Ireland, Britain, Scandinavia and Eastern Europe - while those following the French-German social model are suffering high unemployment and low growth.

Ireland's turnaround began in the late 1960's when the government made secondary education free, enabling a lot more working-class kids to get a high school or technical degree. As a result, when Ireland joined the E.U. in 1973, it was able to draw on a much more educated work force. By the mid-1980's, though, Ireland had reaped the initial benefits of E.U. membership - subsidies to build better infrastructure and a big market to sell into. But it still did not have enough competitive products to sell, because of years of protectionism and fiscal mismanagement. The country was going broke, and most college grads were emigrating. "We went on a borrowing, spending and taxing spree, and that nearly drove us under," said Deputy Prime Minister Mary Harney. "It was because we nearly went under that we got the courage to change."

And change Ireland did. In a quite unusual development, the government, the main trade unions, farmers and industrialists came together and agreed on a program of fiscal austerity, slashing corporate taxes to 12.5 percent, far below the rest of Europe, moderating wages and prices, and aggressively courting foreign investment. In 1996, Ireland made college education basically free, creating an even more educated work force. The results have been phenomenal. Today, 9 out of 10 of the world's top pharmaceutical companies have operations here, as do 16 of the top 20 medical device companies and 7 out of the top 10 software designers. Last year, Ireland got more foreign direct investment from America than from China. And overall government tax receipts are way up.
"We set up in Ireland in 1990," Michael Dell, founder of Dell Computer, explained to me via e-mail. "What attracted us? [A] well-educated work force - and good universities close by. [Also,] Ireland has an industrial and tax policy which is consistently very supportive of businesses, independent of which political party is in power. I believe this is because there are enough people who remember the very bad times to de-politicize economic development. [Ireland also has] very good transportation and logistics and a good location - easy to move products to major markets in Europe quickly." Finally, added Mr. Dell, "they're competitive, want to succeed, hungry and know how to win. ... Our factory is in Limerick, but we also have several thousand sales and technical people outside of Dublin. The talent in Ireland has proven to be a wonderful resource for us. ... Fun fact: We are Ireland's largest exporter."

Intel opened its first chip factory in Ireland in 1993. James Jarrett, an Intel vice president, said Intel was attracted by Ireland's large pool of young educated men and women, low corporate taxes and other incentives that saved Intel roughly a billion dollars over 10 years. National health care didn't hurt, either. "We have 4,700 employees there now in four factories, and we are even doing some high-end chip designing in Shannon with Irish engineers," he said.

In 1990, Ireland's total work force was 1.1 million. This year it will hit two million, with no unemployment and 200,000 foreign workers (including 50,000 Chinese). Others are taking notes. Prime Minister Bertie Ahern said: "I've met the premier of China five times in the last two years." Ireland's advice is very simple: Make high school and college education free; make your corporate taxes low, simple and transparent; actively seek out global companies; open your economy to competition; speak English; keep your fiscal house in order; and build a consensus around the whole package with labor and management - then hang in there, because there will be bumps in the road - and you, too, can become one of the richest countries in Europe.

"It wasn't a miracle, we didn't find gold," said Mary Harney. "It was the right domestic policies and embracing globalization."

Text 22.  Case 9 - Ireland: The End of the Miracle?
By Kerry Capell, Business Week, 27 march 2008

The powerful euro has crushed the country's decade-long economic expansion—and its competitiveness

Once the envy of Europe, Ireland's economy is set to grow at a crawl this year. Joblessness is spiking to 6%. Exporters, one of the country's biggest growth engines, are getting clobbered. The rising cost of doing business is leading some multinationals to rethink their commitment to Ireland. House prices, which rose to record levels on the back of extraordinary economic growth, are plummeting. "Ireland's competitiveness has markedly deteriorated," says Jim Power, chief economist at the Dublin investment advisory firm Friends First.

This sorry tale is the flip side of the Irish miracle. Starting more than three decades ago, policymakers slashed corporate taxes, pumped money into higher education, deregulated aggressively, and courted multinationals desperate to escape the slow-growth, red-tape environment of Continental Europe. The strategy worked brilliantly: Ireland's economy expanded an average of 6% annually for a decade or more. Now, exports are slowing as the euro surges against the dollar and sterling, the currencies of Ireland's two biggest trading partners. Wages, once among the lowest in Western Europe, have increased by substantially more than the euro zone averages, Microsoft (MSFT) Ireland managing director Paul Rellis told the American Chamber of Commerce Ireland in a February speech. Even strong productivity gains can't offset the loss of competitiveness caused by the powerful euro.

was $23.82 in the U.S., $25.96 in Ireland, and just $4.99 in Poland. "We're seeing increased competition from lower-cost destinations," said Rellis in his speech.

Major multinationals have been cutting jobs, closing plants, or postponing investment. In May, 2007, Motorola (MOT) shut its plant in Cork city, laying off 330 workers. In October, the world's biggest biotech company, Amgen (AMGN), shelved plans to build a $1 billion manufacturing plant in County Cork. Both outfits say they acted based on the global business environment and not on the business climate in Ireland. But economist Power believes Ireland's foreign investment model is under threat as developing countries replicate Ireland's success and the European Commission plans to harmonize tax rates across Europe.

The situation has burst a housing bubble that was in percentage terms bigger than that of the U.S. According to the International Monetary Fund, Ireland enjoyed the greatest property boom worldwide on record, says Alan Ahearne, an economist at the National University of Ireland at Galway and a former senior economist at the U.S. Federal Reserve. The average house price topped $490,000 at the beginning of last year, an increase of more than 300% in just over a decade, compared with 130% in the U.S. Two years ago residential building accounted for more than 12% of the Irish economy, with over 90,000 new homes constructed. According to the Economic & Social Research Institute, that was double what the country needed. Home prices fell by 7% in 2007 and should drop further this year. "There are a lot of people who bought at the top in 2006 who are now in negative equity and don't even realize it," says Karl Deeter, co-founder of Irish Mortgage Brokers in Dublin. Davy, a Dublin brokerage, predicts a net loss of 20,000 construction jobs this year.

One problem for Ireland: Its currency is the euro, and its interest rates are set by the European Central Bank. So it can't unilaterally weaken its currency or lower rates to get out of recession. That leaves the painful solution of reining in both public and private spending. Says Ahearne: "The way we'll regain our competitiveness is to ensure we don't pay ourselves too much."

Text 23. Case 10 - Switzerland: a split personality

The Economist print edition, Feb 12th 2004

There is not just one Swiss economy, but several. Some are more impressive than others

After more than half a century as the richest country in the world, Switzerland has lost the crown. [M]easured by GDP per head at purchasing-power parity (UE-27 = 100), the Luxembourgers, the Norwegians and the Americans are now richer than the Swiss, and others are close behind (see chart below). What went wrong? The first thing to note is that the Swiss are not actually getting poorer; it is just that other countries are getting richer faster. Switzerland started with a huge advantage after the Second World War because almost all its infrastructure had remained in one piece. But as other countries started rebuilding their economies, the advantage gradually diminished. According to figures calculated by Angus Maddison, an economic historian, Switzerland's income per head in 1950 was 80% above the European average. But by 1998, its GDP per head at purchasing-power parity was only 14% above the European average.

Certainly, Switzerland's recent growth rate seems to have been exceptionally slow. Average annual growth in GDP for the past two decades has been 1½%, less than half the OECD average. During the 1990s, real GDP per head remained absolutely flat, whereas in Britain and America it grew by around 2%. This has caused some Helvetic puzzlement. After all, the country continues to feel comfortably and increasingly wealthy. The economists got to work, and concluded that things were not as bad as they looked. The low growth of the past two decades is "something of an optical illusion", says Ulrich Kohli, chief economist at the Swiss National Bank. In a recent paper, he argues that it is partly explained by a huge improvement in Switzerland's terms of trade, of 34% between 1980 and 1996. Better terms of trade allow a country to export less for any given quantity of imports, or import more
for any given quantity of exports. The resulting current-account surplus is solid enough, but by definition it does not show up in the real gross domestic product.

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\text{GDP per capita (PPS, EU-27 = 100)}
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Source: Eurostat

[...] Switzerland's growth paradox is anything but new. As Mr Kohli points out, the country's average real growth per person lagged behind that of most other countries for the whole of the 20th century. Yet, even though Switzerland in the 19th century was poor compared with most of its neighbours, it ended up very rich half a century later. It seems to be the tortoise that always wins the race.

This time, however, even if some of the lack of growth can be explained away by technicalities, there remains plenty of cause for concern. [...] There is only so much the Swiss can do to help themselves. One Swiss franc in two is earned abroad (from exports of goods and services, income from direct investment and so on), and if most of the countries they trade with are doing badly, they cannot expect to do much better. Some 60% of Swiss exports go to members of the EU, and much the biggest chunk of that to Germany, which has had plenty of its own problems of late.

But not all of Switzerland's economic troubles come from abroad. One big home-made problem is a steep rise in recent years in public spending at all levels of government—federal, cantonal and communal—which has pushed up the public-sector deficit. The country has always prided itself on its small government, and state spending as a proportion of GDP is still smaller than in other European countries, but the gap is narrowing (see chart above). The main culprit has been an alarming increase in social-security spending. The outlay on health care, for example, is now well over 10% of GDP, double its level 30 years ago. [...]
The first, big and international, sector of the economy is impressive by any standards. For a country of its size, Switzerland has an unusual number of large multinational companies. The list includes big banks such as UBS and Credit Suisse; big insurance companies such as Zurich and Swiss Re; Nestlé, a huge multinational food company that grew from small beginnings in Vevey on Lake Geneva more than 130 years ago; Novartis and Roche, two world-class pharmaceutical companies; and Swatch, the company that resuscitated the Swiss watch industry after a nearly terminal assault by cheap quartz watches from East Asia in the 1980s. [...] They are there because Switzerland has plenty to offer such firms: political and economic stability; an attractive tax and regulatory regime; well-developed capital markets; good communications; an educated and flexible workforce; and an excellent quality of life. They make a huge contribution to the economy but a much smaller one to domestic employment, accounting for well under 10% of Swiss jobs, because much of their business is abroad.

The second category covers small, nimble companies in sectors such as engineering, biotechnology, medical instruments and watchmaking that spend a lot on R&D and export most of their output. Again, their share of domestic employment is relatively small, but their economic contribution is significant. The third group, state-owned or semi-privatised enterprises, which account for about a quarter of all jobs, could probably be reinvigorated by further privatisation, but is unlikely to display great dynamism.

The bulk of Swiss employment, around 60%, is in the fourth economy: small and medium-sized builders, craftsmen, retailers, hoteliers, restaurateurs, consultants and so on. They are safe not only from international competition, but often from rivals nearer home too. The Swiss federal government has been trying for decades to create a truly integrated domestic market, with mixed results. Swiss doctors and lawyers are now able to move freely from canton to canton, but plenty of restrictions remain elsewhere. [...] To a foreigner, almost everything in Switzerland is hair-raisingly expensive. According to the central bank, this is not because the Swiss franc is overvalued, but because the domestic cost base is high. The high wages paid by the internationally competitive sector of the economy filter down to other, less efficient companies. Food [also] costs a lot because Swiss farmers are not large enough to operate at optimum efficiency, and Switzerland’s tariffs on imports of agricultural goods average around 50%. Tariffs on manufactured goods are low, but technical barriers can be pretty effective at keeping out imports. A basic washing machine, for example, costs two or three times as much in Switzerland as it does in France or Germany. Measured by a standardised basket of goods and services, prices in Switzerland are nearly 40% higher than the OECD average, whereas in neighbouring France and Germany they are only 10% higher and in Italy 10% lower. In a small country with fairly open borders, that encourages a lot of Swiss families to nip across the border to buy their groceries more cheaply. Chart below shows how Swiss price levels in particular sectors compare with the EU average. It is a textbook illustration of economic forces at work. Where Swiss taxation is below that in other countries (eg, tobacco, cars, fuel), prices are lower than in the EU. Where international competition is strong and there is no special tax treatment (e.g., clothes and shoes), prices are much the same. But where there is no international competition (health-care services, rents), strong protection (food) and/or a high labour content (construction, hotels, restaurants), prices are much higher.
The least market-oriented sector of the Swiss economy is agriculture. Some of this is a hangover of the second world war, when Switzerland wanted to be as self-sufficient in food as possible. It still produces three-fifths of its own food. That may reassure its citizens about the reliability and quality of supplies, but it is not the most cost-effective way of feeding them. Still, the farmers are not just there to produce food. They are also paid to look after the countryside. Where it is not picturesquely wild and mountainous, the Swiss countryside does indeed look manicured. [...] The Swiss government subsidises agriculture and forestry even more extravagantly than does the EU with its famously profligate agricultural policy. But some progress is being made. [...] [Then again] high domestic prices hurt some of Switzerland’s export industries, particularly tourism. The economics ministry recently commissioned a study comparing the cost of a standard skiing holiday in a medium-class hotel in Switzerland with the same sort of thing in Austria, and found that the Austrian package was one-third cheaper. That sort of price differential must put many people off. But at least prices are stable. The Swiss central bank’s inflation target, defined as a range of 0-2%, has been met every year since the mid-1990s, after a scary period in the early 1990s when inflation topped 6½%. Prices actually turned down for a brief period in 1998, causing worries about Japanese-style deflation. But, in contrast to Japan, Swiss demand held up well [...].

Switzerland’s biggest competitive advantage is its people, who are well-educated, sensible, conscientious and hard-working. Labour-market participation is among the highest in the world, around 90% of those of working age (though this includes many part-timers, particularly among women). Swiss workers put in long hours, if not as long as in America, and take shortish holidays. A proposal for a 36-hour week was turned down in a referendum in 2002. Moreover, in contrast to neighbouring countries, where early retirement is widespread, most people work right up to pension age. Swiss workers also hardly ever go on strike [...]. And pay increases in recent years have been modest, reflecting the tougher economic environment: nominal wages in 2001 went up by 2.5% and in 2002 by only 1.8%.

So far as employers are concerned, another good thing about Swiss workers is that they can be fired when necessary. They will get unemployment pay, but not for very long, and they have to show that they are genuinely looking for work. Left-of-centre politicians such as Andreas Gross, a Social Democrat MP, describe the system as “brutal”. But it may help to explain why unemployment is around 4% and not 10%, as in France or Germany. [...] Yet note, too, that a fifth of the population and a quarter of the labour force are foreigners, who seem to be working every bit as hard as the natives. [...] More than half of these foreign workers come from EU countries (and another quarter or so from former Yugoslavia). Under a bilateral agreement negotiated with the EU, from the middle of this year all European citizens will be entitled to work in Switzerland. Nobody is expecting a rush, but this change will make the country a little less special still.

Text 24. Case 10 - Swiss economy shrinks as exports slump

http://www.swissinfo.ch/eng/specials/finance_crisis/Swiss_economy_shrinks_asExports slump.html?siteSect=23451&sid=10770245&cKey=1243946744000&ty=st

June 2, 2009

Swiss gross domestic product (GDP) for the first quarter of 2009 has fallen by 0.8 per cent on the previous three months, its worst quarterly performance since 1992. Negative growth was registered in particular in exports, according to the State Secretariat for Economic Affairs (Seco) on Tuesday. The year on year drop was 2.4 per cent, the sharpest contraction since 1976. "It’s a bad number – Switzerland is in a bad shape – but in other countries the effect is even worse," Seco’s chief economist, Aymo Brunetti, told swissinfo.ch. He admitted it was "more or less in line with what we expected". "We all know that at least for world markets it’s the worst recession since the Second
World War, so it's not very surprising that Switzerland is affected," he said. This was confirmed by UBS analyst Reto Hünerwadel. "The 2.4% drop in GDP is not very upbeat, confirming the Swiss economy is still feeling the heat of the global economic slowdown. But it is still comparably solid compared with other European economies," he said. German GDP for example has slumped 3.8% on the quarter in the first three months of 2009. Seco reported that exports dropped by 5.4% on the quarter, coming on top of an 8.7% fall in the final quarter of 2008. Exports of goods – down 6.6% – were again more seriously affected than exports of services, down 2.3%. In contrast to exports, imports of goods and services remained at the same level as the previous quarter.

"Of course we've been very clearly affected on the exports side, but at least on the domestic markets we had some very good years, so we think the domestic market is quite resilient," Brunetti said. He highlighted some factors he believed played a role in Switzerland's less-worse-than-others performance. "We don't have the kind of problem in the housing market that many other countries have. We had quite high wage settlements at the end of last year and these might give some stabilising effect on the consumption side." Nevertheless, Switzerland slipped into recession last summer and the Swiss National Bank (SNB) forecasts an economic contraction of up to 3% in 2009, which would be the worst decline in over 30 years, after an overall growth of 1.6% in 2008. A "noteworthy" rise in spending, said Seco, was observed only in the fields of healthcare and communications. In contrast, spending declined in the sectors for clothing, furniture, transport and financial and insurance services. Construction continued its downward trend, dropping 1%.

As for the future, Brunetti hopes "that the policies that have been undertaken until now will be sufficient, but if the recession continues, there is a discussion in Switzerland on whether there is a need for another package of measures". The economic stimulus measures would follow two earlier rounds of funding in the past year totalling SFr1 billion. "A lot has been done on the monetary policy side, but intentionally we have a step-by-step approach because the uncertainty is so big – on both the favourable and unfavourable side," Brunetti said. "It will be very interesting to see what happens in the next quarter, because in many countries the first quarter was so bad that the evaluation was that this must be a kind of turning point," he added. "But I would be very careful of making forecasts about the turning point – it all depends on the recovery of world markets. This is the most important thing for the Swiss business cycle right now."

Thomas Stephens, swissinfo.ch

Text 25. Case 11 - Russia and Western clubs: no thanks, Geneva

From The Economist print edition, Jun 18th 2009 | MOSCOW

Why Russia is turning its back on the World Trade Organisation

It had become almost a ritual. Every year Russian officials promised that by the end of the following year their country would complete the negotiations to join the World Trade Organisation. Every year the timetable slipped by another year. But now Vladimir Putin, Russia’s prime minister, has broken with the ritual by announcing that, after 16 years of trying to get in, Russia no longer wants to join the WTO on its own but only as part of a customs union that it has forged with Belarus and Kazakhstan. The turnaround shocked trade negotiators on both sides, who only weeks ago were trying to iron out the last wrinkles in a deal.

Why the change? The Kremlin may just be fed up with endless new demands and delays. After last August’s war with Georgia, Mr Putin accused the West of politicising the trade talks and said that Russia would not be pushed around. Both Ukraine and Georgia, two former Soviet republics that cause big headaches in the Kremlin, are now in the WTO, leaving Russia behind (and, not incidentally, acquiring a veto over its membership). By making his announcement before Barack Obama’s visit to Moscow, Mr Putin removed an easy concession the American president might have offered. "We
really thought we could have completed [the talks] by the end of the year," said a senior American official.

In practical terms Russia will lose little. It exports mainly oil and gas, which are largely not covered by the WTO. Being outside the organisation for a bit longer gives it more freedom to raise import duties on second-hand cars or export duties on timber. Some observers suggest that the Kremlin was never truly comfortable with the idea of free trade and saw the rules as a nuisance rather than a stimulus to restructure the economy.

Yet Russia’s aspiration to membership, which in turn opened up the prospect of joining the Paris-based OECD club of rich countries, demonstrated its desire for integration into the global economic system. Now the Kremlin seems to prefer being a distinct regional power that can offer alternative economic and military institutions and alliances to the West’s. Mr Putin has long argued that international organisations such as the WTO and the International Monetary Fund have outlived their day and should be supplemented or even replaced by regional clubs. In the multipolar world that Russia advocates, it sees itself as a centre of regional influence. A military alliance between Russia and Uzbekistan, Belarus, Armenia, Kazakhstan, Kyrgyzstan and Tajikistan, called the Collective Security Treaty Organisation (CSTO), should be "no worse than NATO", Dmitry Medvedev, Russia’s president, argued recently.

Russia sees any foreign project that touches the former Soviet Union, including the European Union’s new eastern partnership, as a direct challenge. Yet the bigger threat to its ambitions to reassert regional influence lies in its own attitude towards the neighbours. Even as it was signing a customs union with Belarus, Russia imposed a ban on Belarusian milk products, which it claimed did not meet its new packaging rules (rather as it once argued that Georgian wine, fruit and mineral water were of substandard quality). But Alyaksandr Lukashenka, the autocratic president of Belarus, interpreted this (probably accurately) as a punishment for being rude about Russia and refusing to back its policy of recognising the independence of the Georgian territories of Abkhazia and South Ossetia.

Mr Lukashenka is known for his own blackmailing tactics. When Alexei Kudrin, Russia’s finance minister, questioned Belarus’s solvency and withheld a $500m loan offer a few weeks ago, Mr Lukashenka hit back by saying: "If it does not work with Russia...we will have to try our luck in another part of the planet." In response to the milk ban, he boycotted the latest CSTO summit, insisting that talk of collective security against the background of trade wars waged by some CSTO members against others made a mockery of common sense. Fyodor Lukyanov, a foreign-policy pundit in Moscow, commented that, as soon as the CSTO ceased functioning as a mere symbol of loyalty to Russia and began to set concrete goals, "it became clear how little the organisation met the real interest of its members."

Text 26. Case 11 - IKEA sets its sights on Russia’s markets […]


Published: April 02, 2003

When Lennart Dahlgren, the general director of Ikea Russia, arrived in Moscow on August 17, 1998, to set up the company’s first superstore, his heart sank. He walked into an unfolding economic crisis as he had arrived on the same day that the rouble crashed, losing three-quarters of its value against the dollar overnight. It was the start of a journey that has turned him into a retail-driven foreign investment success story. “I was a bit shaken, but my friends from other businesses said I was lucky, as it would be much easier to invest following the devaluation. And it was. There was a complete change in attitude. Where the authorities were difficult and arrogant before, after the crisis they
welcomed foreign investors with open arms,” says Mr Dahlgren sitting in the airy, open-plan office you would expect of the world’s leading furniture producer.

Ever since Ingvar Kamprad founded the company in 1943, he has been a true believer in Russia. He travelled to the Soviet Union in the 1960s and became convinced that the country’s massive raw material base and high levels of education made it the obvious production centre for a global furniture company. But politics and economic collapse kept IKEA out of Russia until the fateful day of the devaluation. Since it was founded, IKEA has doubled in size every four years. The biggest problem the company faces is not how to sell furniture, but where to buy it from. IKEA has been sourcing furniture from Russia for more than 20 years, but without a presence on the ground it has been unable to boost the volume much beyond $20m a year. Having already tried to set up in Russia twice – once in 1988 shortly before the Soviet Union’s collapse and again in 1993 when Boris Yeltsin unleashed tanks in the capital – the first store opened with much fanfare in March 2000 and a second followed a year later. Between them, the two stores, which were aimed at the middle class from the outset, should produce combined sales of $240m this year. They have surprised management by already surpassing IKEA’s western European stores in terms of per-square-metre sales.

But Mr Dahlgren says that IKEA is still losing money in Russia and does not expect to turn a profit until 2005. He adds that IKEA now needs the turnover from four stores and to boost locally produced furniture from 13% now to more than 30%, to be profitable. Both these objectives will be reached when the third store opens in Moscow this year and after construction on the first regional store in St Petersburg, which began in March, is complete. Eventually IKEA is planning to have two-dozen stores across the country. But the really ambitious goal is to supply its entire global operation with Russian-produced furniture. Although IKEA will open its first company-owned furniture factory this year near St Petersburg, which has attracted most of Russia’s direct foreign investment, most of the investment has gone into building up domestic producers.

IKEA has already invested $400m, buying its 60-plus suppliers equipment and granting credit for investment and working capital – as Russian companies’ biggest headache is their inability to borrow from the local banks. The company plans to invest another $600m over the next five years. “You have to think long-term in Russia. The biggest mistake other companies make here is to come with second-class goods, materials and people. You need the best in Russia,” says Mr Dahlgren. “You have to understand that this market is much bigger and sophisticated than it appears.”

Text 27. Case 11 - IKEA expansion in Russia stalled


Nataliya Vasilyeva, AP Business Writer, Published: June 15, 2009

The IKEA northwest Moscow store in Russia is pictured May 29. The company may halt its expansion into Russia after running into red tape. AP Photo by Mikhail Metzel

Moscow (AP) — In just nine years, Swedish furniture retailer IKEA has opened 11 of its huge stores in Russia in hopes of capitalizing on Russia’s nascent middle class. Now the company says it may halt its expansion drive after running into trouble with the government’s powerful reach. But some observers say the economic crisis may be as much of a factor in IKEA’s fortunes as the local bureaucracy.
IKEA hit a bump when officials in Samara in the Volga River region demanded a planned store be able to withstand near-hurricane-force winds, although such violent weather is rare. The strongest recorded winds never exceeded 17 meters per second, a little more than half the 30-meter-per-second standard set by local government. Back in April, IKEA said the store in Samara was tentatively scheduled to open May 11. More than a month later, the store has not opened yet, and IKEA said it cannot give even a tentative timeline.

But another blow came last month when Russia's anti-trust watchdog began investigating the Swedish furniture maker for allegedly urging tenants at its mall outside Moscow to use services of selected companies — an accusation IKEA denies. "Every time there is some kind of inspection, there are new points coming up, so one gets a feeling that someone somewhere does not like us", said Per Kaufmann, IKEA Russia's director general. "The Russian board today questions whether it's worthwhile to expand further. First we need to open up in Samara, then we will see. The question has not been answered yet."

Regulators and bureaucrats frustrate entrepreneurs everywhere, but Russia's multilayered government has proven especially difficult for businesses to negotiate. And in addition to red tape, sometimes there's corruption. President Dmitry Medvedev last year declared corruption a key threat to his country's modernization and social stability and pushed through anti-corruption legislation, but little progress has been made. In the early part of the decade, IKEA was vocal about corruption, asserting it were subjected to blackmail, sabotage and pressure for bribes. As the company gained a foothold, the rhetoric vanished and IKEA executives now shun the words "bribe" or "corruption" and prefer phrases like "gray areas" to account for their troubles with the officialdom. While other companies also confront such issues, IKEA has been among the most vocal.

"The biggest challenge is not on the commercial side, but is on the administrative side — what you actually do to come through to get necessary permits, be able to open ... We don't really know what we can do," Kaufmann said. "Shall we stay quiet and say it's OK? We keep our people and we'll never open? That's not possible." The Samara administration said it wants to ensure safety for shoppers. "IKEA has not provided all the documents we need, they still have not received all permits for construction," an administration official said on condition of anonymity as he was not authorized to speak to the news media. "The faults we pointed to still have not been rectified. So far they are merely trying to push through this decision. What IKEA is doing is just blackmail."

Russia's weaker economy may be another factor in throttling back the retailer's growth plans. "The main motivation now is the uncertainty of where the economy is going," said Chris Weafer, chief strategist at Uralsib investment bank. "Corruption, bureaucracy and red tape have never put them off before." The discretionary income of Russians has declined, people are holding off on buying apartments and doing renovations, and, as a consequence, are buying less furniture. "They need GDP growth to help them expand, and that's reversed," said James Fenkner, head of Moscow-based Red Star Asset Management.

Privately held IKEA does not disclose its profits, but IKEA's Kaufmann says the company has "positive accumulated sales" in 10 out of 11 Russian stores with "double digit growth" for Russia on average. IKEA previously said it had invested more than $3 billion in Russia and was planning to open four stores this year. IKEA employs 7,000 people across Russia.

Text 28.  

Case 12 - German roots of Greek crisis remain

The rescue deal may have stopped the financial markets bankrupting Greece but the underlying problem stays unresolved

George Irvin guardian.co.uk, Wednesday 14 April 2010
On the face of it, the 16 finance ministers of the eurozone countries meeting on 11 April finally put a strong enough aid package on the table to stop the financial markets bankrupting Greece – and apparently to stop contagion from spreading to other indebted Club Med countries. Admittedly, the €30bn deal was done in such a way as to avoid both breaching European Central Bank’s (ECB) anti-bailout statutes and burdening German taxpayers; the important thing though is that as a result of the eurozone agreement brokered by the Spanish presidency, Greece has seems to have been saved. Or has it?

Three things are important about the Greek saga. First, the conventional account of the crisis – that a spendthrift Greek government has taken the country to the edge of bankruptcy – is only a small part of the story. Secondly, while the deal buys time, it does not ensure the Club-Med countries against further speculative attack. And thirdly, the true lesson of the story is that it is the Eurozone in general – and Germany in particular – which must put its house in order.

While stories of Greek government nepotism, ludicrously high pensions and the like abound, let us be clear that Greece is not broke. From the mid-1990s until 2009, Greek GDP per head grew faster than the EU average. Its government debt-to-GDP ratio is 113%, yes, but that is not much higher than the OECD debt ratio of 100% projected for 2011 and much less than Japan's 192%.

In essence, what has happened to Greece has happened to most other OECD countries; deep recession has caused a rise in government current transfer expenditure and a precipitous decline in tax receipts. Greece is too small to borrow much domestically, so funding the budgetary gap has meant going to the international market where, fuelled by speculation about debt default, the cost of borrowing has risen to over 7% per annum. Yes, it’s true that the previous Greek government attempted to massage the deficit figures with a little help from Goldman Sachs. But Greece's recession-induced budget gap is no different from Britain’s.

What is different is that the European Commission wants the budget deficit reduced by 10% of GDP over two years. In the words of Joseph Stiglitz: "With Europe's economy still weak, an excessively rapid tightening of its budget deficit would risk throwing Greece into a deep recession." Anyone in doubt about this principle should look at Ireland where as a result of self-imposed fiscal tightening, GDP in the fourth quarter of 2009 fell by a massive 2.3% (equivalent to 8% annually).

"The hedge funds are operating very aggressively," says Hans Redeker, chief currency strategist at French bank BNP Paribas. Few people seem to realise that 95% of Greek sovereign debt is held mainly by European banks within the eurozone. Last year, before the crisis exploded, banks and hedge funds had bought up a large amount of Greek debt cheaply, insuring it by purchasing credit default swaps (CDSs). The crisis has enabled banks to make a killing by selling what is now high-yield Greek debt and issuing further CDSs at a huge premium.

Moreover, the ECB, by pouring liquidity into the European banks, helped spur the Greek debt purchasing spree. As a recent report in the Financial Times put it, a lot of smart traders saw the crisis coming – one only had to look at the amount of sovereign debt the ECB was pushing European banks to buy. The ECB further exacerbated the problem by refusing in future to accept Greek bonds as collateral. And during the two-month period when eurozone ministers have refrained from taking concrete action on the grounds that dallying would "force" the Greeks to clean up their act, these same smart traders have made millions.

While Greek mismanagement and speculation against Greek bonds are part of the story, the key to understanding the crisis lies not in Greece but in Germany. Germany insisted on a eurozone with a strong monetary authority (the ECB) focused on fighting inflation, but without a "euro treasury" to conduct countercyclical fiscal policy and to effect transfers to countries in need of support – in sharp contrast to arrangements in, say, the US. Germany also continued to pursue a "strong money" policy, promoting export-led growth by means of restraining public spending and private-sector real wage growth, and thus domestic demand. The eurozone version of this policy was the 1997 stability and
growth pact requiring eurozone members to keep the budget deficit below 3% and the debt/GDP ratio below 60%.

There are two problems here. First, not all countries can be net exporters like Germany. Two thirds of its exports go to the eurozone, and since one county’s exports must be another’s imports, the German surplus is reflected by deficits elsewhere; inter alia, the Club Med countries. Second, the eurozone’s monetary and fiscal arrangements are inherently deflationary. A balanced budget may be acceptable in "normal times" but it is positively harmful during a global recession. It is notable that current statistical indicators for the eurozone show the recovery weakening, particularly since the ECB in recent weeks has refused to offset tight fiscal policy with further monetary loosening.

In sum, while the deal agreed on 11 April may have stopped financial markets from bidding up Greek government bond yields to dizzying heights, the underlying problem remains unresolved. The current economic architecture of the eurozone puts intolerable deflationary pressure on its most vulnerable members at times of crisis, and if one member should be forced out of the eurozone, contagion could overwhelm many more member states, possibly toppling Europe’s most important integration achievement since the creation of the Community in 1957. But Europe’s current political leaders remain focussed on their narrow national interests; so far, they have lacked the vision required to chart the new course needed—not just for Greece but for Europe as a whole.

Text 29. Case 12 - Why Germany needs to change

Mar 11th 2010 | From The Economist print edition

Elsewhere in the world, Europe is widely regarded as a continent whose economy is rigid and sclerotic, whose people are work-shy and welfare-dependent, and whose industrial base is antiquated and declining—the broken cogs and levers that condemn the old world to a gloomy future. As with most clichés, there is some truth in it. Yet as our special report in this week’s issue shows, the achievements of Germany, Europe’s biggest economy, tell a rather different story.

A decade ago Germany was the sick man of Europe, plagued by slow growth and high unemployment, with big manufacturers moving out in a desperate search for lower costs. Now, despite the recession, unemployment is lower than it was five years ago. Although Germany recently ceded its place as the world’s biggest exporter to China, its exporting prowess remains undimmed. As a share of GDP, its current-account surplus this year will be bigger than China’s.

This feat gives the lie to the picture, common in America and Asia, of Europe as a washed-up continent incapable of change. And, for the rest of Europe, there is a lot to be said for having a strong economy at the continent’s geographical and political centre. Yet Germany’s success is paradoxically also causing problems for its neighbours—problems which they, and Germany, need to address.

Germany’s impressive flexibility is the consequence of old virtues combined with new ones. The old consensus-building management system helped employers keep unions on side when costs needed to be held down. The famous Mittelstand (small and medium-sized firms, often family-owned) went through its operations, step by step, judging what to do in Germany, what to send abroad and what to outsource.

At the same time, economic policy took a new, liberalising, direction. The Schröder government introduced reforms to the labour market and welfare systems in 2003-04; spurred on by those, and by competitive pressures from Europe’s single currency, German business ruthlessly held down real wages. Unit labour costs fell by an annual average of 1.4% in 2000-08 in Germany, compared with a decline of 0.7% in America and rises of 0.8% and 0.9% in France and Britain respectively. Although last year’s recession hit Germany hard, its economy is in much better shape now than it was a decade ago—a point that should be noted in France, where President Nicolas Sarkozy has taken to railing...
against outsourcing, and in southern Europe, which bends over backwards to preserve overgenerous wages and restricted labour markets.

Germany is rightly proud of its ability to control costs and keep on exporting. But it also needs to recognise that its success has been won in part at the expense of its European neighbours. Germans like to believe that they made a huge sacrifice in giving up their beloved D-mark ten years ago, but they have in truth benefited more than anyone else from the euro. Almost half of Germany’s exports go to other euro-area countries that can no longer resort to devaluation to counter German competitiveness.

While Anglo-Saxons were throwing money around, Germans kept saving. Domestic investment has not kept pace. The result of Germans’ prowess at exporting, combined with their reluctance to spend and invest, has been huge trade surpluses. Germany’s excess savings have been funnelled abroad—often into subprime assets in America and government bonds in such countries as Greece. It would be absurd to maintain that a prudent Germany is responsible for Greece’s profligacy or Spain’s property bubble (though a few heroic economists have argued this). But it is true that, within a single-currency zone, habitual surplus countries tend to be matched by habitual deficit ones.

Imbalances cannot be sustained forever, whether they are deficits or surpluses. Yet surplus countries tend to see themselves as virtuous and deficit countries as venal—the implication being that the burden of adjustment should fall on the borrowers. Germany’s response to the troubles of Greece, Spain and other euro-area countries has followed just such a line. A bail-out for Greece, once taboo, is now being debated—and German ministers have even come out in favour of a putative European Monetary Fund (see article). But the idea that Germany should itself seek to adjust, through lower saving and higher consumption and investment, still seems unacceptable to Angela Merkel’s government.

It is certainly true that Germany’s neighbours have a great deal of work to do. France, Italy and Spain need to follow Germany in loosening up their labour markets; Italy, Spain and Greece need to tighten their public finances. But Germany also needs to push ahead with liberalisation. Its web of regulations is too constricting; its job protection is too rigid; its health, welfare and education systems still need big doses of change; its service sector is underdeveloped. You do not have to be a free-market zealot to think that it is too hard to start a new business in Germany, or to worry that a fat tax “wedge” to pay for health care and welfare reduces low-paid service jobs. Nor do all the changes Germany needs to make mean cutting government back. Too few women are in full-time work, partly because child-care support is lacking. The country’s demographic prospects are dire.

A bold programme of German structural reforms would do much to boost consumption and investment—and, in turn, to raise Germany’s GDP growth, which remains disturbingly feeble. Germany can also afford growth-boosting tax cuts without ruining its public finances. If only Germany would lift its head, it would see that this is in its own wider interest, both because it would be good for German consumers and because it would help the euro area to which it is hitched. Europe’s single currency, like the European Union itself, owes much to past German leadership. When that goes missing, both the currency and the club tend to suffer—and Germany is foremost among the losers.