Mario Draghi: Trade, competitiveness and Europe

Opening remarks by Mr Mario Draghi, Governor of the Bank of Italy and Chairman of the Financial Stability Board, at the 2nd EFIGE (European Firms in the Global Economy) Scientific Workshop and Policy Conference, Rome, 18 June 2010.

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It is a honour and a pleasure for the Bank of Italy to host the second EFIGE Scientific Workshop and Policy Conference. EFIGE stands for “European Firms in the Global Economy: Internal Policies for External Competitiveness”, and no topic could be more relevant for the policy debate today: we are in the aftermath of a global recession that may have redesigned the comparative advantages of nations; that is challenging the capacity of most European economies to maintain competitiveness.

Foreign trade has been one of the main channels of contagion in the global crisis since 2008. The case of Italy is emblematic. Despite a financial structure with many strong points, from the stability of the banking system to the financial health of households and firms, Italy suffered greatly the international crisis. In 2009 Italy’s GDP contracted by 5 per cent, more than the whole euro area, more than in any other time since World War II. Despite some recovery since the second half of 2009, industrial production is still one fifth below the cyclical peak recorded in the spring of 2008.

The survey of Italian firms that the Bank of Italy conducts every year has allowed us to unveil the mechanisms through which the crisis propagated within the productive system. The large and sudden fall of demand in international markets led exporting firms to sharply cut back production, investment and purchases. These direct cutbacks have spread over through the supply chain: larger firms could offload a good part of the non-diversifiable risk due to the fall in demand on small suppliers. This effect was possibly amplified by relocations and re-internalizations of some production activities. Hence the crisis also hit firms less open to foreign trade. More broadly, the increasingly widespread international supply chains have contributed to the universal reach of the crisis, compounding the effects of distressed financial markets.

It has been a big shock. Looking ahead, the point is now to understand to what extent trade flows and the geographical patterns of global production networks have been reshaped by the crisis. How has the position of individual firms and countries changed? What can the impact be of the necessary unwinding of global imbalances in the years to come?

In 2008 and 2009 several countries undertook trade-defensive measures, in particular imposing discriminatory anti-dumping duties specifically targeted against low-cost exporters, such as China. In a number of cases, developing countries have also introduced new tariff and non-tariff barriers; advanced countries have instead often turned to measures in support of the domestic sector (such as the bail-out of specific domestic industries or economic stimulus packages incorporating discriminatory clauses), with potential indirect anti-trade effects. More importantly, lack of effective political support has continued to delay the conclusion of the WTO Doha Round.

Protectionism remains the wrong answer, all the more at the present juncture. Trade is a powerful engine of growth. It helps break down local monopolies, reduce prices to the benefit of consumers and firms. International competition favours productivity improvements through the reallocation of resources from less to more efficient firms and by spurring firms to innovate.

This takes us to the second keyword of the EFIGE project: ***competitiveness***. In a monetary union the lack of competitiveness causes stagnation, unemployment, and, in the long run, budgetary strains. The new European Strategy, “EU2020”, sees in competition, human capital, innovation and R&D the crucial growth-enhancing factors. These factors also interact with firm productivity and size to determine a firm's success on international markets. In the manufacturing sectors more severely hit by the crisis, the most resilient firms have been those that have been capable of shifting their sales to the most dynamic emerging markets, and those with a high degree of market power warranted by their ability to innovate and satisfy their customers' needs.

The EFIGE project has a third important facet which is worth mentioning: its ***European perspective***. In Europe, common cultural and historical roots, common goals and policy frameworks live together with a pervasive national heterogeneity. The diversity ranges from institutional architectures to political decision-making, to economic agents' choices and patterns of behaviour. For analysts, this is a resource: they can compare countries and firms located in different countries to isolate the relevant differences, to learn from such differences, to identify the best practices. For policy makers it is a difficult challenge.

We must reinforce the construction of Europe: the difficult times some European countries have had this year in coping with competitiveness and fiscal crises prove that beyond any doubt. We definitely need a stricter and more coordinated budgetary discipline, but what we need above all is progress on structural reforms in order to enhance growth potential, within a renewed European Pact. That should be our ambition.