



Social Market Economy and Globalisation





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Konrad Adenauer Foundation
Warsaw Office
02-561 Warszawa, ul. Dąbrowskiego 56
tel. (+4822) 845 93 30
fax (+4822) 848 54 37
www.kas.pl www.kas.de
e-mail: kas@kas.pl

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Gdańsk Institute for Market Economics
80-227 Gdańsk, ul. Do Studzienki 63
tel. (+4858) 524 49 00
fax (+4858) 524 49 08
www.ibngr.pl
e-mail: ibngr@ibngr.pl

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Maciej H. Grabowski

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Preface

We have raised the topic of social market economy and globalisation with the intention to open a discussion about it in the context of the factors conditioning Poland's development and the challenges facing Europe. In the times of rapid growth, the idea of a social and economic model based on the freedom of conducting business combined with solidarity was generally accepted. New challenges that face Europe, increasingly frequently recognised and shared from the Polish perspective, provoke questions concerning the principles of economic and social order conceived in the above way. Questions whether to change that model, how to modify it, should the tendency of increasing inequality of incomes should and could not be reversed, whether Europe will tend toward more extensive coordination of social welfare systems and their eventual harmonisation? How promptly can changes be introduced in social policy, adapting it to changing circumstances, without destroying the previously achieved order?

We raised these and similar questions intriguing us to invited panel experts and participants of the seminar “Social Market Economy — How to Reconcile Economic and Social Challenges?”, which was organised on 29 November 2007 at the conference hall of the National Library in Warsaw by the Gdańsk Institute for Market Economics in cooperation with the Konrad Adenauer Foundation in Poland. The Seminar was opened together by the Director of the Konrad Adenauer Foundation in Poland — Mr Stephan Raabe and the present author.

The introductory statement was presented by the Vice-President of the National Bank of Poland, Dr Krzysztof Rybiński. He presented a broad range of problems concerning the competitiveness of the European Union, including the new Member States, in the context of the development of China and the emerging industrialised economies in Asia. The conclusion of his presentation was very clear: persistence of the existing development trends in the world will make the European economy much less competitive, its position will be marginalised, and the Asian countries led by China will become the global economic leaders. The future of the Polish economy appears to be even more bleak than that of the European economy as a whole. Yet, without economic growth it may become simply impossible to sustain the social welfare system existing to date. This statement provided the frame of reference for most subsequent voices raised. In the order of succession, the following panellists presented their opinions and comments:

- Michał Boni (social policy expert, adviser to the Prime Minister of Poland);
- Piotr Dardziński (philosopher, director of the Centre for Thought of John Paul II, lecturer at Tischner European University);
- Maciej Duszczyk (economist, Deputy Director of the Social Policy Institute, University of Warsaw, and civil servant at the Office of the Committee for European Integration);
- Łukasz Hardt (economist, lecturer at the Economics Faculty of the University of Warsaw, consultant of the Sobieski Institute and of the Office of the Committee for European Integration);
- Aleksandra Wiktorow (expert at the Gdańsk Institute for Market Economics).

After the speeches of the panellists, Mr Krzysztof Bień, who moderated this session of the seminar, opened the discussion. Representatives of the academic community and of the administration took the floor. Some of them, preoccupied by social issues, pointed at the significance of values in economic relations, others, drew attention to the tough conditions necessary for economic development. The exchange of views and arguments was extremely inspiring, as many statements referred not only to normative arguments pointing at the desirable situations in their opinion, but also indicated the orientation of solutions leading towards the preferred state of affairs.

All the statements of the panellists and participants in the discussion are included in the present publication. They have been preceded by the introductory remarks by Mr Stephan Raabe and Mr Krzysztof Rybiński. Additionally, we have presented a speech given by Madam Commissioner Danuta Hübner at the conference of the Committee of the Regions entitled *Solidarity versus Competitiveness — European Regions and the Challenges of Globalisation*, which also took place in November 2007, similarly as our seminar. The topic and the theses of the Commissioner's speech seemed to us to provide a very interesting addition to the voices of the participants of our seminar.

Thanking all the panellists and participants of the seminar once again for their active participation in the discussion, I invite you to its interesting reading. The subject matter concerns our common future, after all, and the debate on the shape of the economy and society will unfold and accompany us on our way forward.

Warsaw, December 2007 — Maciej Grabowski

Maciej H. Grabowski

From the Perception of Globalisation to the European Budget

The increasing international and inter-regional flows of goods, services, capital, persons, ideas, patents and innovations, increasing since the 90-ties of the past century, are usually associated with the word “globalisation”. This process leads to a change of the spatial organisation of social and economic life, the creation of international flows and networks of activities and links. It has its protagonists, believing that it mitigates poverty in the world, and opponents, who perceive in globalisation the cause of economic and social problems, i.a., of Europe. These aspects are most frequently perceived and raised.

Globalisation also has its evident qualitative dimension. It may be argued that the increased flows and the global electronic media market alone cause a change in the self-perception of employees, consumers and citizens. Regardless of the degree, to which these real globalisation processes actually set an imprint on the lives of inhabitants of Poland or Europe, the perception of their impact upon our present and future condition may be completely different. Following the European press and largely also the Polish one, one may get the impression that currently globalisation makes a strongly negative impact on the European economy, being to blame for delocalisation,

the relocation of jobs and the troubles of industrial companies. The interests of European consumers are usually ignored, and possible threats to the workers are exaggerated. On the other hand, the awareness of real economic development, mainly of the Asian countries, and how they are building up their competitive advantages, is very low. So on the one hand we have the perception of present day globalisation — which I have the feeling is excessive, in comparison to its real negative impact upon our European economy, and on the other hand — very low awareness of future challenges, which we will face only in a few years time, when the factors behind the competitive edge of the Asian countries will change. The anxiety and lack of awareness lead to the situation that workers are losing faith in the strength of the European economy and their self-confidence is eroded, as they fail to see clearly the challenges of the future. This situation results in the often negative evaluation of the process of economic globalisation and the lack of imagination when undertaking activities concerned with the shaping of development policy.

The change (caused by globalisation) in self-perception and in the framing of their own interests may also be reflected in the acceptance of globalisation and perception of one's chances in its (inevitable) intensification.

Also another question may be raised: Do the values shared in society influence the assessment of globalisation together with its economic and cultural face? Do the opinions concerning globalisation stem from the perception of one's economic interests, or rather from shared values? This is of key significance for the capacity to take political action in connection with the current new challenges.

Research points at the fact that acceptance, or the lack of acceptance of the globalisation process does not depend on the inclination to support left wing or right wing (conservative) government, and that social-democratic parties can both favour and be against globalisation. The same applies to Christian-democratic parties. The strongest factors explaining the acceptance of globalisation in society consist of the level of education and shared values¹. The acceptance of globalisation, both economic and cultural, increases with the level of education. This is no surprise. On the other hand,

¹ Martin Edwards (2007) *Public opinion regarding economic and cultural globalization: evidence of a Cross-National survey*, *Review of International Political Economy*, Oct. 2006.

societies and persons reluctant to accept the free market, disliking the pace of contemporary life and convinced that consumerism is a threat, believe that cultural and economic globalisation brings negative effects. This implies determined consequences for politics, as values tend to persist unchanged in societies.

Therefore, governments will prefer to slow down the process of globalisation, if the previously noted social values do not favour their its acceptance. Information and public communication measures alone will not be of help here, as even the benefits gained from globalisation by consumers will not soften their negative opinion about it.

In Poland, the process of globalisation in the last few years has very clearly overlapped with the integration of our country with the European Union. The general social acceptance of integration by the general population already in the first year of our membership of the Union² and the decisive improvement of the social and economic situation starting from the year 2005 have caused that the negative aspects of globalisation, so universally perceived in the old member states, were practically not revealed in our country. It should be noted here that the integration of countries with considerable low qualified labour resources (new member states) with countries disposing of abundant highly qualified labour (EU-15), according to the theory of exchange, ought to lead to proportionately higher growth of wages of labour with low qualifications in such a country as Poland, and to relative growth of wages of highly qualified employees in the more wealthy part of the continent.³

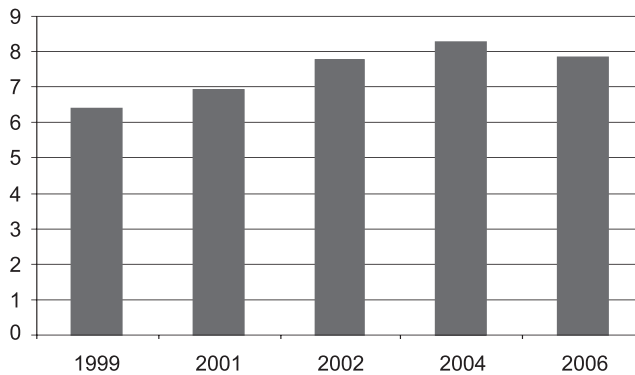
This indicates that the differentiation of wages in the new member states should decrease, and that it should grow in the old ones. This last phenomenon combined with globalisation processes may exacerbate the negative

² *Polska w Unii Europejskiej – doświadczenia pierwszego roku członkostwa [Poland in the European Union – experiences of the first year of membership]*, UKIE [Office of the Committee for European Integration], Warsaw 2005.

³ E.g.: M. Grabowski, *Integracja, zmiany struktur gospodarczych a perspektywy rynków pracy [Integration, changes of economic structures and the prospects of labour markets]*, in: *Uwarunkowanie rozwoju regionalnych rynków pracy w Polsce, Polska Regionów nr 25, IBnGR, [Regional labour market conditions in Poland, Poland of the Regions No 25, Gdańsk Institute for Market Economics]*, Gdańsk 2000.

perception of globalisation in the EU-15 countries. I do not dispose of data concerning wage differentials in these countries after the enlargement in 2004. Nevertheless, data from the graph presented below indicate that indeed the differentiation of wages in Poland, which had been growing from year to year since the mid nineteen-nineties, fell for the first time in 2006. This happened despite the significant growth of employment and real wages. In this regard, in our country, this was probably the expected effect of integration.

Figure: Ratio between average wages from the 10th and 1st decile wage group in the years 1999–2006.



Source: Structure of wages by professional groups in October 2006, GUS (Central Statistical Office), Warsaw 2007.

The above conclusions from the process of integration indicate that the values of social market economy — solidarity and social cohesion may be increasingly at risk in the old member states, as the economic phenomena related with integration will favour greater differentiation of wages. Globalisation reinforces this phenomenon even further. How can these issues be reconciled? The discussion about these problems is gaining a very real budgetary dimension also in Europe. The future of EU policies, the future of cohesion policy and the initiated discussion on these themes are clear evidence of that. It seems that it is neither possible nor desirable to sustain the present shape of the common European budget with its main objectives focused on equalising incomes (Common Agricultural Policy) and the level of development (cohesion policy). The currently dominating values of

cohesion and solidarity should be at least balanced by such values as equalising the development opportunities for persons and regions, general access to public goods and civic dialogue (between the economy, the consumers and government), as a form of arriving at consensus.

This last issue is extremely important. As I have indicated above, the perception of economic and cultural globalisation depends mainly on the level of education and on accepted values. It is not feasible to realistically and effectively implement the instruments of economic and social policy that contradict the values shared by society. Yet, these vary across Europe. This is why the adaptation of the social market economy to the conditions of globalisation, both at the level of our country and of the whole Union, requires to strike a balance between a diversity of views and opinions.

*Stephan Raabe**

The social market economy is one of the most important fields of activity of the Konrad Adenauer Foundation worldwide. There are two reasons behind this:

1. The experience of economic success of Germany after 1945 under the conditions of liberal democracy and social market economy, and therefore the combination of free participation of the citizens with responsibility and economic affluence with social justice.
2. The experience demonstrating that it is indeed in the course of difficult transformation and development processes that the acceptance and functioning of democracy remains closely connected with the improvement of real standards of living, with the response to social problems, such as poverty, unemployment and social stratification.

What do we have in mind, as Christian Democrats, when we use the concept of “social market economy” in Germany? The essence of social market economy consists of exploiting the market and free competition to achieve social goals. The free interaction of market forces and competition is neither an art for art’s sake, nor a goal in itself, but provide the means of achieving justice and “welfare for all”. It is worth adding that “Welfare for All” (*Wohlstand für Alle*) is the title of a bestseller work by Prof. Ludwig

* Director of the Konrad Adenauer Foundation in Poland. Opening speech of the Conference.

Erhard, the first minister of the economy and later the Chancellor of West Germany and also a Christian Democrat.

According to this concept, the role of the state consists of defining few but clear economic rules, so as to assure the social function of competition. The state, therefore, shapes and instils economic order, but does not steer the economic processes, which are governed by their intrinsic laws. It establishes the principles serving the general wellbeing and the common interest. The welfare of all, in turn, is the outcome of public debate in society based on determined fundamental values, which ultimately stem from the vision of humanity, from the way in which the role of the individual and society are conceived.

One cannot and must not consider the issue of the efficiency of markets in detachment from the issues of decent life. Therefore, the implementation of social justice, conceived not in egalitarian terms, but as the equality of opportunities, is the lasting objective of the market economy. Normative and ethical-social issues are therefore at the foundation of the concept of social market economy, similarly as are the questions concerning social goals.

The market economy is inscribed in the politically defined social and moral framework. It is socially integrated, as it were. The belief behind this is that economic orientation alone is absolutely insufficient. Social market economy represents more than a purely economic concept. It seeks to develop a holistic economic and social order. Economic freedom is social only if it is embedded in the social order.

“Freedom and order are not mutually contradictory. They condition one another. The creation of order implies the creation of order in the spirit of liberty”, once wrote Prof. Walter Eucken, the founder of the “Freiburg ordo-liberal school”, in his work on the foundations of national economy.

Today we sometimes encounter the question, whether such a concept in the age of globalisation encompassing also the economy, is consistent with the spirit of our times. I am convinced that the social market economy still remains very pertinent indeed, as it is a matter of the predominance of politics. The state and the community of states in the form of the European Union are inherently responsible, also in the age of globalization, for giving shape to order and determining the framework, taking the obviously relative autonomy of the economy into account. It is obvious that changes of the

framework conditions require the adaptation of the concept of social market economy. It is also of paramount significance in this context to recognise the following distinction: the concept of order in terms of social market economy is completely different from the concept of an outsized welfare state, which in its official capacity appropriates many spheres of life and separates the economic from the social sphere, instead of recognising them as mutually complementary parts of a greater whole. I believe that the issues of the position of social and economic policy and of the challenges carried by globalization, require in depth discussion on our part.

To conclude, I would like to stress that in Germany as well as in the international activities of the Konrad Adenauer Foundation, the principles of social market economy that I have outlined have stood the test and given tangible benefits. The Polish Constitution clearly states in Article Twenty: "A social market economy, based on the freedom of economic activity, private ownership, and solidarity, dialogue and cooperation between social partners, shall be the basis of the economic system of the Republic of Poland." Therefore, in our activities in Poland we would like to provide numerous strong impulses for debate on the concept of social market economy. The present conference organized by the Gdansk Institute for Research on Social Economics is a step in this direction. In spring we will continue the discussion on social market economy in the framework of the international conference in Gdańsk.

I believe that the issues concerning the conditions enabling the functioning of social market economy in the contemporary world merit more in-depth reflection.

*Danuta Hübner**

Competitiveness and Solidarity: Friends or Foes

I am very pleased to speak to you today, in the Committee of Regions, on global challenges for European regions and on the way in which they can meet and benefit from these challenges.

I would like to start by saying some words on the relevance of the global context and global challenges for the development of European regions. Secondly, I shall have a closer look the way in which regional policy can help regions successfully address these changes. Finally, I would like to come back to the title of our seminar and discuss with you and the role that competitiveness and solidarity can play in this respect.

In the past the main frame of reference for the regional development in the Union has been of internal nature, somewhat leaving dealing with external challenges to national governments and community policies, such as trade policy. Regional policy was mainly about the economic changes taking place within the country or just across the border. China or India were far away.

Today we live in a different world where India and China is around the corner. Every week the Chinese government builds a new power station;

*European Commissioner for Regional Policy. The speech “Competitiveness and Solidarity: Friends or Foes” was presented during the Committee of Regions’ seminar “The Solidarity and Competitiveness: European Regions and Challenges of Globalisation” on the November 20, 2007.

1 in every 2 cranes standing in the world today is on a building site in China; when in 2004, Infosys advertised 9000 software engineer jobs in India almost 1 million people applied. We often describe this new world by referring to the increasing economic competition which is now felt across all the Union's territories and all sectors of European economy. Or we speak about the changes the magnitude of which requires a co-ordinated action involving European and world actors.

Clearly, these changes are of fundamental importance to European regions. Expanding the horizon to the global level is particularly important for the competitiveness of the EU regions in light of the rise of **several global challenges**, which were identified in the Fourth Cohesion report. So, let us now look at three of them: economic competition, climate change and social polarisation.

Every fourth region in the Union has a high share of employment in sectors where **competition from emerging economies** is very high. There are 61 regions in the Union which have more than 3% of their total employment concentrated in vulnerable industries, such as textiles, audiovisual and ICT equipment or steel making. These are regions which need to engage into significant restructuring processes aimed at diversifying their economic structure into new, growing sectors.

Secondly, climate change will have an impact on the broad range of European regions from the Arctic down to the Alps and the Mediterranean. It will result in recurring natural disasters such as floods and droughts. This will pose serious problems to regions dependent on tourism and agriculture. Already today 7% of the Union's population live in areas at high risk of floods; on the other hand around 9% lives in an area where there are over 120 days a year without rain.

Thirdly, social polarisation will be felt across our regions with diverse intensity following variations in education levels. Today these variations are more pronounced between regions than between Member States: in the less developed regions of the EU27 only 14% of population in working age had tertiary qualification in 2005 against 25% in the more developed regions. Thus regional development strategies must take into account that in a global economy the successful participation in economy and society will

require increasingly complex skills and education and that the cost of social exclusion will grow with each new generation.

I could continue this list, as Fourth Cohesion Report abounds in other examples of global challenges. Take demography — we have in the Union 85 regions which are experiencing absolute population decline, and another 76 which maintain population growth only thanks to migration. Another example is R&D and innovation deficit, which is today a key asset to economic development of Europe. At the one end of the scale there are regions which invest 8% of their GDP in R&D (Braunschweig) while on the other we have regions which invest merely 0,1% (Świętokrzyskie).

The important point to make is that global challenges will increasingly set the context for the European regional development in decades to come. Today European regions and cities cannot ignore external developments and wait until globalisation knocks at their door. It does not matter how remote your region or city is, it cannot develop without thinking how to plug in to the external world.

But how to do it? How European regional policy can help regions to address their development against the backdrop of such challenges?

Until now we looked at global challenges only at the context of the impact they leave on regional development. This is of course very true. However, there is another angle of globalisation which often escapes our attention — that of the regions being best placed to drive development in a global world. In other words, regions can be actors on the global scene, not only supernumeraries.

The explanation of this can be found in new growth theories. They suggest that although ICT technologies reduce the importance of geographic proximity in business, at the same time new reasons for proximity emerge. Localized productivity advantages such as business environment, skills, innovative SMEs, research capacities and talents which a region can offer are ultimately more valuable to firms than the cost of inputs.

In other words, globalisation reinforces the importance of territory and moves regional and local economies into the core of economic development. Some years ago it was possible to design a national development strategy with a time horizon of 20 years and to implement it undisturbed throughout

this period. Today a change may happen overnight. It will be increasingly difficult to anticipate, react and benefit from those changes through the policies designed far away from the regions.

This has an impact on the meaning of subsidiarity. Indeed, we can see it in the Berlin declaration which puts regions at the same footing as Member States and European Institutions. The new Treaty enshrined territorial cohesion together with economic and social cohesion which confirms the role of the European territories in economic development. Member States themselves have been increasingly recognizing that devolution of governance fosters efficiency and growth through a process of decentralisation and relying increasingly on local and regional planning.

New European regional policy recognizes the link between regional development and globalisation by giving to the latter increasing importance in the process of catching up. While caring for internal convergence at the same time the role of regional policy is to help regional economies find their place in world markets, in critical global networks and clusters. Global challenges represent opportunities to innovate and grow for both, better-off and lagging regions.

That is why renewed Lisbon agenda and innovation has been put in the heart of the new European regional policy. The planned investment for innovation in 2007–2013 will be above EUR 85 billion which corresponds to 25% of the total new envelope for EU-27. This value is more than 3 times higher than in 2000–2006.

Climate change is another example. The UK Stern report stated the benefits of tackling climate change far outweigh the costs, especially if tackled early. New regional policy is matching this approach by investing in renewable energy, energy efficiency and renewable energy production. Compared to the previous programming period, investments earmarked for energy efficiency have doubled and for renewable energy have even quadrupled. As a result, close to € 9 billion will be invested in sustainable energy during the current programming period.

But there is one more way in which regional policy can help regions respond to global changes. New growth theories and business books which top bestsellers lists today talk a lot about co-operation. The new buzz words in economic and business circles are openness, peering, sharing and acting

globally. The reason for this is that changes in the nature of technology and the global economy are giving rise to new models of production based on collaboration and self-organization rather than on hierarchy and control.

So, competitiveness and co-operation are not foes but friends! Today co-operation and partnerships turn out to be one of the principal preconditions for competitiveness and economic change. And, by involving new actors and tapping new resources, they have the power to change the global game, to move away from zero sum game. Instead of stealing jobs we can enlarge the cake.

Well, this is the same co-operation and partnership which since almost 20 years has been of the key principles of the regional policy. That's why INTERREG has now become a fully fledged objective of its own and why we have reinforced the role of partnership in new regulations.

I have spoken of the global challenges confronting EU regions today. And I was trying to make the point that European regions can take an active part in the global game, rather than being just a bystander. As we have with us today President Walesa and the President of Pomorskie region I cannot resist thinking about one global change which started in Gdańsk, with Solidarność movement, 27 years ago.

This change brought democracy and paved the way for Union's enlargement. And today it is perhaps the most striking example of how solidarity and co-operation can underpin economic development of the whole Union. Let me quote here the last publication of Lisbon Council which says that "nowhere in Europe has economic growth has been as impressive and durable as in the countries of Central and Eastern Europe" and concludes that the enlargement "has been a boom to Europe at large, providing a much needed economic stimulus to EU-15".

The former Minister of Foreign Affairs in Poland, Mr Bartoszewski, used to say that there are two different things in life — those which are worth doing and those which pay off — and that they rarely go hand in hand. Fortunately, European solidarity — which is also manifesting itself through European regional policy — is something which is both, worth doing and paying off.

*Marek Radzikowski**, *Krzysztof Rybiński***

Achieving sustainable growth will new Europe fly or crawl in the 21st century global knowledge economy

Abstract

The goal of this paper is to identify factors that will be crucially important for maintaining long-term sustainable growth in three dimensions: economic growth, social cohesion and environmental sustainability. We document how Central and East European countries score in all three aspects in comparison with the peer group of countries. While a sizeable progress has taken place in all three dimensions, the future prospects will depend crucially on institutional and knowledge infrastructure.

Institutional environment in CEE-4 is generally conducive to sustainable economic growth, there are independent monetary institutions, economies are as open and deregulated as in EU-15 member states. However, there is

*Economist at the National Bank of Poland.

**Deputy Governor of the National Bank of Poland and member of the Polish Financial Services Authority. Opinions presented in this article are those of the authors and do not represent the official position of the NBP or the PFSA. Paper presented for the conference "The Future of Europe. Sustainable Development and Economic Growth" organized by the Club of Rome and Polish Academy of Sciences, Vienna, 12–13 September 2007.

still a substantial gap with the EU-15 with regard to the legal system and property rights. Both the old Europe and the new Europe have much bigger governments than NIEs or the U.S.

We argue that old Europe can sustain its standard of living only when it remains of the world innovation frontier. This can be achieved only when Europe's intellectual capital is properly developed. We document that while the old Europe scores well in many measures of intellectual capital, China and NIEs are rapidly closing the gap, or even leapfrogged Europe in some aspects. We present a broad range of indicators showing that the new Europe has very low ability to generate innovations and will not be able to develop intellectual capital unless a dramatic shift in structural policies takes place.

Based on our research we formulate policy recommendations. We call on authorities to abolish the “destructive creation” of the Lisbon agenda, with many contradictory ideas floated and a lost sense of strategic direction. A new long-term vision, of strong and prosperous Europe in 2050 has to be developed. There will be no success in the 21st century without courage or luck. Those who do not wish to make their future prosperity a hostage of pure luck need to show courage to change their policies towards developing proper innovation capacity. It is high time to act!

Introduction and description of research methodology

Why we decided to write this paper? We would like to use the opportunity offered by the Club of Rome conference “The Future of Europe” to voice our deep concern, that present set of policies both at the European level and at the country level in most EU members is not adequate to meet challenges and explore opportunities offered by the 21st century global knowledge economy. As argued in Rybinski (2007b) Europe is facing the risk of becoming meaningless in the next decades. Numerous global challenges that Europe has to face have been documented in Kuklinski, Pawlowski (2005b) and the need for new European strategic choice has already been voiced in Kuklinski, Pawlowski (2005a).

We argue that if Europe wishes to maintain its standard of living it needs to remain of the world innovation frontier, while the innovation lead over emerging markets and new industrialized economies (NIEs) that Europe

enjoys today is vanishing at a fast pace. We show that the key factor behind ability to innovate is intellectual capital.

In this paper we provide evidence of European structural deficiencies in the area of intellectual capital and we call for a new vision and a new strategy to put Europe back on robust sustainable growth path. We pay particular attention to the new Europe, the set of countries that became EU members in the last three years. In the new Europe structural deficiencies related to the creation of intellectual capital are even bigger, and there is a significant risk that after a brief period of high growth fuelled by positive demand shock related to EU accession (lasting few years) new Europe growth prospects may be harmed by immensely low ability to innovate and very slow pace of knowledge transfer related to foreign direct investments. The competitive edge the new Europe enjoys today may also vanish amid high wage and inflation in many Central European economies.

Our research methodology is based on two main, irreversibly connected, sources: literature review and basic empirical analysis. With the aim of attaining a balanced, but robust, view on the subject matter we tried to take into account as wide and up-to-date literature as possible. Hence, a number of both: theoretical and empirical papers and books that concentrate on sustainable growth and its components (particularly growth and knowledge economy) are cited. The findings from the literature were challenged against our own empirical analysis.

The empirical tier is based on the analysis of a number of various figures to show how CEE-4 (the Czech Republic, Hungary, Poland and Slovakia) score in sustainable development issues as well as in the area of knowledge economy. Not only do we take into account the changes in the performance of CEE-4 alone, but we also try to analyze these changes in a comparative view. Thus various benchmarks are taken into account as useful controls. The usual set of them includes five countries and regions. Three of them include developed countries: EU-15, which is close to CEE-4 regionally, culturally and (after the EU accession) also has close political and economic ties; the U.S. that competes with EU-15 in many areas though in some (e.g. environment) is often said to be lagging behind and NIEs that, taken altogether, are closer (than other benchmarks) to CEE-4 in size of population¹,

¹ CEE-4 account for 64 million people while NIEs account for 83.

but seem to follow different policy-mix. Two other benchmarks, China and Latin America and Caribbean, consist of emerging markets to which CEE-4 countries still belong.

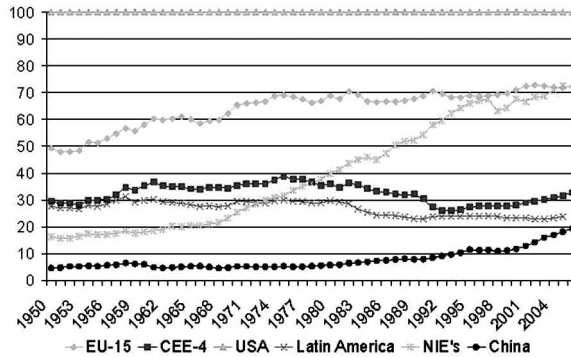
1. The evolution of sustainable development

Sustainable development is defined as balancing the fulfillment of human needs with the protection of the natural environment so that these needs can be met not only in the present, but also in the indefinite future. When discussing sustainable development we should not forget that this idea is more than a two-dimensional issue. It is conceptually broken into three factors: economic development, environmental protection and social development (United Nations General Assembly 2005, p. 2).

1.1 Economic development and institutional framework

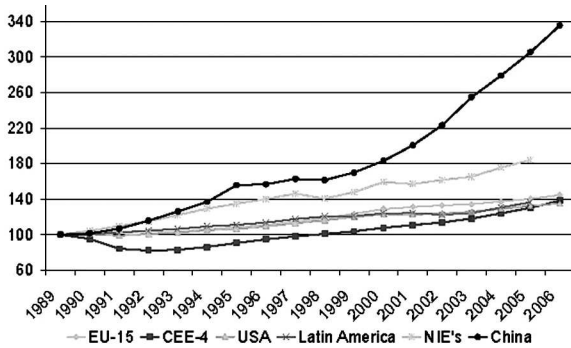
Although it is the last 18 years that are the most significant from the point of CEE-4 it is always useful to look at growth from a longer perspective. Figure 1 shows growth performance of CEE-4 and some benchmark countries and regions since the 50s. When compared to the U.S. the communist economies of CEE-4 stagnated already in the 60s. After an initial decline in the beginning of the 90s, when the transition commenced, they started their convergence actually from scratch. Similar process was present for a long time in Latin America, where many countries manipulated with the so called “third way”. Until the middle of the 70s Western European economies grew at a very high pace. From that time on, however, there has not been much convergence towards the U.S. Their performance slightly improved in the beginning of the 90s, which may have been a result of the enforcement of the single market and its four freedoms. NIEs recorded a stable economic growth from the 50s and an enormous acceleration from the end of the 60s. China woke up after a long time of communist dominance over economy and started catching up in the 80s.

Figure 1. GDP per capita in 1990 US\$ (converted at Geary Khamis PPPs, US=100)



Source: Groningen Growth and Development Centre and the Conference Board, Total Economy Database, January 2007, <http://www.ggdc.net>

Figure 2. GDP per capita in 1990 US\$ (converted at Geary Khamis PPPs, 1989=100)



Source: Groningen Growth and Development Centre and the Conference Board, Total Economy Database, January 2007, <http://www.ggdc.net>

From the beginning of the 90's CEE-4 commenced their path of transition. Although they formed the most successful group from the post-communist countries,² altogether they reached the initial level of GDP per capita only in 1998. In 2006 they were richer by 38% — the performance close to

² At least in the 90's as later in this decade it is the Baltic states and some CIS countries that outperformed CEE-4 with regard to annual GDP growth.

the EU and Latin America. In the same short period of time NIEs grew by more than 80% and China more than tripled its GDP per capita. The level of GDP per capita in CEE-4 in 2006 accounted for 33% of the U.S.'s and almost half of the EU-15's and NIEs levels. These outcomes do suggest that although CEE-4 have performed well in their transition period, the implicit forces of convergence might not have been used to the full.³

Successful transition was subject to implementing reliable and firm market institutions as well as undertaking appropriate economic policies. Fraser Institute's Index of Economic Freedom is one of the few complex indicators that embrace such a long period in the attempt to make a comprehensive assessment of some institutional and policy factors.⁴ One of the institutional factors assessed is legal system & property rights. In this area CEE-4 were in 1990 in the mid-way (index value: 6.9) between Latin America & Caribbean (4.6) and China (5.8) and EU-15 (8.0) and the U.S. (8.3). Although methodological changes do not fully allow to announce a regress, benchmark comparisons are quite meaningful. The last assessment shows that in 2004 CEE-4 (6.1) were lagging not only behind developed Western countries, but also NIEs (7.1).⁵ The low estimate of CEE-4 comes from the very low assessment of the impartiality of courts (sub index value: 4.2 which was even less than China: 4.3), insufficient protection of intellectual property (4.7 — i.e. far better than in Latin America and Caribbean and China but substantially worse than developed countries) and judiciary independence (4.8 — position similar to the protection of intellectual property). Interestingly, CEE-4 scored less than China (7.1 and 7.5 respectively) also in the sub area: law and order.

As we can see from figure 3 in the beginning of the transition in the area of “sound money” CEE-4 scored very low (index value: 5.7), which was

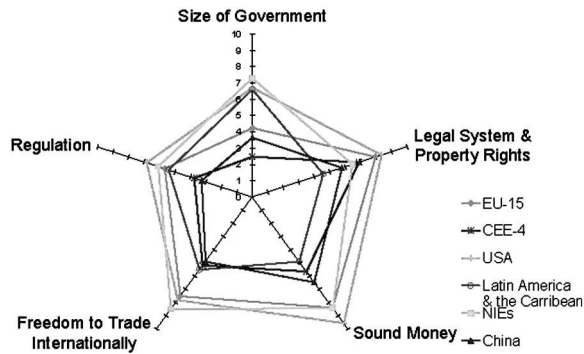
³ Lucas (2007) claims that: “*there are strong forces for convergence in income levels in the pure economics of growth. We can see these forces in theory, evidence. We need to create and maintain environment that lets them operate*”.

⁴ The Fraser Institute Index of Economic Freedom is based on 5 sub-indices that include: size of government, legal system and property rights, sound money, freedom to trade internationally and regulation. The index and sub-indices range from 0 (lack of economic freedom) to 10 (full economic freedom). They are based on statistical and survey data. It is also important to note that there are many doubts as to the use of the indicators. Although they constitute a beneficial tool for comparative studies there are some problematic issues concerning not only the assessment criteria but the indicators themselves, their comparability, and the weights used.

⁵ These findings are supported by other assessments (e.g. World Bank's Doing Business).

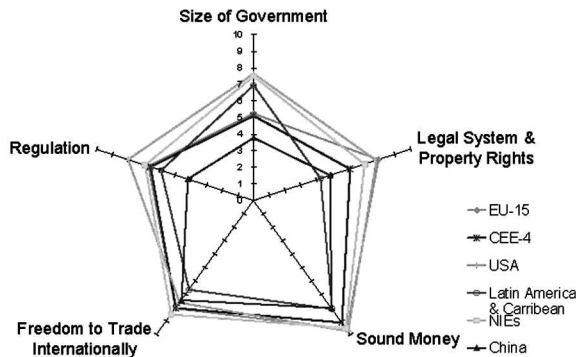
slightly better than Latin America & Caribbean, but worse than China. All developed economies were far ahead at that time. This situation was mainly caused by a relatively high difference between the long term dynamics of money and real GDP. Another reason was limited freedom of citizens to own foreign currency bank accounts. Even taking into account the outcome-driven nature of this index we can certainly claim that in 1990 the monetary institutions were yet fledgling. In 15 years CEE-4 built credible and independent monetary institutions that brought about sound money — in 2004 in this area CEE-4 scored 9.1, i.e. close to the U.S. (9.7), EU-15 (9.6) and NIEs (9.5).

Figure 3. Index of economic freedom in 1990



Source: Fraser Institute.

Figure 4. Index of economic freedom in 2004



Source: Fraser Institute.

Freedom to trade internationally was very limited in CEE-4 in 1990. The overall score in this area was slightly higher than in China (index values: 5.2 and 4.9 respectively). It was mainly due to severe restrictions in foreign capital market exchange estimated according to the index of capital controls in 13 IMF's categories. In this sub area CEE-4 scored the lowest possible value (i.e. 0). Other troublesome sub areas were: low share of trade sector (5.6% of the economy) and high difference between official and black market exchange rates. Already in the beginning of the transition CEE-4 opened their economies. That is why in 2004 they scored 8.0 in this area — the result lower only than NIEs (8.5) and equal to EU-15. In 2004 the only one sub area that was significantly lower than in other regions and countries was the highest standard deviation of tariff rates (amounting to 11.3) among the whole group.

In the beginning of the transition CEE-4 were heavily regulated. In 1990 regulation was higher only in China (index values: 3.8 and 3.3 respectively) while all other benchmark countries and regions were far ahead. It was mainly due to high price controls (0), high state ownership of the banks (sub index value: 0.7, with only China scoring lower: 0), low extension of credit (3.3), high interest rate regulations (3.0) and rigid labor market regulations (3.6) especially within collective bargaining practices and the use of conscripts. After 15 years of transition CEE-4 have substantially improved in this area. They scored slightly less than EU-15 and NIEs (6.6, 6.7 and 6.9 respectively) with the U.S. being substantially ahead (8.0). The most vulnerable sub areas in 2004 were: the extension of credit (the lowest sub index value: 6.9) and unemployment insurance (second lowest sub index value: 4.7), burden of regulations (second lowest sub index value: 3.0) and irregular payments (second lowest, ex aequo with China, sub index value: 6.4).

Size of government constituted the worst area in CEE-4 compared to benchmarks. It resulted from pervasive state ownership of the companies, high government consumption expenditure and high share of transfers and subsidies in GDP as well as distortionary taxation. Most of these factors were the legacy of the centrally planned economy. Due to mushrooming small and medium enterprises and widespread process of privatization there has been much progress in the area of state ownership of companies. In spite of these positive changes in 2004 CEE-4 scored in this area much worse than

benchmarks (index value: 5.1). It was better than China (3.8) and close to EU-15 (5.2) but far away from the U.S. (7.6), NIEs (7.5) and even Latin America (7.0). The main reason for that was high general government consumption as a share of total consumption (23.4%), high transfers and subsidies as a share of GDP (21.0%), and distortionary taxation (with top marginal income and payroll tax rate equal to 55.5%, the highest in this group).

As it can be easily seen from the above analysis CEE-4 have done much progress in building stable and independent monetary institutions. In the first step it stabilized their economies and in the second step, it helped to protect from inflation that for a long time was very persistent in Latin American countries. CEE-4 succeeded also in opening their economies to the world. Apart from that they managed to deregulate them. Although there are still some worrying dilemmas in this area it can be generally claimed that they are close to the leaders at this point as well. Thus using corporate language we can sum up by saying that in these three areas CEE-4 followed best practices and finally reached them. In the two others, however, the progress has not been as substantial. A worrying situation is in the area of legal system and property rights, where there is still a substantial gap with the leaders. This is especially troublesome when we take into account that they struggle to be perceived as the countries based on law and order. Another worrying fact is low score in the scope of government suggesting that there is too much government in the economy. In this regard CEE-4 are seemingly converging to EU-15 rather than to the U.S. and NIEs. The problem is that the European welfare model may not be a good pattern to follow.

1.2 Social development

Social development is one of the three areas of sustainable development though very often it is only growth and environment that are highlighted. The key objectives of the EU within this area are to: “promote a democratic, socially inclusive, cohesive, healthy, safe and just society with respect for fundamental rights and cultural diversity that creates equal opportunities and combats discrimination in all its forms” (Commission of the European Communities 2005). According to The World Bank (2005, p. 2):

- Inclusive institutions promote equal access to opportunities, enabling everyone to contribute to social and economic progress and share in its rewards.

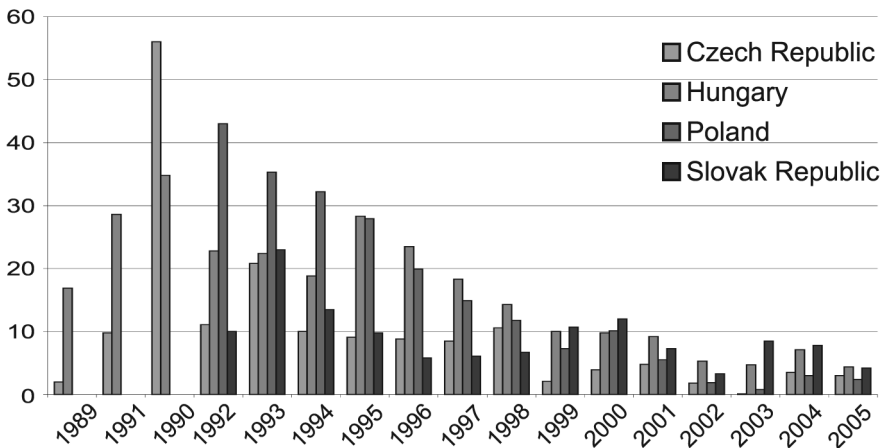
- Cohesive societies enable women and men to work together to address common needs, overcome constraints and consider diverse interests.
- Accountable institutions are transparent and respond to the public interest in an effective, efficient and fair way.

As it can be seen social development is itself a multi-factor phenomenon that received much attention in a broad range of literature and that forms a subject of interest for many disciplines. The aim of this paper therefore is not to perform a thorough research on these factors but instead to shed some light on empirical evidence of CEE-4 within these topics as well as on mutual relations between these factors and other dimensions of sustainable growth.

Social development is especially committed to reducing poverty (The World Bank 2005). The economic transition in CEE-4 elicited this problem. In the first years of the transition the official share of people leaving in poverty increased.⁶ It is however important to note that the poverty was not necessary the consequence of the transition. It did exist before, but very often was not officially recognized due to widespread political propaganda: under communism much data were kept secret (e.g. periodic family budget surveys), biased due to national scale of the studies that omitted regional differences (Górniak 2001, p. 147) or disguised by regulative norms (such as controlled prices and hidden unemployment). Hence the profound change in economic structure uncovered many problems latent in the centrally planned economy. For instance, hidden unemployment transformed into an evident phenomenon when labor market was deregulated and monetary overhang resulted in high inflation when price controls were removed. The fall in output and simultaneous inflation made the real wages go down (United Nations 2004).

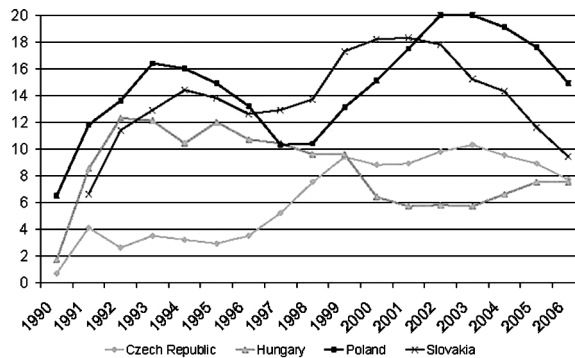
⁶ One of the most evident problems in analyzing poverty is defining it as all poverty lines, used to differentiate the poor from the non-poor, are arbitrary. A commonly used international definition of absolute poverty is having to survive on less than \$1 per person a day. This standard was worked out by the World Bank on the basis of the poverty lines of 10 low-income countries, all of which were located wholly, or partly, in the tropics. The World Bank therefore argues that for the central and eastern Europe higher poverty line (\$2.15 a day) should be considered as the climate is colder which requires additional spending on heat, clothes and food.

Figure 5. Inflation, consumer prices (annual percent change)



* Inflation in Poland in 1989: 251.1%, in 1990: 585.8%.
Source: IMF WEO.

Figure 6. Unemployment rate (registered, in %)



Source: ILO and EcoWin Economic from national statistical offices.

It was especially high inflation that hit the most vulnerable groups triggering high inequalities (Bulir 1998). The situation of large social groups like peasants and families with children worsened.⁷

⁷ Interestingly, according to UNICEF's study and against traditional view, families with children did worse than pensioners during the transition (The Economist 1995).

In CEE-4, as in all post-communist countries, the main reason for the increase in poverty was the initial drop in the output. It explained 50 to 90 per cent of the poverty that emerged in the first years of the transition (ABI/INFORM Global 1996). Other causes of the poverty included the restructuring of state owned enterprises and, as a consequence, the removal of social services previously provided by them. The decline in the economy resulted in a surge in unemployment. Until 1993 most of the poor in Poland (95 per cent) were poor because they were unemployed or because their wages were too low (ABI/INFORM Global 1996). Similar situation was present in other CEE-4. Long time of absence from the labor market resulted in passivity and the so-called welfare dependency syndrome. Throughout the transition process the unemployment has remained one of the most significant risk factors with regard to poverty (Forster 2005).⁸

Thus appropriate labor policies seemed to be the most important weapon to combat the poverty. Unfortunately many policies undertaken in CEE-4, instead of helping, worsened the situation. One of them was the leakage of social assistance to people who were not poor in fact. For instance in Poland it was estimated that in 1993 between 50 to 80 per cent of the recipients of social transfers (excluding pensioners) were not poor. For social assistance benefits which should be especially targeted on the poor, the leakage accounted for 40 per cent (ABI/INFORM Global 1996). Another impediment was the minimum wage that squeezed out of the labor market the weakest part of it — the young, people with low level of education and the least skilful.⁹ A different approach was taken by NIEs where social transfers have always been very limited and, if granted, were carefully targeted.¹⁰

This seems to be in line with what Górnjak notes that *“the key to solving the problem of crisis-induced poverty lies in guaranteeing stable economic growth and creating new jobs.”* It also seems to be true when we take a broader picture into account — the UN’s goal of halving the world’s poverty by 2015 from its 1990 level is likely to be reached mainly due to a spectacular and sustained growth recorded by East Asia and the Pacific and South

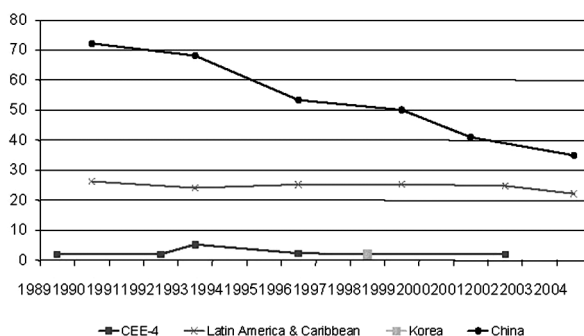
⁸ Forster (2005) notes that it “constitutes the strongest risk factor for falling into poverty, be it defined as monetary, non-monetary or consistent poverty, equally in older and new EU countries”.

⁹ The literature on this subject is enormous. One of the latest papers on negative impacts of minimum wage and anti sweatshop legislation is: Greene et al (2007).

¹⁰ This is mainly achieved through means and assets tested social assistance as well as through higher involvement of private safety nets.

Asia. Sub-Saharan Africa seems to be way off track, the Middle East and North Africa is heading to narrowly reach the goal and Europe together with Central Asia and Latin America and the Caribbean is to be close to it (Anonymous 2007).

Figure 7. Poverty headcount ratio at \$2 a day (PPP) (% of population)



Source: World Development Indicators 2007.

Another dimension of social development is the distribution of income, between enterprises and employees and between income deciles of employees. This dimension has become more important with rapid advancement of globalization in the last two decades.¹¹ In this period China, India and countries belonging to former communist bloc joined the global economy and the global labor market. According to Freeman (2005) this has led to an increase of the global labor supply from 1.46 billion to 2.93 billion, which Freeman calls the “great doubling”. According to Heckscher-Ohlin model¹² labor abundant countries should specialize in labor intensive goods, and capital abundant countries should specialize in capital-intensive goods. Additionally according to Rybczynski theorem¹³ great doubling should lead to a decline of prices of labor-intensive goods relative to capital intensive goods. Because relative differences in labor and capital endowments between countries increase, gain from international trade of good and services will

¹¹ See Rybinski (2007a) for a discussion on the impact of outsourcing and offshoring on labor market and on economic prosperity.

¹² See Ohlin (1933)

¹³ See Rybczyński (1955)

increase and it should lead to an improvement in the global prosperity. However there will be groups that will lose in this process, especially when labor markets in their countries are not flexible enough. For example labor intensive production in developed economies will be reduced and many jobs in these sectors will be lost. Higher global labor supply could also reduce the relative bargaining power of employees vis-a-vis employers.

Figures 8 and 9 below shed some light on these developments in the last fifteen years. In many countries compensation of employees as a share of GDP declined, in some case this decline was very sizeable. For example in the EU-15 the share of employee compensation to GDP fell four percentage points, this drop was marginal in the United States, but the most pronounced reduction of the part of the value added pie going to employees was in Poland, it fell by an astonishing eight percentage points between 2000 and 2005.¹⁴ This evidence suggests, that globalization of the labor market was accompanied by the rising bargaining power of corporations, while in some countries there were also other idiosyncratic factors (such as domestic monetary policy) that strengthened or weakened this process. It is interesting to note that in CEE-4 region we have seen diverse developments, a sharp decline in labor share of GDP in Poland and Slovakia, and a moderate increase in the Czech Republic. It is worth remembering, that both Poland and Slovakia recorded the highest levels of unemployment in the European Union.

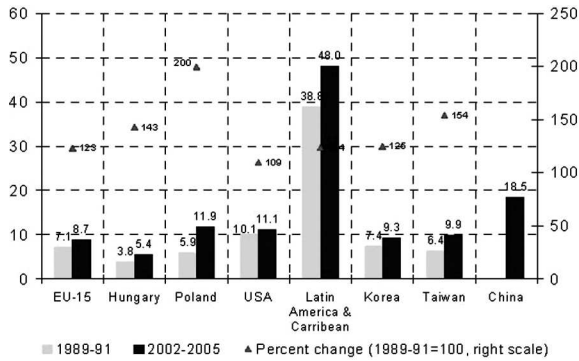
Income dispersion rose in the last fifteen years within all regions, reflecting rising return to knowledge. Again the strongest growth of income inequality among the analyzed countries/regions took place in Poland, where it almost doubled and moved from level typical to the socialist country (everybody equally poor) to level indicating higher inequality than in the United States, and much higher than in the EU. It is worth noticing that at the same time NIEs managed to grow rapidly and recorded much smaller increases in income inequality.

It is important to stress that globalization reduces inequality, as documented in Sala-i-Martin (2006), where eight indices of world income inequality declined in the period 1970–2000. However we witness two diverging

¹⁴ The magnitude of this effect suggests that there were important idiosyncratic factors at play in Poland, such as effects of the Russian crisis in 1998 and domestic monetary policy.

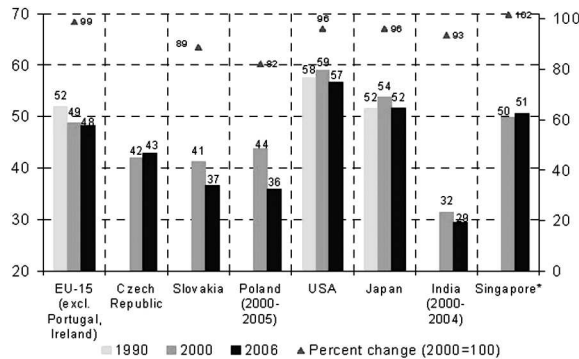
trends, globalization allows poor countries to catch up, which reduces international income inequality, while at the same time, as described above, there is a trend of rising intra-country inequalities.

Figure 8. Decile dispersion ratio (10th income decile/1st income decile)



Source: WIDER World Income Inequality Database; World Development Indicators 2007. U.S. Census Bureau; Korean Statistical Information Service: <http://www.kosis.kr/eng/main.htm>; Report on The Survey of Family Income and Expenditure in Taiwan Area, National Statistics Republic of China (Taiwan): <http://eng.stat.gov.tw/ct.asp?xItem=3458&CtNode=1597>.

Figure 9. Compensation of employees (in % of GDP)



* Refers to earnings and excludes employer social contributions.
Source: Ecwin Databases; Ecwin Economic and OECD QNA.

Studies show that poverty can be both a determinant and a result of ill health. On the one hand illness may undermine households' ability to cope

financially and thus can be the reason of why they end up in poverty. On the other hand, it may also be a cause of ill health as poor people suffer from a number of deprivations (e.g. lack of adequate food, clean water, good sanitation and health services) that have an impact on it. It is also important to note that health, as a human capital ingredient, is especially relevant for sustained economic development and, as such, is increasingly seen as a robust predictor of economic growth (WHO 2006).

Under communism worsening state of health constituted another worrying trend in CEE-4. The 70's saw a major deterioration in health trends in all CEE-4. The best evidence was an enormous divergence in death rates compared to the West (Schweitzer 1990). The reason of this situation was many-fold:

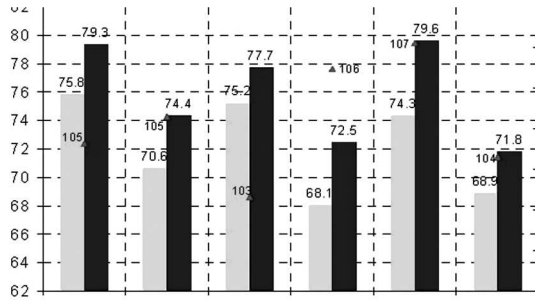
- A universal entitlement to comprehensive and free health services made the system very inefficient with excess human and physical infrastructure. According to the World Bank studies management and financing of health services were inadequate. It resulted in severe shortages of drugs, equipment and high-volume disposable articles like needles and syringes.
- Another reason was environmental pollution, especially in the regions such as Bohemia in Czechoslovakia and Silesia in Poland. It resulted in high-risky areas in which syndromes of lead poisoning were very intensive. It included high incidence of anemia, digestive tracts problems and mental disturbances.
- But the main reason for that seems to be a very unhealthy lifestyle: heavy alcohol consumption and smoking as well as high-fat diet and lack of exercise.¹⁵

Most significant health indicators (e.g. life expectancy at birth) in CEE-4 stagnated or even deteriorated in the first stage of the transition but later in the decade a significant improvement appeared. Although many common health problems, cardiovascular and cancer diseases in particular, still remain more prevalent than in the EU, overall health conditions have improved

¹⁵ Eberstadt (1990) and Antal (1994) record a dramatic rise in the per capita consumption of cigarettes and alcohols in Eastern Europe between the mid 1960's and 1980's. According to Okolski (1993, p. 177) "of all plausible determinants of adult male mortality increase in Eastern Europe, the most widely accepted underlying factor is growing alcohol consumption".

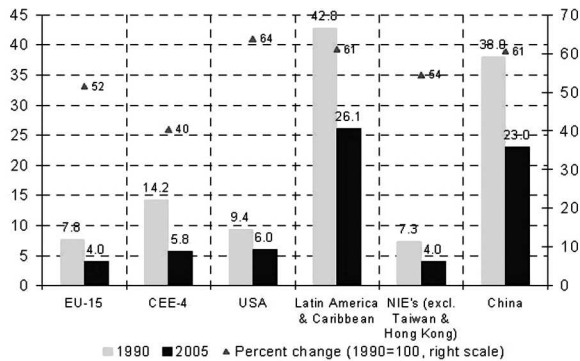
dramatically. Life expectancy jumped by 5% to 74.4 years, which still leaves room for improvement compared to developed countries. At the same time infant mortality rate went considerably down (by 60%) to 5.8 per 1,000 live births — the level slightly better than in the U.S. though still higher than the EU's and NIE's.¹⁶ While these trends in CEE-4 are highly positive the superior performance of NIEs is also meaningful.

Figure 10. Life expectancy at birth, total (years)



Source: World Development Indicators 2007.

Figure 11. Infant mortality rate (per 1,000 live births)



Source: World Development Indicators 2007.

¹⁶ Life expectancy rates are sensitive to trends in infant and child mortality. Reducing child mortality, as measured by both infant and under five deaths is one of the World Bank's Millennium Development Goals.

Together with dramatic economic and social changes all CEE-4 recorded low birth rates, net emigration (that rocketed after the EU enlargement) and, as a consequence, falling populations, especially those of working age. The share of older people in population, though still lower than in the EU-15, dramatically increased (European Communities and World Health Organization 2002). It has had an important impact not only on economic issues, but also social, including political, aspects.

According to Commission of the European Communities (2005) pursuing a democratic system is one of the key elements of social development. After almost half of the century under communism, CEE-4 as well as most post-communist countries transformed their political systems into democracies. It is of prime importance for sustainable development to make the state work for its society as a whole and not for the interest groups. This is however very difficult to do under democracy as many studies show.¹⁷ The most evident example of this tendency is CAP under the auspices of the EU, consuming 44% of the EU's budget,¹⁸ which shows that even pan-European bodies are prone to the pressure from the interest groups. Western multinational agreements tying these issues may be even more difficult to challenge. Another example may be a mass exodus of young Polish people (usually under 35) to the West, which may be a form of protest against the lost balance in the society.¹⁹

This stays in stark contrast with highly successful and, paradoxically, non-democratic NIEs.²⁰ Thus it seems that, to reach high long term growth,

¹⁷ For example Barro (1996) finds that the overall effect of democracy on growth is weakly negative and hypothesizes about a nonlinear relationship in which democracy enhances growth at low levels of political freedom but depresses growth when a moderate level of freedom has already been attained. A Polish philosopher and advisor to the Solidarity movement, Miroslaw Dzielski, claimed that democracy can limit freedom and it is economic freedom that should be pursued first and then, slowly, democracy.

¹⁸ One of the very few examples of democracies that does not subsidize agriculture is New Zealand.

¹⁹ According to Community Statistics on Income and Living Conditions Poland is the only one country in Europe, in which the average income of people aged 65 and more is higher than the average income of people aged 0-64 (it amounts to 113% in Poland and 55%-94% in other European countries). As already stated studies show that it is not the pensioners that lost the most in the transition.

²⁰ More precisely, South Korea democratized in the end of the 80's, Taiwan — in the middle of the 90's. Hong Kong and Singapore are still considered autocracies. The same can be said about China and India. See for instance Freedom House at: <http://www.freedomhouse.org>

democracy is not a necessary condition. Does it mean that democracy should be abandoned? Of course not. Let us think of many other autocracies, e.g. Zimbabwe (where the IMF forecasts inflation to reach 100000% in 2007), North Korea or not so remote experience of the communist bloc. While under democracy there is a certain control of the society over the government, under autocracies it is not the case. Hence, the autocratic governments may choose market-oriented or communist stance as well.²¹ The answer therefore has to be: do not abandon democracy, change it! This is, however, not a trivial task.

1.3. Environmental protection

The communist countries based their development on rapid industrialization. Not only were their economies big polluters, but also they were very inefficient. Hence the centrally-planned regimes led to an intensive and excessive use of natural resources, which had a highly adverse effect on the environment. As a result the environmental issues in these countries posed a significant and wide-ranging problem: serious pollution of air and water, degradation of soil and forests as well as significant contamination of rivers and seas. Lack of sufficient water supply and waste water (e.g. treatment plants) infrastructure made untreated waste water flow to groundwater, lakes, rivers and the sea. Many people lacked access to clean drinking water. There was no coordinated solid waste management.²²

This situation had a negative impact on health boosting e.g. birth defects and such diseases as cancer and thus worsening the standard of living and reducing life expectancy. Between the mid-1970s and mid-1980s life expectancy in all Eastern European countries, apart from East Germany, even dropped. This brings about an evident relation to the other dimension of sustainability — social development.

This situation posed an urgent need of a systemic approach to change the attitude of economic agents towards the environment. There was a great need of enhancing efficiency and reducing waste in the production process.

²¹ It is also of prime importance to note that under autocratic states human and civil rights are usually heavily violated.

²² The detrimental consequences of the communist economies are recognized and received much attention in the literature. See: World Bank 1994, Carter and Turnock 2002.

Water supply and waste water infrastructure had to be improved or very often set up from scratch. Old landfill sites had to be closed and new sealed landfills had to be built in order to prevent hazardous waste from contaminating surrounding soil and groundwater. The communist legacy in CEE-4 left also a huge backlog with regard to road network, which obviously was not neutral to the environment.²³

A positive, yet still sluggish, move forward in the environmental agenda in CEE-4 can be dated back already to the second half of the 1980's (Darst 2001) when a political thaw fostered an environmental cooperation between the West and the East. A breakthrough, however, has occurred from the outset of the transition. CEE-4, together with Slovenia, paved the way to stricter environmental agenda for the whole post-communist bloc (Carter and Turnock 2002). It was partly due to the fact that environmental issues were given high priority in the EU widening process. This impact was three-fold:

- In the early 90's the policy towards the post-communist countries adopted by the EU was to promote flexible regulatory approach that focused on cost-minimizing economic instruments and on building the civil society.
- In the second step the accession countries faced strict environmental conditions for accession with simultaneous supportive measures: a pre-accession technical assistance in the areas of financial and administrative support from the second half of the 90's.
- In the third step the framework of environmental regulations, once accepted, is to be obeyed by the EU members.²⁴

The transition process itself as well as the mixture of pressure and incentives from the West brought about a number of significant changes. One of them was a steady process of switching to less share of agriculture and industry

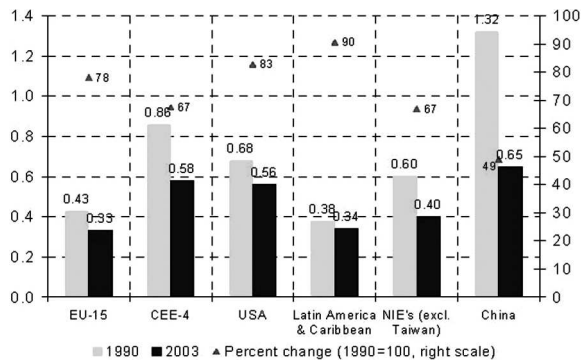
²³ Investment in this area eases traffic congestion in and around cities. It is therefore fuel efficient, which means less pollution and gas emissions. Schemes aiming at solving these problems were carried out not only by the EU, but also such international bodies as the World Bank and the EBRD (2006).

²⁴ The most troublesome areas enjoyed transition periods. Accession negotiations over environmental chapter were finished in 2001 and the European Commission shifted to monitoring implementation and delivering investment through the Instrument for Structural Policies for Pre-Accession (ISPA).

in the economy and higher share of the services. It helped to reduce the significance of heavy industry in the economy — the most detrimental to the environment. Unfreezing energy prices and implementing competition improved energy use efficiency both in factories and households. In the years 1990–2003 CO₂ emissions per unit of GDP slumped in CEE-4 by 33%, a result comparable only to the China's (35%) and NIEs (33%). In spite of this positive process the level of energy inefficiency in relation to GDP still remains high (0.58), especially when compared to EU-15 (0.33) and Latin America & Caribbean (LAC) (0.34), but also to NIEs (0.40). It is worth mentioning that considerable efficiency gains were also attained through adopting new technologies.

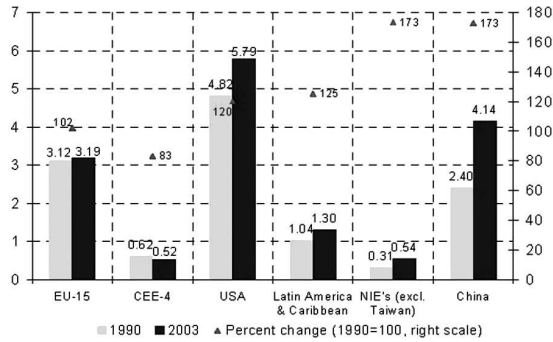
Not only has the improvement been made in the CO₂ emissions relative to GDP, but also in nominal and per capita terms. In the years 1990–2003 the volume of CO₂ emissions has diminished by 17%, which is the only case of a slump among the countries under consideration. Similar phenomenon can be noticed while comparing the per capita emissions. In 2003 CEE-4 reached the level substantially lower (8.0%) than the U.S.'s (19.9), EU-15's (9.6), comparable to the NIEs (8.8), though still much higher than China's (3.2) and LAC's (2.4). The positive trends in the CO₂ emissions were feasible to a high extent due to a shift in the use of energy sources.

Figure 12. CO₂ emissions (kg per 2000 PPP \$ of GDP)



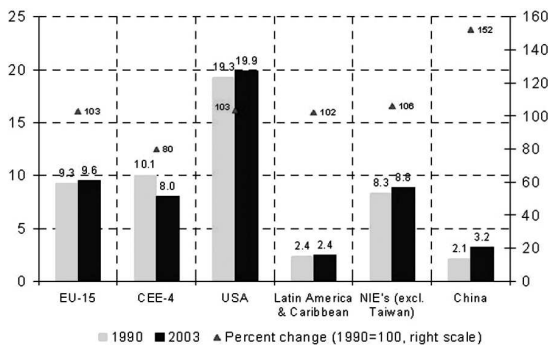
Source: World Development Indicators 2007.

Figure 13. CO₂ emissions (million kt)



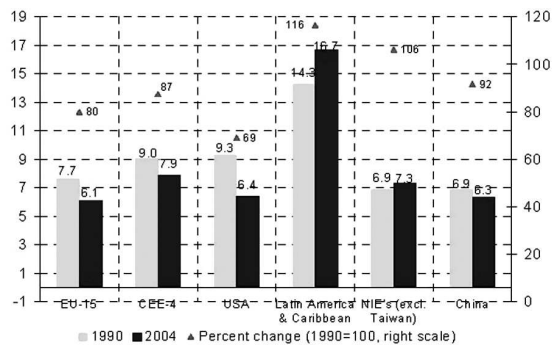
Source: World Development Indicators 2007.

Figure 14. CO₂ emissions (metric tons per capita)



Source: World Development Indicators 2007.

Figure 15. Electric power transmission and distribution losses (% of output)

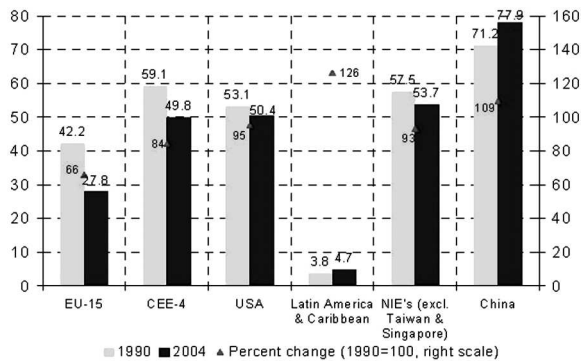


Source: World Development Indicators 2007.

CEE-4 countries for many years were, and still to a some extent are, highly dependent on fossil fuels, especially coal. Relatively higher energy prices brought about a shift in the composition of fuel use. It broke the tradition of excessive coal consumption in favor of, less harmful for the environment, energy sources such as oil and gas. In the production of electricity the coal source, most harmful to the environment, has been reduced by 16% to the level comparable to the U.S.'s (50.4) but still much higher than the EU-15's (27.8) and LAC's (4.7).

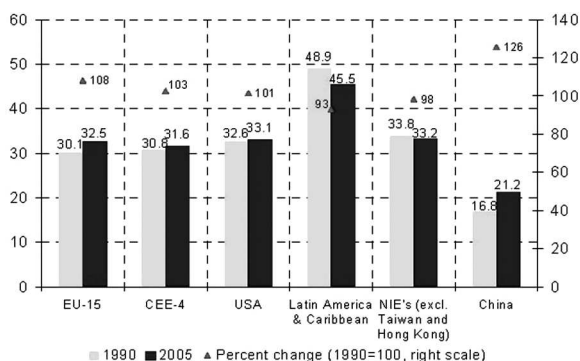
Exposure of companies transmitting and distributing energy to market competition as well as liberalization and partial privatization reduced wasteful practices. Power transmission and distribution losses as a share of total output decreased by 13% in the years 1990–2004. Although at the end of this period the losses were still higher than in other developed countries and China, it was significantly better than in LAC.

Figure 16. Electricity production from coal sources (% of total)



Source: World Development Indicators 2007.

Figure 17. Forest area (% of land area)



Source: World Development Indicators 2007.

Another example of positive changes is the higher percentage of land (by 3% in the years 1990–2005) occupied by forest area — a trend that is also seen in the Western Europe, the U.S. and China. It is also worth noting that in this area, just as in the others, economically high-performing countries like NIEs do not lag behind EU-15 in terms of environmental issues. On the contrary in many indicators they are one of the leaders.

In the globalization era it is perhaps also interesting to mention how this phenomenon affected environmental changes in CEE-4. There can be differentiated two mutually contradictory streams in this area that have been mainly put forward in the literature:

- On the one hand exposure to global markets may have a negative impact on environment as international competition demands loosening of regulations, including the environmental ones. As many experts note the increased competition from global counterparts forces companies to relocate their investments into countries that minimize regulations.²⁵ Thus governments find themselves under pressure either to turn a blind eye on disobedience or to reduce regulation costs (Ichikawa, Tsutsumi and Watanabe 2002).

²⁵ This is especially viable now when discussing the Kyoto protocol that is to leave outside the system most developing countries thus increasing the chance that environmentally harmful businesses relocate there.

- On the other hand we can observe a positive spillover effect from the already high income countries as they can put an effective pressure on economic agents to increase environmental protection if this is made a precondition to enter international markets. Because of this many companies from CEE-4 that exported their goods to the Western countries implemented environmental plans stricter than internally required even long before joining the EU (Jha, Markandya and Vossenaar 1999).

All in all, it is evident that the changes in the main environmental indicators in CEE-4 from the beginning of 90's have been positive. We can also generalize saying that economic development is a strong driver of the positive environmental changes. One of the most evident proofs of that is that environmental damage was much worse in Eastern Europe under communism than in Western Europe under capitalism (The Economist 1990). Another argument for that is that all transition countries (not only the EU accession ones, which faced stringent accession conditions) implemented environmental plans.²⁶ It is also worth mentioning that many counter environmental measures came from non-market forces. For instance the strive for environmental changes in CEE-4 had to face strong interest groups, e.g. powerful and highly unionized electricity and coal production sectors in Poland.

Although all environmental effects of economic development are not yet fully clear the experience of CEE-4 and the, relatively longer, experience of NIEs confirm fairly new findings of the so-called Environmental Kuznets Curve (Grossman and Krueger 1991).²⁷ According to these findings environmental pollution forms an inverted U-shape function of economic development. In the early stages of growth, little interest is given to environmental concerns. After a certain threshold, when basic physical needs are met, the trend is reversed as the demand for better quality of environment eventually prevails leading to less degradation. At this stage the society already has both: funds and willingness to reduce the pollution. This implies that environmental protection may be a superior good. It is however important to know that there is no single EKC for all kinds of pollutants.

²⁶ It is important to say that the transition to a market-based economy was very diversified in all post-communist countries (see: EBRD, Transitions reports) and this certainly influenced the way and extent to which the economic growth impacted the environment.

²⁷ It is also said that China can be ideal test case for the idea of the environmental Kuznets curve and thus the widespread gloomy view on its environmental future may be overstated (Hayward 2005).

Its viability is also subject to other factors like place and time. Though still highly discussed (Dasgupta et al 2002; Harbaugh, Levinson and Wilson 2002) and tested (Shafik 1994), the EKC casts doubt on the ubiquitous belief of the conflict between growth and environment.

The EKC hypothesis has important implications for economic policy. It suggests that some environmental pollution is inevitable, especially in the early stage of economic growth. Apart from that it claims that once the threshold is attained, economic development will help to tackle the pollution generated in the earlier stage.²⁸ This means that policies that aim at generating growth are good for the environment as well. It does not necessarily imply a passive government. On the contrary right policies, such as the removal of distorting subsidies, the imposition of pollution taxes, facilitating new efficient technologies and promoting environmental awareness as well as sound institutions such as more secure property rights over resources may flatten the EKC and thus be beneficial to both the economic growth and environmental protection.

2. What matters?

Imagine we have the year 2050²⁹ and we have gathered in Vienna at the conference which aims to assess what were the most important factors that contributed to prosperity of particular regions in the first half of the 21st century. It is very likely that the crucial factor identified by this prestigious audience would be the regions' ability to develop intellectual capital.³⁰ While in the 20th century the key determinants of long term sustainable growth were sound institutions, in the 21st century, the era of the global knowledge economy, it was the ability to innovate that proved to be the fundamental

²⁸ The same idea is shared by the Nobel Prize winner Gary S. Becker.

²⁹ See Kuklinski (2007) for explanation why establishing a vision for 2050 is of crucial importance for the prosperity of European citizens.

³⁰ The concept of intellectual capital encompasses three dimensions: knowledge capital, structural or organizational capital and relationship capital. Knowledge capital refers to formal knowledge acquired at school or university, to experience gained at work and to tacit knowledge. Structural capital encompasses capital of processes in organization, innovation capital (such as patents), and organizational culture, for example flat corporate structure, knowledge-sharing attitude, sharing common vision and goals. Relationship capital refers to relations with clients, suppliers, it describes both the client base but also the clients potential. Intellectual capital can be measured, and this measure can refer to companies, cities, regions and entire countries. For broad discussion of intellectual capital see for example Marcinkowska (2004), Kasiewicz et al. (2006) (both in Polish), Sveiby (1997), Stewart (1999) or Skyrme (2003).

component of a countries', regions' and corporations' success. Those who understood the importance of innovations for growth they thrived and prospered in the first half of this century. Unfortunately old Europe was not amongst them, and today, in 2050, it is struggling to reverse a decline in the standard of living which began in 2020s and lasts to this day.³¹

2.1 Knowledge economy as the growth engine

If we travel back in time some 50 years, we will find out that already in the final years of the 20th century economists developed a theory of economic growth that took into account the importance of knowledge and innovation.³² Already then we had a family of neoclassical growth models pioneered by Robert Solow, these models assumed constant returns to scale. In other words, if you double the production inputs, such as capital (machinery, buildings), the number of employed workers and the number of material inputs, then you will also double the output. Of course these models allow for technological progress, a creation of new technology that allows to produce faster, cheaper with fewer inputs allows to increase output more than proportionally to the increase of used inputs. In early years the technological progress was treated as exogenous, simply assumed that it somehow happens. In the later stage economists made an attempt to explain why technological progress takes place which gave birth to new class of models: endogenous growth models.

In order to explain what happened in the first half of the 21st century it is worth to briefly remind ourselves about the branch of the endogenous growth models pioneered by Paul Romer, with his well-known article published in 1986 that was a shortened version of his dissertation from 1983.

What were his key observations? Romer argued that one of key factors of economic progress are innovations, ideas or more broadly knowledge. Such innovations as electricity, light bulb, internal combustion engine, Wal-Mart business model or a cell phone had immeasurable consequences for billions

³¹ There were studies in early 21st century warning that such a bleak future lies ahead unless there is a new vision and strategy developed that recognizes the challenges of the global knowledge economy, see for example Rybinski (2007b).

³² Milestone papers of the growth theory and the importance of knowledge are the following: Solow (1956, 1994), Dixit, Stiglitz (1977), Romer (1986, 1990), Grossman, Helman (1991), Aghion, Howitt (1992), Jones (2004).

of individuals around the globe. However, while we often focus on big inventions, often called “disruptive innovations”, also the little ones, which come largely unnoticed have far reaching implications for world economic prosperity. For example nowadays in most bars coffee paper cups have lids with the same diameter, irrespectively of the size of the coffee: small, medium or large. Few years earlier bigger cups had bigger lids. This little innovation allows bar owner to reduce costs and the cup lid producer to simplify and expand production.³³ There are millions of such small innovations and together with the big disruptive innovations they are shaping the world economy and contribute to the improvement of the standards of living.

Romer’s second observation was non-rivalry of ideas. In the case of capital or labor the same worker or the same machine cannot be employed in two different places at the same time. That is why when we model output using standard 20th century production function we assume constant return to scale, doubling inputs (machinery, employees) doubles output. This is not the case with knowledge, ideas and innovations. When certain innovation become available (is in the public domain, or can be used under IPR agreements) it can be used at the same time in hundreds of enterprises. It applies to anything from chemical formulas to different way of managing business processes. So doubling the amount of knowledge used in the production process will more than double the output, resulting in increasing returns to scale.

This second Romer observation has a number of important consequences but for the purpose of this paper we will focus on just one. Knowledge increasing returns to scale imply that the higher the number of knowledge, idea-rich workers the higher the output. And because the number of knowledge workers should be proportional to the overall number of workers one could draw a conclusion that large countries grow faster than small ones and that large countries should have higher standard of living.³⁴ Of course examples of Ireland, Hong Kong, Singapore or Luxemburg on the one hand and India and China on the other show that it is not the case, and that the

³³ Example used by Paul Romer in his interview, *Post Post-Scarcity Prophet*, “Economist Paul Romer on growth, technological change, and unlimited human future”, Interview by Ronald Bailey, December 2001.

³⁴ Jones (2004) quotes William Petty, tax expert, who wrote in 1682 “As for the Arts of Delight and Ornament, they are best promoted by the greatest number of emulators. And it is more likely that one ingenious curious man may rather be found among the 4 million than 400 persons”.

biggest countries are not richest ones, quite the contrary often very small countries enjoy very high level of income per capita. But one can also show the example of the United States, which is a very large country with very high income per capita.

As we said earlier the ability to innovate is a function of the country, region or corporation intellectual capital. Knowledge is only one of the three components of intellectual capital. Imagine there is a “genius innovator” in a company, who can produce ideas which double the company profitability. But this genius needs resources (lab, computers, funding), and the company corporate culture and organization has to support breeding innovations. If proper structures, procedures, incentives and resources are not in place, then even the brightest minds will have little chances to create ideas and transform them into usable technology. In other words the company has to develop structural capital to support its knowledge capital. The same can be said about the country structural capital. A nation which is plagued by corruption, has malfunctioning law enforcement, does not respect IPRs, has large cost of starting up a business, does not support innovative companies with proper policies, such nation is poised to fail in the global knowledge economy. Finally, ICT deepening that took place in the past twenty years removed geographical borders, and nowadays innovations are often created by teams of experts located in different countries or even in different continents. Therefore country or company prospects will depend also on the ability to source knowledge and innovations from other locations, which requires development of a proper relationship capital.

In the light of above arguments a simple comparison of economies with different level of structural or relationship capital could lead to wrong conclusions. For example Diamond (1997) presents a study which compares similar regions, which were isolated and could not source ideas from other regions. The last ice age ended some 10,000 years BC. Before oceans were covered with ice, people could travel and exchange ideas, for example how to make the best stone weapon. However with ice melting, continents became isolated, people could not travel and communicate until 1000–1500 of modern era, when large sail-boats were constructed. For some 12,000 years all ideas were developed locally. What were the results?

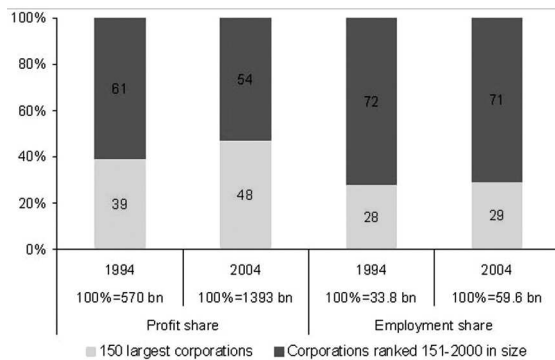
The most populated Europe achieved biggest technological progress. Europeans, such as Christopher Columbus discovered and conquered other

continents. Next in this ranking were also relatively well populated Americas, with the cultures of Azteca and Maya. Australia was far less populated and although its inhabitants invented fire and boomerang they remained hunters and fishermen. In the least populated areas, such as Flinders islands, human race did not survive. This very-long-term analysis does show that in old times the number of inhabitants was important for achieving sustainable growth, as large populations were more likely to create innovations.

In the modern knowledge economy the ability to source knowledge globally has become a key advantage that can be exploited by small countries with excellent knowledge infrastructure (such as Finland or Ireland). It can be used to leverage growth by large corporations, which have access to many markets which serve as customer driven innovation platforms or, alternatively, small companies that managed to grow rapidly amid adopted global vision or thanks to access to large markets (such as in India or China).

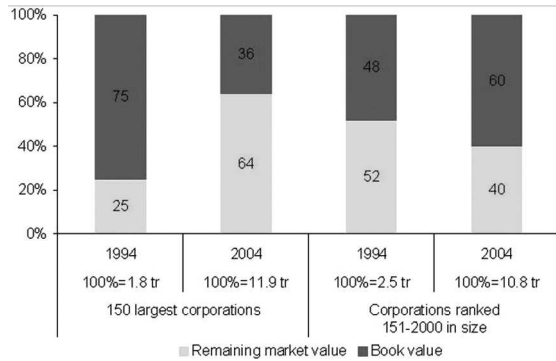
Bryan, Zanini (2005) repeated the exercise performed in Diamond (1997) for continents at a company level. Authors compare growth dynamics of the largest 150 corporations listed on US stock exchanges to that enjoyed by firms ranked by size between 150 and 2000.

Figure 18. Employment and profit share of the 150 largest corporations listed in the US, 1994 and 2004.



Source: Bryan, Zanini (2005).

Figure 19. The share of intellectual capital in the market value of corporations listed in the US (in US\$ trillion)



Source: Bryan, Zanini (2005).

Figure 18 above shows the share of both groups of firms in total profits and total employment. In those 10 years the share of largest firms in employment remained unchanged and their share in profits rose from 39 percent to 46 percent.

This superb performance of largest corporations calls for understanding what is behind their success. Partial answer to this question can be found in the figure 19 above. In the case of largest corporations the ratio of book value to market value fell from 75 percent to 36 percent, while in the medium size companies the ratio rose from 48 percent to 60 percent. Although there could be several explanations, the most plausible one is that the level of intellectual capital in large corporations exceeds that in the medium ones, which is adequately priced by the financial markets.³⁵

For example GE employed 300,000 persons in 1984, in 2004 GE employment marginally fell but the percentage of managers and highly qualified specialists doubled. In the same period income per employee adjusted for inflation rose from 13,000 dollars in 1984 to 54,000 dollars in 2004.

³⁵ Results presented by Bryan, Zanini (2005) do not take into account results presented in Hobijn, Jovanovic (2001). Authors showed that in the years 1980–1990 highest growth rates were achieved by firms which managed to take over smaller, more innovative companies. Organic growth models, such as Wal-Mart or Gillette were exceptions. This remark is particularly relevant in the 21st century, when LBO and private equity activity exploded and takeovers become a very important growth and innovation accelerator. This particular corporate experience cannot and should not be replicated at the country level.

It appears that in the last 20 years typical large corporations achieved on average significantly better results than typical medium company, if they functioned in a similar regulatory environment. This success was possible amid much stronger focus on development of intellectual capital in large corporations. Global reach, ability to source innovations from many markets, outsourcing and offshoring, also knowledge process outsourcing, were important factors behind development of intellectual capital.³⁶

Another example of the role of intellectual capital and ability to innovate in rapid corporate development is discussed in Aguiar (2006). The title of the paper is “The New Global Challengers. How 100 Top Companies from Rapidly Developing Economies Are Changing the World”. Based on the analysis of 100 fast growing companies (4 from China, 21 from India, 12 from Brazil 7 from Russia, 6 from Mexico and 10 from other RDEs³⁷, making the RDE100 list) that went global authors develop six primary globalization strategies listed in the box below:

The focus on development of intellectual capital in above strategies takes several forms:

- Taking RDE brands global is aimed at creating new intangible values by 28 companies (18 from China) that pursue this strategy, such as global brand awareness among customers around the globe. A combination of super-large, low cost manufacturing base, large network of suppliers, world-class R&D centers, strategic alliances with old world technological leaders, positioning as good-value-for-money products to well established brands and creating global brand awareness could prove a very successful strategy to win significant global market share. This applies especially in such sectors as consumer electronics, household appliances or automotive equipment. A representative company in this segment is China’s Hisense, premier manufacturer of TV sets with production sites in China, Algeria, Hungary, Iran, Pakistan and South Africa.

³⁶ In-depth discussion of outsourcing and offshoring is beyond the scope of this paper, see for example Rybinski (2007a).

³⁷ There is not a single company from the Central and Eastern Europe on that list, although initially 12 companies from the region were analyzed as candidates. The reason is that larger globalizing companies in the region are subsidiaries of foreign multinationals.

- 22 companies on the global challengers' list are growing internationally by marketing innovative technology-based solutions. Boston Consulting Group proposes WIPRO, IT-services group as a representative company for this sample. According to BCG study "*WIPRO creates much of its value by completely redesigning its' clients' business processes, a task requiring comprehensive process-innovation capabilities. Furthermore, WIPRO is taking innovation to the next level by building extensive engineering capabilities, thus making R&D services the next battle battleground. The company already claims to be the world's largest third-party provider of R&D services*". According to BCG innovation-based globalization will require new global challengers to mobilize engineering and science talent to leapfrog existing giants from the Western World. Already many new global challengers score very well on the R&D front, for example China's large telecom Huawei was rated as a more attractive employer than any of its multinational competitors in ranking by university students in China. Out of 22 companies pursuing this strategy based on global innovation 11 are based in India.
- 13 companies on RDE100 list are going regional or global by rolling out new business models to multiple markets. This is achieved by rigorous approach to acquisitions and by operational excellence as in the case of Mexican cement giant Cemex. Other companies in this category strive to achieve world superiority along critical dimension, others exploit advantages such as cultural similarities, shared language or political ties to obtain privileged access to a market. Boston Consulting Group presents an example of Orascom Telecom, which is using its Egyptian home base to expand to neighboring markets. Another example of this type of activity is Chinese presence in many, if not all, African countries, which aims at building sizeable relationship capital, which will be a useful leverage in the future for many Chinese companies.³⁸

³⁸ China established a special USD 20 bn fund to help Chinese companies to expand or establish their presence in Africa.

Globalization strategies adopted by new global challengers

Model 1: Taking RDE brands global

Model 2 : Turning RDE engineering into global innovation

Model 3: Assuming global category leadership

Model 4: Monetizing RDE natural resources

Model 5: Rolling out new business models to multiple markets

Model 6: Acquiring natural resources

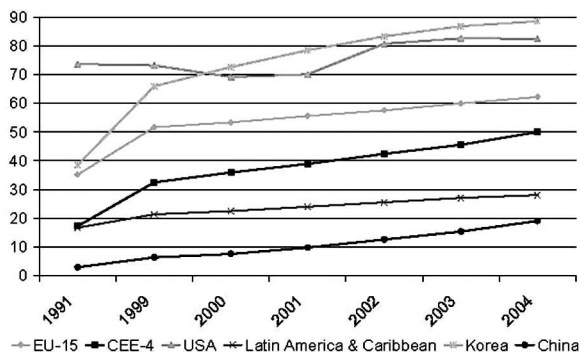
Source: Aguiar et al. (2006), The Boston Consulting Group

Above analysis clearly shows, that old, 20th century world division of labor (with Asia ex Japan providing cheap labor intensive goods) is no longer valid, and that the 21st century will bring massive changes in this respect. This conclusion can be reached not only on the basis of case studies, but also by analyzing the aggregate statistics. It is also worth noticing, that RDE100 companies expand to multiple markets by becoming global leaders of innovation, and that these innovations are not simple or small value added ones. As shown above some innovations are related to reengineering of complicated business processes and can have significant implications for future productivity of businesses or in entire sectors.

One of more important indicators measuring future knowledge potential of particular country or region is tertiary enrollment. As documented in figure 20 below tertiary education enrolment has risen in the last fifteen years in all analyzed regions. Interestingly, South Korea which lagged in this respect behind the United States has become a leader in our classification. The gap between U.S. and other regions has narrowed but still the difference remains very large. China is closing its tertiary education gap with the Latin America, while CEE countries which had similarly low percentage below 20 percent in early 1990s, last year reached 50% ratio, almost double the level recorded in Latin America. In light of earlier arguments about positive correlation between number of researchers and the amount of growth accelerating innovations it is worth to look at the absolute number of people in the process of tertiary education as it may be a good proxy for the future number of domestic researchers, data is presented in figures 21 and 22.

Recent years have witnessed an important shift in the balance of the world intellectual capital as measured by the number of people engaged in tertiary education. Number of higher education students³⁹ reached 30 million in China, which is equal to the number of such students in U.S. and EU taken together. Fifteen years ago China had only four million students in this category. We can safely predict that with recent war for talent in Asia raising economic return to education, the number of students will increase further and China will have increased number of people in tertiary education tenfold in just 20 years. The absolute number of students in CEE-4 has also increased significantly, but the gap with NIEs remained, or even widened when measured by the number of university-level students. Because of a relatively small population and a number of structural deficiencies presented below it is very unlikely, that this increase in the number of students in CEE-4 will translate into higher innovation potential in the coming decade, unless there is a dramatic change in policies in CEE-4. It is also worth noticing that LAC countries make steady progress and the number of university-level students topped that in the EU and approached the level recorded in the U.S. (figure 22).

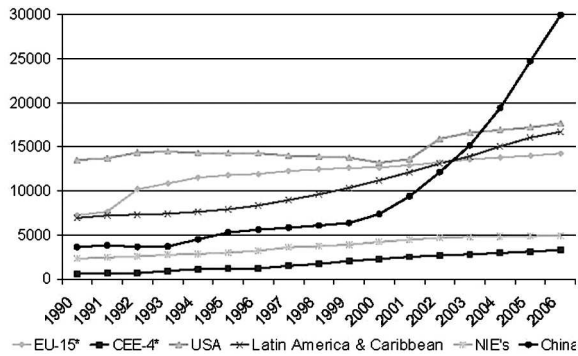
Figure 20. School enrollment, tertiary (% gross)



Source: World Development Indicators 2007.

³⁹ Higher education: Post-secondary education at colleges, universities, junior or community colleges, professional schools, technical institutes, and teacher-training schools. University: An educational institution that usually maintains one or more four-year undergraduate colleges (or schools) with programs leading to a bachelor's degree, a graduate school of arts and sciences awarding master's degrees and doctorates (Ph.D.s), and graduate professional schools.

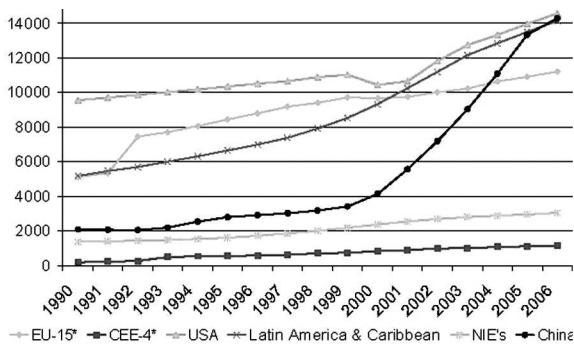
Figure 21. Higher education students (incl. universities) in thousands



* Data for Germany are available from 1992 and for the Czech Republic and Slovakia from 1993.

Source: Euromonitor International from national statistics/UNESCO.

Figure 22. University students in thousands



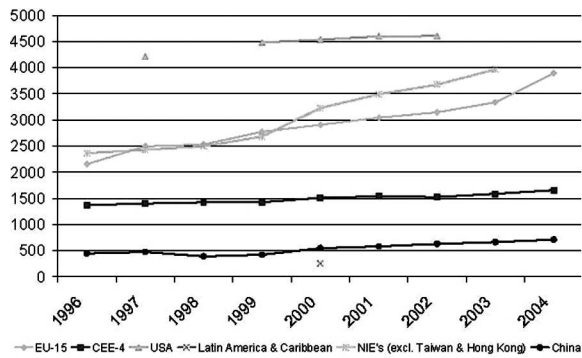
* Data for Germany are available from 1992, for Luxembourg from 1999 and for the Czech Republic and Slovakia from 1993.

Source: Euromonitor International from national statistics/UNESCO.

Of course this discussion assumes that the quality of education is similar in all regions, which is not the case. The average quality of higher education in the EU or the U.S. is higher than the quality in China or LAC countries. But emerging markets are making steady and fast progress improving the education system, and the increase in white-collar wage premium in recent years is very likely to accelerate this process.

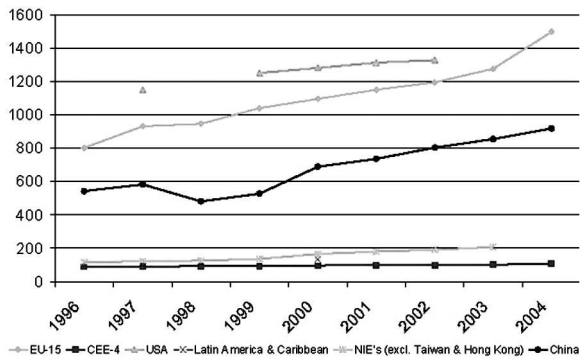
While the number of people enrolled in tertiary education is a good proxy for country innovation potential in the future, the current ability to innovate can be assessed by the number of researchers. As shown on the figures below the U.S. continues to dominate the world both in terms of researchers intensity (per million of citizens) and absolute number of researchers in R&D. However in terms of researchers' intensity both the EU-15 and the NIEs are closing the gap, and in terms of absolute number of researchers China is the third biggest in the world, although the average researcher still has poor skills in comparison with the U.S. or EU average.

Figure 23. Researchers in R&D (per million people)



Source: World Development Indicators 2007.

Figure 24. Researchers in R&D in thousands



Source: World Development Indicators 2007.

It is evident that in the last ten years the research gap between the NIEs and the CEE-4 has been growing. Both regions had similar number of researchers in mid-1990s, while two years ago NIEs had twice as many people employed in R&D in comparison with CEE-4.

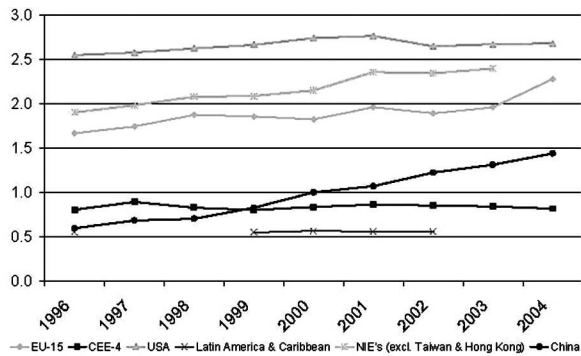
Two more indicators describing country ability to generate innovations are research and development expenditure and ICT expenditure. First indicator measures funding available to people with great ideas. Second indicator is a proxy for country ability to source knowledge globally thank to massive ICT deepening witnessed around the globe in the last decade.⁴⁰ Because knowledge sharing, exchange of ideas, networking of researchers is becoming more and more important factor in achieving technical progress, ICT development is likely to facilitate those needs and contribute to creation of more inventions. Those two indicators are presented in figures 25–28 below.

While U.S. and NIEs are world leaders in terms of R&D and ICT spending, China has made an enormous progress, raising R&D Spending per capita 12 times over the last 15 years. The EU has been closing the gap with the U.S. in terms of R&D spending as a ratio of GDP but it lags badly behind the US in terms of ICT expenditures. With growing importance of ICT using industries for productivity growth⁴¹ it may signal the Europe's troubles lying ahead despite its improvement in R&D spending.

⁴⁰ According to Friedman (2005) world has become flat, and according to many experts 21st century will be a wireless century, which opens new possibilities for improving productivity, create new businesses and improve living standards, both in developed and developing world.

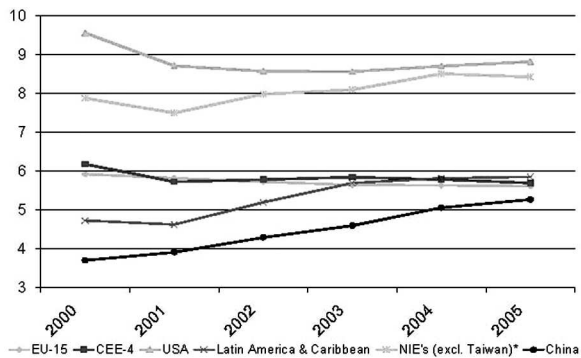
⁴¹ See van Ark (2005) and Inlaar, van Ark (2005), which show that US — EU productivity growth differential in the past decade can be explained by differences in productivity growth in ICT using industries (retail and wholesale trade, financial services).

Figure 25. Research and development expenditure (% of GDP)



Source: World Development Indicators 2007.

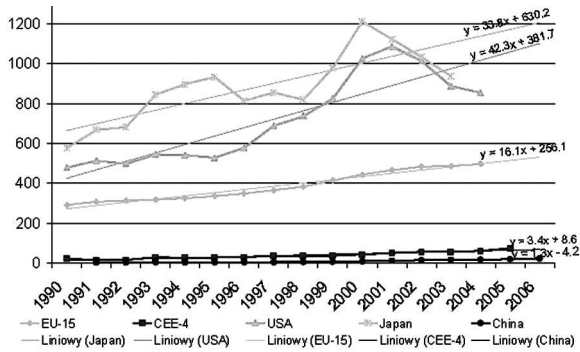
Figure 26. Information and communication technology expenditure (% of GDP)



Source: World Development Indicators 2007.

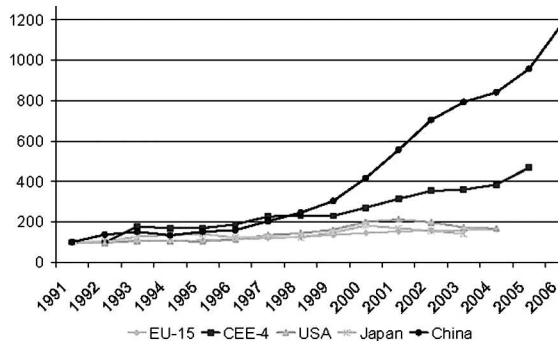
In the last ten years there was no improvement in R&D spending in the CEE-4 countries, it remains well below 1 percent of GDP and lags badly behind the 1.5 percent in China. In terms of absolute levels of spending per capital still U.S. and Japan top the league and exhibit similar volatility pattern.

Figure 27. Total R&D spending per capita (in ECU/euro)



Source: Eurostat, CEIC Data ISI Securities China Premium Database.

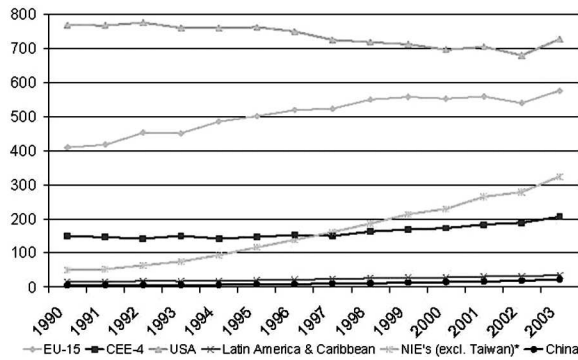
Figure 28. Total R&D spending per capita (in ECU/euro, 1991=100)



Source: Eurostat, CEIC Data ISI Securities China Premium Database.

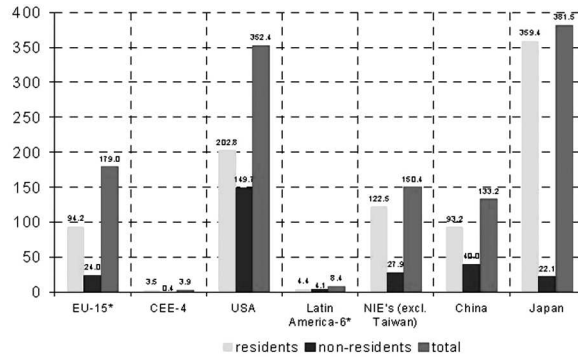
Various indicators discussed above show that CEE-4 countries lag badly behind other regions in terms of its current and future ability to generate innovation. The same picture emerges when one looks at the number of scientific and technical journals publications and patent filings. The U.S. and EU-15 dominate the world in terms of publication intensity. In early 1990s CEE-4 published twice as many papers per million of citizens than NIEs, but in recent years these proportions changed, and NIEs scholars publish 50% more than their CEE-4 colleagues.

Figure 29. Scientific and technical journal articles per million people



* From 2000 data exclude Hong Kong
 Source: World Development Indicators 2007.

Figure 30. Patent filings by office in 2005 in thousands



* Data for EU-15 are the sum of patent filings from national patent offices and the European Patent Office. According to WIPO EPO patent filings in 2005 amounted to 60.8 thousands. The total number of patent filings may be overstated as the EPO grants patents on behalf of the member States of the European Patent Convention (EPC), the membership of which is larger than that of the European Union as some EPC member States are not members of the European Union. Furthermore many European patent applicants seek patent protection in multiple EPC member States, therefore, non-resident patent filings by Europeans in other EPC member State offices and at the EPO have become common. Data for Italy are not available. Latin America-6 includes: Brazil, Chile, Colombia, Cuba, Ecuador and Peru.
 Source: World Intellectual Property Organization

The statistics showing patent filing by office in 2005 do paint an interesting picture. There are two world leaders, Japan and the USA, while China,

NIEs and EU-15 file one-third to one-half the number of patents compared with the leaders. Of course this is a very simplistic picture, because what matters is not the number of innovations, but the quality of innovations, especially the number of disruptive innovations. The picture shows that CEE-4 does not exist on the patent map.

Having said that and has to add that good innovation creation capability is not enough to achieve sustainable growth, both on the company and on the country level. (2007) discuss the innovation value chain, which consists of idea generation, conversion and diffusion. There are companies and possibly also regions and countries which may suffer from existence of a weak link in this value chain. So instead of focusing on generating more innovations authors recommend that companies should find and analyze its weakest link in the innovation value chain, and take corrective actions. This is also true in the case of countries and regions and examining several other aggregate indicators may lead to identification of weak links in the knowledge based economy.

Hansen and Birkinshaw define three types of innovation deficiency, quote: *“Organizations typically fall into one of three broad “weakest-link” scenarios. First is the idea-poor company, which spends a lot of time and money developing and diffusing mediocre ideas that result in mediocre products and financial returns. The bottleneck is in idea generation, not execution.*

By contrast, the conversion-poor company has lots of good ideas, but managers don't screen and develop them properly. Instead, ideas die in budgeting processes that emphasize the incremental and the certain, not the novel. Or managers adopt the “1,000 flowers” approach, letting ideas bloom where they may but never culling them. The need is for better screening capabilities, not better idea generation mechanisms.

Finally, the diffusion-poor company has trouble monetizing its good ideas. Decisions about what to bring to market are made locally, and not-invented-here thinking dominates. As a result, new products and services aren't properly rolled out across geographies, distribution channels, or customer groups. For such companies the real upside lies in aggressively monetizing what it has already been able to develop, not in paying further attention to idea generation or idea conversion.”

The same typology can be applied to regions or countries, on average⁴². For example country or region with high R&D spending share in GDP and relatively low number of patents can be a conversion-poor country or region if great ideas remain unnoticed, or idea-poor country or region, if poor ideas are generated.

Figures 31 and 32 present some insights. First shocking observation is that U.S. has only marginally higher number of researchers than the EU-15, but records twice as many patent filings. In Asia NIEs are much more effective than China, but again smaller number of researchers produces almost as many patents as EU-15. Of course quality of patents also matters, and Europe may produce more disruptive innovations than China (but not for long) but figure 31 does indicate many weak links in the innovation generation process in Europe. Figure 32 shows the effectiveness of dollar spent on R&D. The U.S. holds a supreme position, China files almost as many patents as EU-15 with half of the EU-15's level of R&D expenditure as a share of GDP. CEE-4 spend much more on R&D than LAC countries, and produce fewer patents. Both regions hardly exist on the world R&D map.

⁴² Of course in every country there are companies which have no or very few weak links, and also those who fail in the stage of generation, conversion or diffusion. However certain institutional and other factors can cause that certain type of companies will dominate, and the differences on average could be traced from the aggregated data.

Figure 31. Researchers in R&D and total number of patents filled

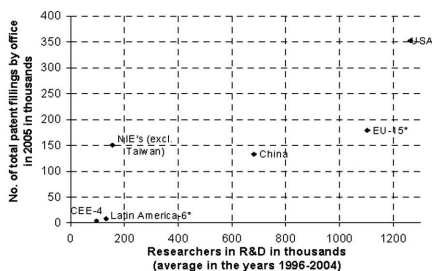
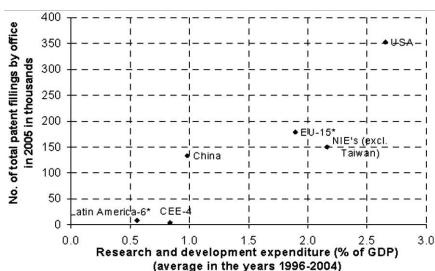


Figure 32. Research and development expenditure and total number of patents filled



* Data for EU-15 are the sum of patent filings from national patent offices and the European Patent Office. According to WIPO EPO patent filings in 2005 amounted to 60.8 thousands. The total number of patent filings may be overstated as the EPO grants patents on behalf of the member States of the European Patent Convention (EPC), the membership of which is larger than that of the European Union as some EPC member States are not members of the European Union. Furthermore many European patent applicants seek patent protection in multiple EPC member States, therefore, non-resident patent filings by Europeans in other EPC member State offices and at the EPO have become common. Data for Italy are not available. Latin America-6 includes: Brazil, Chile, Colombia, Cuba, Ecuador and Peru.

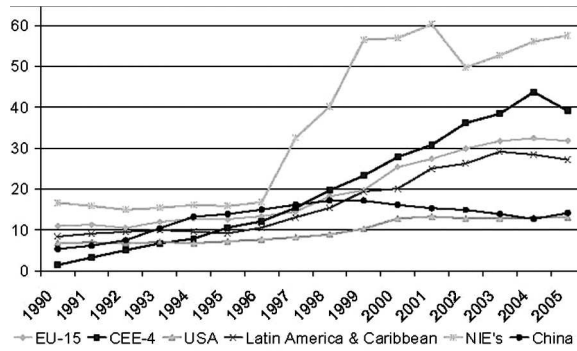
Source: World Development Indicators 2007, World Intellectual Property Organization.

As documented above CEE-4 countries lack ability to generate great ideas and to transform them into products or services. Therefore it appears that foreign direct investments become the most important modernization channel. Indeed as shown below CEE-4 became a very large recipient of FDI, with FDI stock to GDP ratio topping 40 percent. Only NIEs economies managed to attract higher FDI stock in relation to GDP and enjoy higher FDI annual inflows.

However, in the global knowledge economy it is important to attract high foreign direct investments to sectors that can become globally competitive, in particular to these sectors that export high-technology, i.e. high value added goods or services. While CEE-4 significantly improved the structure of exports, the high-tech goods account for only 12 percent of manufactured exports, which is the world worst result, lagging even behind LAC countries. NIEs are world leaders and China is about to take over the second post from the United States.⁴³

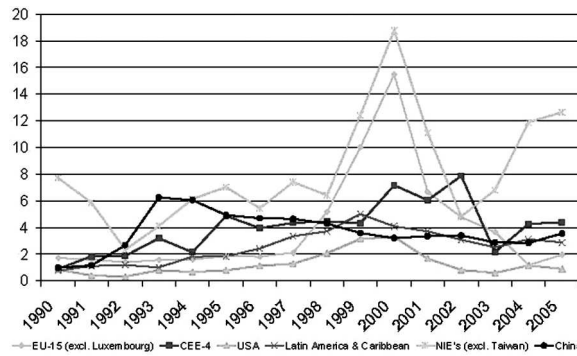
⁴³ We are aware of the arguments raised in recent OECD report "OECD Reviews of Innovation Policy, China", OECD (2007). Report states that exports have large innovative import component,

Figure 33. Inward FDI stock (in % of GDP)



Source: UNCTAD, World Economic Outlook.

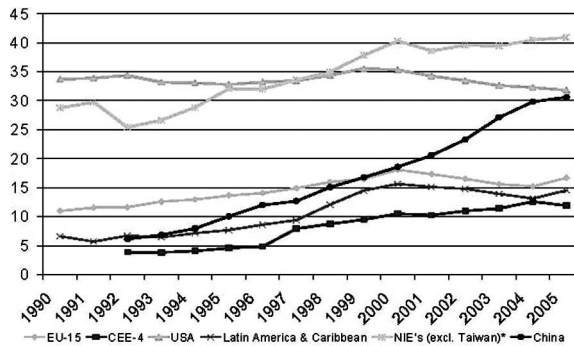
Figure 34. FDI, net inflows (% of GDP)



Source: World Development Indicators 2007.

that high-tech exporting companies are predominantly foreign owned and domestically owned companies export low value added goods. However recent initiatives taken by Chinese authorities (such as creation of high-technology clusters) are likely to improve the ability of Chinese companies to innovate.

Figure 35. High-technology* exports (% of manufactured exports)



* High-technology exports are products with high R&D intensity, such as in aerospace, computers, pharmaceuticals, scientific instruments, and electrical machinery. Data for Hong Kong are included from 1992.
Source: World Development Indicators 2007.

The 21st century will see a new paradigm. Data shown above suggest that China and NIEs will become thought, innovation and idea leaders. A very fine summary of this line of thought was offered by Hexter, Woetzel (2007), a quote:

“In such a competitive hothouse, adapted practices will evolve quickly, and as China merges into the world economy best practice there will become best practice globally. More products developed in China will become global products; more industrial processes developed in Chinas will become global processes. The ability to develop a Chinese talent pool will therefore be critical across all functions. Learning how to execute in China — the world’s most competitive market — will teach companies how to compete more aggressively elsewhere”.

The last few years were very good for CEE-4 countries. EU accession serves these economies well, the EU funds help modernize economy, transfers make farmers richer, EU demand for CEE exports has been rising at a very robust pace. Some economists are predicting five percent plus growth for CEE-4 region top last many years. However analysis presented in this section identified important structural deficiencies of the CEE-4 knowledge economies. In particular these economies lack the ability to generate innovation, and have attracted large pool of FDI to modernize economic structures. Unfortunately, as export structure suggests FDI have been located in relatively low value added industries. All of this does suggest that the new

Europe after a period of EU-accession positive output shock may find it difficult to maintain fast and sustainable growth path, unless there is a meaningful shift in policies towards supporting creation of intellectual capital.

The limitations of the scope of this paper did not allow to discuss another major deficiency of Europe, which was inherited by new Europe as well. This deficiency is the lack of ability to create shared and ambitious vision, strategic goals and successful implementation of strategic plans⁴⁴. We would not go as far as Tausch (2007) who analyzes 13 indicators used by the European Commission to assess the Lisbon agenda progress, presents inherent contradictions in the Lisbon approach and calls Lisbon agenda a “destructive creation”. However a number of analyzed indicators suggest that Europe needs a new vision⁴⁵, and this applies even more to new Europe.

Last but not least new Europe is struggling with massive emigration to Western Europe which offers better paid jobs. The scale of this migration has topped 5 percent of the labor force in some new Europe countries and has become a significant brain drain. It remains to be seen whether governments in new Europe will reach out to good examples of building large and effective diasporas⁴⁶ supporting creation of national intellectual capital networks around the globe and transforming “brain drain” into “brain gain”.

3. Conclusions

Lucas (2007) argues that in the long run income of all countries will converge. Bearing in mind what Lord Keynes said about long-run we document in this paper that income convergence did take place in all analyzed regions. On top of that we also find convergence in the standard of living as described by social cohesion and environmental indicators. Progress made on this front varies with the starting point and the range of adopted policies. Although it is extremely hard to make general statements on such a broad area as sustainable development we can propose the following general classification: at least according to some measures there are countries

⁴⁴ For a broad discussion of the importance of vision and strategy in 21st century see for example Kuklinski, Skuza (2003, 2006), Kuklinski, Pawłowski (2005a, 2005b), Kuklinski, Lisinski, Pawłowski (2006), Jakubowska, Kuklinski, Zuber (2007).

⁴⁵ See Rybinski (2007b) for a broad discussion titled “Meaningless Europe?”.

⁴⁶ For example Global Scott Network, Mexican diaspora in the United States or Portuguese diaspora in France.

that perform better with regard to growth and social progress and worse with regard to environmental protection (the U.S. and China), countries that achieved higher social and environmental standards but low growth (EU-15 and CEE-4) and countries that maintained eco-friendly environment but accomplished neither high growth, nor significant social cohesion (Latin America & Caribbean). It should be however noted that NIEs made biggest progress, managed to increase substantially the level of income while scoring well both in the environmental and social development. This example clearly shows that extraordinary economic performance may be a powerful means not only to achieve superior social development, but also to maintain decent environmental protection.

This paper presents evidence and argues that ability to innovate will be the key factor of sustainable growth in the 21st century global knowledge economy. Globalization of business processes implies that parts of these processes will be moved to locations where the cost to quality ratio is most attractive. Because emerging economies quickly move up the value added ladder reducing costs at the same time, it implies that companies located in developed economies face a real threat that more and more business processes will be relocated to emerging markets. The only response that will allow the old world to face the new world competition is to stay on the world innovation frontier. Data presented in this paper suggest that the ability to retain technological leadership by the U.S. and especially by the EU is rapidly vanishing, because:

- Population of present and future innovators in Asia (China and NIEs) is rapidly enlarging;
- Environment is much more competitive in many Asian markets than in Europe or the US, and tough competition breeds success;
- Sharply increasing return to education (white-collar wages) is likely to strengthen recent trends, which will lead to even faster closing of the technology and innovation gap between the U.S. and China or NIEs;
- Biggest developed world democracies, the UE and the U.S. lack clear vision and strategy, while strong strategy focus and robust implementation is present in China and NIEs;

- Western world has failed to understand the importance of intellectual capital to future prosperity. For example China involvement in Africa is a very sound investment in 21st century relationship capital, while Lisbon agenda maybe called an example of “destructive creation”;

The new Europe is gradually converging to the Old Europe. This progress is most evident in terms of institutional development, as shown in our paper. However new Europe lags badly behind old Europe and behind China and NIEs in terms of ability to create and diffuse innovation. All indicators presented in this paper which measure country innovation potential are at very low levels in the case of CEE-4, with one exception of tertiary school enrollment. It is evident that the ability to innovate is very weak in the new Europe, and there is no evidence suggesting that the situation might change. Therefore the new Europe in large part has to rely on foreign direct investments as a technology and know-how transfer. But here also we find evidence that these investments are on average not very innovative, as documented by very low share of high-tech goods in new Europe exports.

So far performance of the new Europe has been good in all three dimensions analyzed in this paper. However in order to achieve high rate of sustainable growth new Europe has to change its priorities and policies. New efforts focused on development of intellectual capital are called for.

Based on presented evidence we formulate the following policy recommendations:

- Abolish present “destructive creation”, when many often contradictory ideas are floated and the sense of strategic direction is lost;
- Create long-term vision reaching out to 2050, imagine how new Europe will be able to compete in 21st century global knowledge economy;
- This vision has to be universally shared by citizens and politicians, based on this vision strategic action plans have to be developed;
- Analyze what assets are needed to fulfill that vision, invest to create these assets, stop wasting money on assets that will become obsolete in the created vision;

- Conduct a careful analysis of strategies developed and implemented by most successful global corporations, especially those from emerging markets. While managing a company is certainly a simpler task than managing a democratic nation, many important lessons can be learnt by the public sector from a successful model of socially and environmentally responsible corporation.

There will be no success in the 21st century without courage or luck. Those who do not wish to make their future prosperity a hostage of pure luck need to show courage to change their policies towards developing proper innovation capacity. Innovation cannot emerge without reaching an adequate level of intellectual capital. The quest for intellectual capital of the 21st century has already begun. Both the old and the new Europe have to wake up and join the race.

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*Michał Boni**

I thank the Institute for having invited me, and Mr President (K. Rybiński — ed.) for his most inspiring presentation. The question how to reconcile economic and social challenges, should indeed be preceded by a particular meta-question, which ought to be formulated as follows: What conditions should be created for the development of Poland and in what terms should one think about Polish competitive advantages in the global economy? An answer to the question, whether we can and how we should manage to reconcile the economic and social challenges, without setting the previously indicated goal, seems to be an intellectually futile exercise. For various reasons we may wish to reconcile both these challenges, but if we wish to reconcile them just in the name of some ideology, idea, or philosophy, without recognising the development outlook in the long-term perspective, such discussion will fail to produce any tangible results. This is my first suggestion.

The second suggestion is the following: We live all the time in the shadow, on the one hand, of the challenges of transition, on the other hand, of the achievements of transformations already accomplished, and thirdly, under the pressure of the weight of the transformations. This prevents us from mobilising the imagination, which would be an “imaginative vision for 2050”... We only dispose of “imagination 2007”. “Right now we have

* Adviser to the Prime Minister of Poland.

the budget for the year 2008, but can we manage to assure in the year 2008 that the year 2009 will be vested with different priorities and goals?"

We shall be lagging behind until we manage to release strategic thought, and that covering a long-term perspective. We are in the European Union, in the economically competing global universe, where communication is much easier and where people know, which countries are developing successfully, etc., etc. If we fail to build up our own strategic advantages, we will keep dragging behind. Strategic thought could liberate us from the challenges of transformation. Please note the public debate of two years back, on the "Liberality versus Solidarity" alternative. It was a debate of a different age, as it were. This is not the kind of debate, which can drive Poland forward.

So the first premise is the question concerning Polish competitive edges. The second one — consists of the long-term perspective and strategic thinking. The third element, in my opinion, could be observed right now. I would recognise here certain positive elements concerned with democracy. They include the high level of social mobilisation, by Poland's standards, especially the high turn out of young people at the general election of 21 October 2007. It seems to me that if the young people participating in that election (whose votes enabled the change in the political domain) will not receive an answer from the world of politics and will not be provided with prospects for themselves and for their children, the potential of energy that has been released will begin to disperse. It seems to me that the three elements, which I have mentioned, are very important, as well as the orientation toward the young generation — as it is the one that will build, step by step, the future of our country. Referring to the statement by Mr President Rybiński, and which has strongly moved me, I wish to comment on a number of issues. I often talk myself about the role of the modernisation factor and the weight of long-term policy.

Without intergenerational solidarity, or telling the young generation what are its opportunities, what is its place, without mobilising the energy of the older generation, consisting of trying to look at the older generation in terms of the contribution that it can still make to the development of the Polish economy (and not in terms of silly satisfaction that at the age of 52, 53, 54... years they may now retire and take a rest), we will not be able to move forward.

Very briefly now, concerning economic and social challenges. Firstly, social policy should be a development factor. It cannot be treated as something contradictory with development. People often believe that the economy produces goods, which we subsequently distribute in the social policy domain. The trade unions claim that if a company makes large profits, it should share them with the workforce. Let us look at the expectations voiced by the trade unions in the last dozen months or so, which were a period of economic growth. If social policy is to be a development factor, it must respond to all the inefficiencies of the market, which emerge in the relationship between society and the economy... The market will not solve all the problems of social cohesion, of accessibility, of mobilising energy and providing opportunities. This is the task for policymaking, including social policy, which without putting a brake on economic growth, should help to clear all the elements needed for promotion, careers, and also human capital and intellectual capital development. On the one hand, social policy is a factor supporting development, on the other hand, it is an element of intervention, but thirdly, it is also an element of responsibility sharing. The responsibility of the state is one thing. The responsibility of self-governance is another thing. The responsibility of the family, about which we sometimes tend to forget, is still different, yet one cannot disregard the responsibility of the family and of the individual. The responsibility of the business enterprise is also different. In the contemporary world, when we conceive social policy very broadly, we note that the business enterprise plays a very substantial role within it, especially when it invests in the development of its employees. This is also the case when it soundly develops balanced work and personal life programmes, when it builds such an equilibrium between the cycle of personal life and the work cycle, which favours the development of family life. Business enterprises, which think of efficiency, but reflect on the significance of a stable, good worker in the longer time perspective, etc., adapt themselves flexibly to this role in that sphere. Therefore, I would not exclude the business enterprise from social policy, as various entities must share responsibilities within its remit...

One thing arouses my very strong concern, when we talk about the year 2050, about sharing responsibilities, about social policy as a development factor... In some circles in Poland we can observe the reduction of social policy to social rights, which are conceived as something that is due, as it is

inscribed in the law. I do not claim that social policy is to be without any rules, but only that the regulated areas keep expanding all the time. It already consists not just of security for old age, basic regulations concerning, e.g., access to the system of education, disability pensions in case of health impairment, access to the health care system, but also increasingly specific rights in every aspect of social and even family life. In Europe, the legally regulated areas are expanding in a monstrous way, we have to do with thousands of different kinds of rights in every possible sphere. Europe, unless it changes its way of thinking about social policy, will be incapable of responding to the real challenges of developments in the world. For it will not be able to build development programmes, which will respond to real needs, as it will be tied up by laws, which are hard to change. Just consider our own example — in Poland, the need of the day is for more aged people to work longer. It is not a matter of wanting to force anyone who is seventy years old to work. We are talking about the average exit from the labour market at the age of 58 years, that is at the age of 54 years for women and 59–60 years for men, which is a situation not encountered in other countries. But we cannot change this all of a sudden, because the respective law exists and the trade unions say “no”. If we are to change anything, we should align the arrangements up to the standards of those, who have the greatest rights, and therefore to reduce the retirement age. That is a caricature of thought, but it applies the categories vested rights: everything that was once given, is given forever. There is no need to analyse the situation, there is no vision of consequences, threats, looking to the future... Only the currently binding law exists, which cannot be changed. I perceive this as an extremely serious threat to the future development of the country.

In conclusion I wish to talk about one more difficult problem connected with democracy. I have the impression that we have began to make use of democracy in a way, which has become old fashioned today, i.e. that it is a democracy without deliberation. In essence, if a social group will claim its rights, we are inclined to assume, that in the name of democracy there is no room for any manoeuvre here. The public authorities and our democratic culture are unable to develop a mechanism, whereby not in a belligerent but rather a positive way, to put on the table the arguments of different groups. To say clearly in the course of such debate that it is not feasible to subsidise the social insurance of miners and their other social rights with billions of zlotys per year, and at the same time to increase the expenditure

on education and the improvement of its quality, to increase the expenditure on health care and improvement of its accessibility. I refer here to Mr President Rybiński's words about competitiveness, education, capital. At the level of primary schools we provide compulsory English teaching only to 48% of the children. Frequently, foreign language learning begins only at the gymnasium or even as late as at secondary school. A foreign language learnt at such a late stage does not provide for competence in the contemporary world and its economy. There are very many examples of this kind. They will persist, until our democracy will move into such a phase, that we will really seriously put forward on the table various arguments and options for debate, and talk about available choices. I attach great hope to the fact that the basis for action, development and thought has to be provided by the increase of social confidence. It will result in the situation, in which we will notice transparency in the usage of the instruments of democracy, that democracy perceived in terms of behind the scenes manipulations will disappear, that open talk about not only the good things, but also the difficult ones, will emerge. The quest for common solutions will consist of allowing all groups to have a say — not only those, which strongly claim their own case. In such a model of democracy, such way of thinking about the future, strategy, etc., a somewhat different participation of the media would be helpful, if they could also adopt this mindset, and not think just in terms of the fight to sell the daily *news*.

*Piotr Dardziński**

Thank you very much for the invitation. I was probably invited due to my function — I run the Centre for Thought of John Paul II in Poland, and it is very good to have someone able to say something about John Paul II. Let me immediately disclaim, that the words pronounced here do not represent any official position of John Paul II or the Catholic Church. I alone assume the responsibility for any mistakes. In daily life I am a philosopher and political scientist, I also study the ordo-liberals and compare them to the legacy of John Paul II, and therefore also the social market economy.

If I knew how to realise the reconciliation of social and economic goals, I would already be a Nobel Prize winner, but of course I do not know. I have decided that the subject of this seminar and the word “to reconcile” is really a provocation. From what has already been said here it follows, that it is not possible to achieve economic aims without achieving the social goals. This is the point of departure of social market economics. These goals are mutually supporting, and not excluding one another. Conflicts arising between these goals are most often only apparent, meaning that the argument concerns only the question, which of these goals should come first: the economy or the social purpose. As Mr Director Stephan Raabe has said, in the social market economy concept the economic aims, the market, the competition, are subordinated to social aims. This is actually consistent with the position of John Paul II, as it puts forward the primacy of culture, the precedence of anything human, over anything that concerns the economy. The economy is just and only an instrument. An instrument, which

*The Centre for Thought of John Paul II, Józef Tischner European University. Unauthorised text.

serves to attain certain goals. Despite the fact that I have never tended to think about leaving Poland, when watching the previous presentation I found that perhaps it is worth thinking about where to possibly move to. But where? Maybe only to China. The European Union scores poorly here, possibly the Asian countries could be considered... And I am again consoled by John Paul II, who says that there is no determinism in the case of social and economic issues. The shape of society is an artefact, something we have created ourselves, for which we are responsible. It is something that we can spoil, but also repair. The main problem is the question how to repair it?

John Paul II begins his social learning from man and it seems that this knowledge, the economics of knowledge, of human capital, consists simply of "human economy". The greatest potential, the natural good, which the state can dispose of, simply consists of human beings, of the citizens. This is optimistic for us, as we do not possess any oil or gas reserves, or any other things. Therefore, taking up the challenge at this level calls us to that field, on which we can try to stand up to it. It is very well that now we do not have to take part only in the race for crude oil.

Man comes first. Here the most serious problems will be found to be linked to demography and the approach to the economy in Poland. Some Poles will emigrate to the European Union, which will please us, as life opportunities will be opened to them, and at the same time we will import the next wave of workers from Ukraine. This is management by displacement of sorts. In this sense nobody thinks about investing and looking after one's citizens. The state does not care for the citizens, but it is rather more concerned about enabling them to leave the country, instead of being able to do something here. I would not agree with the previous speaker that our democracy lacks deliberation... In the European Union there is plenty of this capacity for deliberation, or, as some malicious people might say — for garrulousness. This results in strategies, the development of which consists, roughly speaking, of a process, in which all participants in the debate randomly propose the objectives, which might be attained, and a hundred eighty nine priorities are coined. These priorities, each one of them regarded simultaneously as being equally important, are realized. The outcome is an absolute clinch of priorities, and not only of social and economic priorities. The excellent examples presented by the gentleman before me are priorities just from one domain, of trying to make the market increasingly flexible, but at the same time providing the assurance of guaranteed employment.

Both in the sphere of the economy and in the social sphere, the aims are contradictory. They consist of a wishful thinking fair. I will subscribe now to what Mr President (K. Rybiński — ed.) has said: most exposés made by Polish prime ministers have consisted of talking not about what they wished to say, but about what people wished to hear... So they responded to certain motions from different groups, proposing what they could do for these groups. It sounds pessimistic to say that one needs to be a non-democratic country to stand up to the competition. Yet, it is not a matter of being a non-democratic country, but that it is necessary to discern the limits of democracy. One needs the capacity, from the perspective of the state, to say NO. It seems to us that the history of the economic miracle of Germany was that the hard working Germans, in a reasonable and organized way, said one day — “let us make a miracle”, and they produced their miracle, because that is just the way of the Germans. In reality the concept of social market economy was not at all generally acclaimed from the very outset, even amongst the Christian Democrats themselves. It should be remembered that after the war it was leftist thought that predominated and that Marxism was fashionable. People who claimed that liberalism offered a good solution were rather regarded as being *passé*, rather than being *en vogue*. Liberalism was accused of having caused the second world war and other bad things. Later, when Konrad Adenauer together with his minister Ludwig Erhard, and with advisers, such as Eucken, Miler Armak, Rusthof, proposed a certain concept, the trade unions threatened with general strikes. They striked, they raised demands, they protested, not to mention the administration of the occupying powers, which were not always in favour of what the Germans did. Germans had the capacity to overcome the difficulties, the ability to say “no” to those, who wanted to get something “already” and “now”. This is what we ought to learn from them, but unfortunately our governments are not able to do that from the very outset, that is to say “no”. This is compatible with what you have said that it is necessary to have the ability to put forward your arguments and to stick to them.

John Paul II used the term “human ecology”... It is a phrase, which brings out the multiplicity of dimensions. Human ecology consists of the fact that if we wish to live, to build the common good, we must remember both about human dignity — which has to do with the social dimension, and welfare, in the midst of which we are to live — that is the economic

dimension, but also about peace, in which all humans should enjoy cohabitation... In Poland social policy is usually regarded as identical with social welfare policy.

When we ask Polish business entrepreneurs to support social initiatives, they ask whether they should give something to poor children or to the sick? Polish business people do not regard the university as an institution worth investing in, or even funding without expecting direct returns, based on the grounds that it generates the improvement of the economic condition of the country. Polish pro-social activity is limited to solving such problems, which are most often associated with charity. In this sense social policy should consist of the skill of pointing at what is in front of us, rather than solving whatever is behind us. Therefore, not just single mothers, but the family model in general. This is what ought to be the main object of social policy.

To conclude — an anecdote. Earlier on, Mr Director (S. Raabe — ed.) and Mr Grabowski have mentioned globality and values. Indeed, the social market economy is based on values, on a very clear canon of values, which could be loosely described as the principles of *fair play*. The market requires *fair play rules*. I must tell you, ladies and gentlemen, referring to the Koreans, who are developing very well and against whom we have lost the race for the EXPO 2012. I have read in the “Dziennik” newspaper an interview with a Korean, who expressed his surprise: “Well, you Poles, you have indeed lost at your own request. It is true that we have breached the gentlemen agreement, we did so, because Malta did the same before us. And once it was breached, it was now necessary to breach it over again, rather than wait and complain that *fair play rules* were not being honoured... So what, if we have listed an exaggerated number of countries in support, and if we have handed out expensive gifts... You call it bribery, but for us it is an expression of gratitude. If you have lost the EXPO 2012, it is just your own fault.”

This example just shows a certain dimension of the global market economy. Is it possible with this concept of social market economy to stand up to global competition? In this sense, the Poles have behaved fairly... Just as the Germans, they took a thorough approach to the exercise, they observed the determined conditions, they did not attempt to outbid others with graft, and the end result was a failure. This problem is bothering me for some days now.

*Maciej Duszczuk**

Let me start with two matters. Firstly, I was shocked by the presentation of Mr President (K. Rybiński — ed.), because I make the effort to read the documents prepared by my colleague Krzysztof Gulda, who is the Director of the Economic Development Department. Indeed, that vision is presented exactly like that, but we know about since several years, but nobody has ever answered the question, which has been put forward here — how to do it? Because we know precisely what is the situation, that we lose in many areas. Nevertheless, determination is lacking, to implement the Lisbon Strategy, to put Poland in a higher gear than it is in now. Following what was said about the EXPO and the EURO, I understood why we were able to win the race for the EURO football games — because we had the skills needed to win with Italy and Russia. But why did we lose with Morocco and Korea, looking at the EXPO 2012? This has now become clear to me.

Concerning the issues of how to do it. The Lisbon Strategy, which we often mention and ridicule, as a utopian plan for building another Japan in Poland, was not quite so hopeless in its assumptions from the year 2000. It has become such through the discussion, described by the previous speaker, because of throwing in additional priorities. It ended up with 189 of them, and a strategic plan with 189 priorities is not any strategic plan any more. If the initial diagnosis were returned to, taking up that Lisbon Strategy, which was drafted in the year 2000 on five or six pages, and if it were implemented with determination until the year 2007 or 2008, we would

*Social Policy Institute – University of Warsaw; Office of the Committee for European Integration.

be living in a completely different place today. My observations from the works, not only at the university, but also from working for the government administration as a person, who writes theses for the decision makers, I must say that my participation in numerous meetings at the European level has led me to formulate the proposition, that today we must urgently find an answer for the people, who are losing out on globalisation, who are the losers in consequence of the reform processes.

More and more people put it as follows: Globalisation is the cause, why I have problems. Enlargement of the European Union has caused that there is less work. Migrations will result in a shortage of carp in the English rivers, etc. All the time we are told that these are serious personality problems for the people, who are not prepared for such rapid changes of that kind. So how can one respond to their needs? Unless we respond to them, no substantial reform will be passed... Every reform can be blocked. If we just observe the events in France, we notice the anticipation of massive strikes. In France there is the intention to somehow undermine the certain social consensus, which has been arrived at there. A consensus, which is of course absurd from our point of view, as it consists of employment for life of the staff in the administration, as well as many privileges of the firms in the public sector. These things, from our point of view, are incompatible. Any attempt to change the existing situation in whatever way, immediately faces huge resistance and strikes. There is as yet no government strong enough to be able to protect itself against this, and to win such a debate. The last government of that kind in Poland, the government of Mr Prime Minister Buzek, had the courage to take up such reforms, to debate on them. It got 3,5% of the votes in the subsequent general election.

Indeed, these bold reforms, which were so very much needed, caused the government to lose. Hence, the lesson for the governments that follow suit, not to infringe so many vested conventions, so as not annoy the people, who would somehow be at loss in consequence of these reforms, and yet they inevitably would have to lose. Unless we find an answer for these people, who will have to lose in outcome of the reforms, who will thus become the reform losers, the losers of globalisation, there will probably be no such long-term reform, which would put us into a different gear looking at the time span until the year 2050, as nobody will have the guts to do it. It seems to me that today we must spend much more money on social

policy than we have done to date. We must spend more, in order to be able to unblock the capacity to implement reforms, to address the problems of the people, who lose out on the reforms, in order to be able to buy their approval for the reform of the economy. Probably otherwise we will fail to do it. It is not a matter of handing out money, but of instruments, which would give these people the sense of security. The Danish system can serve as a benchmark model for us. Talking to the Danish Minister of Labour, I heard about the three factors that decided the success of Denmark: efficiently operating administration — which we do not have, budgetary surplus — we do not have it, confidence of the citizens in those exercising power and vice versa — which we also do not have. Therefore, to claim that Poland can succeed in applying the Danish model is like building castles in the air... We must seek our own social model, although based on the experience of others, but nevertheless our own national one. Polish people, similarly as the citizens of other EU member states, are afraid of losing their jobs, of poverty, worry if they will have enough money to provide decent education for their children. Therefore, they defend themselves against any change, which according to their opinion could threaten their stabilisation. In practice, there is simply no solidarity between the unemployed and the employed, which we can be convinced about by reading the positions presented by most trade unions. That is why today we must find solutions, which will enable somehow to convince people that they will not lose anything as the result of reforms. But this can be done only by building an “active social welfare system”, in which a person, who will even just be at risk of losing her job, will be completely sure that in a short time she will be able to find other employment, and that the period of remaining out of work will be short enough not to expose her to social exclusion and marginalisation.

Recently, I have had the opportunity to become acquainted with two documents on social policy prepared by the European Commission. The first one consisted of the Annex on the vision of European social policy in the 21st century, appended to the review of the single market. A document, which is to show the direction, in which we are to proceed, a very general document, but showing one important thing. At the European level this way of thinking that it is necessary to spend more on social policy already begins to function... The European Commission clearly states that without spending

money on social policy at the European level, we will fail to accelerate economic growth in Europe. Indeed, a very significant correlation exists here, but today we must devote much more money to unblock the capacity for future measures, which will help to improve the indicators, which we have seen on the slides of Mr President (K. Rybiński — ed.).

The second document, perhaps not concerning social policy directly, but concerning migrations, a document, which is an attempt to find a way forward for Europe to act, comprises two proposals of directives, opening the option of migration to Europe for highly qualified persons. These documents really tell us that we must begin to enter into competition with other states to attract highly qualified employees... Among the presented slides I missed one very important one for persons dealing with migrations. It concerns the fact that only 5% of the persons wishing to move to a different country find their way to Europe. The potential of Europe is 40%. So we receive eight times less than we have the capacity to absorb, as far as research and development goes. This is a very bad situation indeed. The directives, which are supposed to open up this inflow for us, do one thing. We have an excellent advantage, which is called the free movement of workers... Today, a person coming to Germany cannot move on to France, because of not being a citizen of the European Union. Only after five years such a person may obtain citizenship, according to the law of the given country. The directive puts it as follows: if you will come to Europe, after two years will be able to be treated like citizens of the Union with regards to economic rights and equally free movement of employees. There is a chance to win with some other countries by such a vision, offering the possibility to go to another state and to continue one's work engagement there, to continue one's professional career. It seems to me that we must approach this today in the context of the economy and social policy, to perceive it also from the perspective of our membership of the European Union. Paradoxically, by the fact that today we are somehow united, we have certain advantages, which were built by the European Union... We must use these advantages to the maximum extent in order to try and win in the same way, just as at the outset of the Lisbon Strategy we meant to win with the United States, as that was its initial goal, and so as to defend ourselves today against the attack of China, India, or the Asian countries, simply to enter into rivalry with them.

*Łukasz Hardt**

Thank you very much for the invitation. Today's discussion is very significant. Indeed, the presentation by Mr President Krzysztof Rybiński is impressive, as it shows that we are at the very bottom of the league of developing countries. Yet, that presentation could be further "enriched" and made even more shocking. It missed any slides concerning the demographic situation of Europe or Poland and the demographic crisis, which in the next few years will certainly hit us. That is one of the key challenges, to which we must respond in the immediate future. On the other hand, listening to the final part of your statement, where you talked about the need to build a strategy and reach out beyond the year 2013, or to look even further beyond the year 2050, I wondered whether the construction of such a strategy is really feasible? It seems to me that man is a being with very limited capacity for prediction, with regards to the ability to estimate the probability of occurrence of certain events in the future. In reality we are not truly aware of the challenges that might confront us in 50 years time from now. If we were to look 50 years back and try to build a strategy for the nineteen-nineties we would not be able to do that, because we would not have taken into account the challenges that were to come.

Two books, which made an impact on my way of thinking and my way of perception of the social and economic system, come to my mind here.

*Economics Faculty – University of Warsaw; Sobieski Institute.

One of these books is Hayek's "Constitution of Liberty", which contains the sentence saying that man is great, when he becomes aware of his limited capacities. This ties in well with a book, which I have read recently: "Understanding the Process of Economic Change", by Douglas North. North, building up a certain historical analysis, considers what determined the ability of different states to enter the sustainable growth path, which sometimes lasts for hundreds of years. North answers this question at the meta-theoretical level, but it seems to me that his answer is very important. According to him, those states, those social and economic systems are the winners, which are most adaptive to new challenges and new opportunities... It seems that the recommendation, which stems from this reading and from the works of other economists active in the current of new institutional economics, boils down to the stipulation, that we should build our own social and economic systems, and also the system of social aid and welfare, in such mode, as to make them highly adaptive to new conditions. We really do not know what is awaiting us in the future, but we can build systems, which are not overregulated and which can easily adapt to new challenges. This is a thesis for discussion on whether we can and should build strategies reaching so far out into the future. This is not to say that we should not reflect on the challenges that await us...

The second theme, which I would like raise, is the following. If we are to build up the public debate on the challenges facing Poland, our region, in the forthcoming years, we must consider a strategy for conducting that debate — "on the strategy building strategy". The answer seems rather simple. As you have said, it consists of EDUCATION. As I teach the students at the Faculty of Economics of Warsaw University, since some time I apply innovative techniques of running the classes... For example, such methods, which do not consist of the *top down* approach to teaching, where I would stand up and lecture them, but rather I try to engage them in discussions. I must admit that in Poland this is very difficult. People are not accustomed to active debate. Young people do not learn this at school. If we wish to build a good strategy, if we wish to build our own good debate, we must return to the issue of education, to assure that young people should be able to conduct discussions, to engage in public life. The next theme, which has emerged, is that of confidence. It seems to me that after October 21, 2007, we have found ourselves at a critical turning point, namely that young people, who remained aloof to the state throughout the period of transition

of the political system, have now vested the state with confidence, yet it is the same state from which they had been running away to foreign lands. It seems to me that we are facing a breakthrough moment, when the political class must stand up to this enormous confidence, it must meet the expectations of the young generation. It is very important for the political authorities to formulate in the nearest future the premises for policy addressed to youth.

Coming back to the presentation (by K. Rybiński — ed.), the next slide, which I would add and which would make it more expressive, would present the allocation of social welfare expenditure of the Polish state by age groups. In Poland this is really dramatic. The overwhelming majority of social welfare expenditure, regardless whether they are adequately or inadequately addressed, reaches the elderly people. It is a pity that Madam Minister Joanna Kluzik-Rostkowska, who was in charge of family policy in the Prime Minister Kaczyński's government, is not with us in this room. In the debate, in which I have had the pleasure to participate, I raised the thesis that actually the condition for conducting an effective family policy is a change in the proportions of allocation of welfare expenditure between the elderly and the younger people, so as to channel more public funds to the families.

Returning to the question raised in the title of this seminar, it seems to me that this theme, which was introduced into public debate some 2–3 years ago, trying to build up the public debate along the lines of the juxtaposition between solidarity and liberalism in Poland, is really a great misfortune that happened to us in recent years. There will be no free market economy, no social market economy, if there will be no freedom, if there will be no solidarity. Only free people can practice solidarity. “There is no freedom without solidarity” is a very well known saying, yet it carries fundamental meaning. Referring to the statements of Mr Michał Boni and Mr Piotr Dardziński, the dilemma “how to reconcile economic and social challenges” is indeed *passé* as a question. Firstly, it seems that one ought to reconcile economic and social challenges FOR SOME PURPOSE. We need to have some goals. On the one hand, the increase of competitiveness, investment in knowledge and innovation. On the other hand, it is a very important foundation, often forgotten in the European Union, in the European states, or in public debate in Europe, that there can be no social market economy

without it being based on values. The real foundation of social market economy consists of values, its very essence lies in the notion of human dignity, and the regulatory measures of the state should serve the purpose of defending that dignity. This should constitute the foundation, which we often tend to forget. During the statement of Mr Director of the Konrad Adenauer Foundation I was wondering whether the values, on which the social market economy was built 40 years ago, were still valid today? It seems that some of these values have suffered depreciation. If we ask young people from the European Union, how they understand the meaning of human dignity, how they perceive mankind, currently almost nobody is able answer. Under such conditions, how are we to build the social market economy? And does the social market economy model built on values of 40 years ago still have any chance of being sustained in this global society?

*Aleksandra Wiktorow**

In the 21st century economic progress is linked to social development. Expenditure on social needs cannot be deferred for a later time — until such time, when a higher level of economic development will be reached. It seems that the opposite may be true — if sufficient outlays will not be devoted to the social sphere, economic development in the future will not be as fast as expected. The notion of outlays for the social sphere are often understood as the expenditure to provide benefits paid out in money, especially social insurance — old age and disability pensions, as well as other kinds of benefits for the employed. This is a very important element of social policy, but not the only one, although in the structure of spending it usually occupies the first place. For social development, especially that which is to generate returns in the future, very important expenditures consist of spending on child care, education, and later on also on science. Assistance in the upbringing of children, does not only consist of possible allowances for parents on child care leave or family allowances. It consists, above all, of nurseries and especially kindergartens, taking care of the children of working parents, and when a family is unfit to look after the children adequately, regardless of whether the parents work or not. Only day care at a possibly early age for children from pathological families, disabled families or families short of sufficient income, both in urban and rural areas, will serve the needs of providing equal opportunities. Trying to

* Gdańsk Institute for Market Economics.

level out the chances only as late as at the gymnasium or for teenagers is a misunderstanding, as at this late stage the ability to provide effective help is often already compromised.

The second important element of social development is health. Success may be achieved by an educated and healthy society, which develops evenly, promptly adopting new technical solutions and participating in their creation. Funds for the upbringing of children, education and health care, contribute to reduce future social stratification and to diminish the number of people suffering from exclusion. Such balancing of expenditures for different purposes: broadly conceived social policy and economic development, is the essence of social market economy.

An example of such reasoning is provided by the Scandinavian countries, where traditionally spending on social welfare is high, including especially spending on child care and education. Their societies belong to the best educated, social stratification is the least pronounced there, their birth rates increase, and in recent years also their economic growth is increasingly fast, in comparison with other European countries. Detailed analysis of the economic crisis in Sweden in the early nineteen-nineties shows that its original cause consisted of a crisis on the mortgage loans market, and not, as is often suggested, just excessive social welfare spending. This is not to say that the spending directions did not begin to be monitored there, to be modified according to changing conditions, reducing the outlays on some spheres, and increasing them elsewhere. But these expenditures were not regarded as the decisive cause of the slow down of economic development. Now it is clear that the social expenditures of that time have contributed to the currently faster growth of their economy.

Available indicators show that in some spheres Europe develops at a slower pace than countries in other regions of the world. Also the countries of Central and Eastern Europe are not developing at the pace we would wish. It should be remembered, however, that we live in this particular world and we should make comparisons with countries having a similar geographic location, a similar level of development and comparable traditions. Few people are aware that only 15% of the world population has access to social security. It is hard to imagine Europe and North America today without the pension system or other elements of social welfare policy. Most countries,

where such social policy instruments do not exist, or exist only in rudimentary form, would like to introduce them as a development enhancing factor. The point is not to simply copy the solutions of the developed nations. This cannot be done, if only because there are not two countries with the same social security system, as these were developed long ago, under the specific conditions of each particular country. The point is for the Third World countries also to have the chance of social development.

We ought to be glad that the fast developing countries of distant Asia attach great importance to education and the development of science, but we must not forget about the conditions of work, pay and existence, of overwhelming part of society in these countries. This cannot be justified by global competition, as workers are exploited there not only by their native business entrepreneurs, but also by corporations coming from highly developed countries. Expenditures directly serving the needs of development — on education and scientific research — are extremely important, but they cannot completely replace social welfare spending connected with the improvement of living conditions. It may be claimed that in Europe it is perhaps the direct spending on existential needs that predominates in social expenditure, limiting the outlays for the development of scientific research, and therefore spending linked with innovativeness of the economy, whereas in South-East Asia the opposite is true — current existential needs are limited owing to high development enhancing expenditures. Changes in the proportions of such spending seem to be easier to introduce in Asia than in Europe. Over there they will consist of the eventual possibility of developing the social security system, whereas in Europe they would sometimes have to consist of taking away of some social welfare entitlements, which always meets with strong social resistance.

Looking at Europe, which is changing after all, owing to rapid enlargement of the European Union, it needs to be said that there is no constructive alternative to the social market economy, conceived as an attempt to balance social and economic development. The need to take into account and balance social objectives, or even more narrow social care needs, is reinforced in Europe by the opening of borders, the growth of the scale of migrations, especially in connection with work, and the income differentiation of the societies of the expanding Union, which is more pronounced than what

existed in the Union of 15 member states. Uniformisation of social policy in the framework of Europe is not feasible. Just taking the example of social insurance, the share of which in public expenditure is very large, it has to be admitted that particular countries differ very much from one another in terms of the scope of benefits, the conditions entitling to their use, the value of the benefits, and even the financing methods. Social security contributions do not exist everywhere in Europe. In some cases pensions, disability or social allowances are financed directly from the state budget. In some countries the benefits consist of lump sum payments and are equal for all, in other countries they are set in a determined proportion to individual wages, in still other countries (mainly in Central and Eastern Europe, as these countries are most advanced in reforming the pension systems) they depend on the amount of capital accumulated from contributions during the period of employment. It is not possible to impose on all the countries to introduce the same value of the contributions or the same benefits, even more so, as in particular countries there are different demographic conditions, the level of wages differs, etc...

Therefore, in the social security domain only the coordination of laws is in force, protecting migrant employees from the loss of benefits earned in successive countries, in which they have worked, in order to enable them to receive their pensions. It is presently possible to issue recommendations concerning the equalisation of the retirement age of women and men, increasing that age limit, providing for the propagation of the use of parental leave by men, or to develop common standards of deciding on the disability to work. In other spheres the uniformisation of the social welfare laws is a very distant prospect, as it would excessively interfere with the whole economic systems of particular countries.

In Poland, in various circles, one can hear about the necessity to cut social spending, especially with regard to social security payments, mainly consisting of old age and disability pensions. Voices calling for cuts in spending on health care, education, higher education or science are rather not heard of. In these areas always only the shortage of funds is pointed out, and in the case of outlays for scientific research, our backwardness in comparison to other countries, not only European ones. Changes in the structure of public expenditure and the allocation of their greater part for development purposes are necessary... One cannot count on any major reduction

of spending on social security, with the exception of agriculture. In recent years the number of disability pensions has radically gone down, thanks to the introduction of new standards of awarding them. The number of persons receiving such pensions has gone down by 42% — from 2,644 thousand persons in 1996 to 1,556 thousand persons in 2006. Over the same period, the ratio of expenditure on pensions in relation to the GDP has fallen from 3.5% to 1.5%. In 1996, first time disability pensions were granted to 151,500 persons, whereas in 2006 — only to 50,300 persons. It seems that the situation has already stabilised here and that there will not be any further major changes, although it should be admitted, that the total number of disability pensions will be declining each year, as after reaching the retirement age the beneficiaries are transferred to the old age pension category. This has to do with the fact that in the new pension system the condition for the entitlement to the old age pension is just the retirement age (whereas in the old system the additional condition was to document a determined number of years of work).

In longer term perspective it will be possible to reduce the number of people in early retirement, which may generate certain savings in expenditure on pensions financed from the social security system, but at the same time costs will be incurred to finance interim pensions. The volume of savings cannot be estimated precisely today, as the subjective coverage of such interim pensions is as yet unknown. Poland has a very elaborate system of early retirement pensions for women and for persons working in various professions and positions. At the same time, it is allowed to combine the early retirement pension with employment on very beneficial conditions and increase of the pension for each additional year of work. For working pensioners the pension is sometimes an addition to the obtained income from employment, which for many of them do not differ at all from what they received prior to retirement. This may be an incentive for early retirement.

Until 1968 in Poland, as in any other country, the retirement pension was called the “old age pension”. After all it is an allowance foreseen to provide for the old age period in life. At that time the retirement age in Poland was 60 years for women and 65 years for men, and only a very narrow group of workers was entitled to earlier retirement from employment. Still in 1978 the average age of actual retirement was 61 years for women and 64.5 years for men. It seems that once the name term “emerytura” (from the Latin:

emeritus — meritorious, well-earned) came to be used, the social awareness of the link between the pension and old age began to wane, gradually being replaced by the conviction that it was a benefit deserved in return for the merits of past service. It is hard for a 40-year old woman or a hardly older man, who according to the law may retire from professional occupation, to admit to drawing an old age pension, as it is hard to admit to being elderly, whereas the word “*emerytura*” sounds neutral, and even dignified. Sometimes a seemingly innocent modification of a name may have far reaching consequences. This literal meaning of “meritorious”, “well-earned”, and not the link with old age, is referred to by the trade unions in their negotiations with the government, as they seek to maintain the privileges of early retirement pensions. Regardless of the terminology, however, it is necessary in Poland to seek to increase the age of retirement from work activity. Compared with other countries, the percentage of working people over the age of 50 years is very small.

The average life expectancy increases also in Poland and we cannot afford, as one of very few countries in the developed part of the world, the period of enjoyment of pension benefits to be increasingly long. The modification of the retirement age is necessary and possible. The funds saved in this way could be applied to development purposes, if only those connected with education and science. In this way we come to the intergenerational agreement, which is sometimes used as a way of describing the pay-as-you-go method of financing pensions. Young people pay the contributions — older people receive the pensions. Perhaps indeed an intergenerational deal could be struck here: somewhat higher retirement age for us — better development prospects for the grandchildren.

Transcript of the Discussion

Zofia Czepulis-Rutkowska¹ (Labour and Social Welfare Institute): In the discussions on social welfare expenditure in Poland, the disproportionately high spending on benefits for elderly people is often pointed out. These high expenses are mainly driven by retirement and disability pensions (for persons in pre-retirement age)... Spending on retirement pensions is a multiple of the value of individual benefits and the number benefits paid out. It is believed that the value of the individual pension is relatively high in relation to wages, but taking into account the costs of living, one cannot stipulate any reduction of these benefits.

It is possible and even necessary, however, to reduce the high number of beneficiaries. In order to do that, first of all one ought to try and increase the effective retirement age, which is exceptionally low in Poland. There are many factors behind the early retirement of people in advanced age from the labour market. So called *push factors*, which drive people out of work, and *pull factors*, which attract people away from the labour market, are distinguished. The *push factors* mainly consist of negative attitudes of employers towards more aged employees and the reluctance of aged employees to take on new challenges at the workplace, especially those connected with the application of new technologies.

¹ Comments transmitted by mail.

The *pull factors* include: motivation to take advantage of time for leisure, sufficient magnitude of the pension income, and also the need to fulfil family duties. The last factor — family commitments, will act as a *pull factor* causing earlier retirement from the labour market depending on the functioning of other social welfare institutions. As already mentioned, among other things, the motivation for earlier retirement from the labour market in Poland (similarly as in Southern European countries) results from the need to provide care for small children or elderly, disabled family members. Persons who are able to retire according to the law, but are still physically and mentally fit, often provide care over other family members, although theoretically they would still be able to participate in the labour market.

It seems that one of the measures contributing to defer retirement could consist of developing the institutions providing child care and care of the elderly. The accessibility of such institutions could reduce the pressure on more aged persons in the families to discontinue their formal professional occupation and to take up work in the informal capacity of a baby-sitter.

This solution would be much more transparent, would allow the appropriate interpretation of social welfare expenditure. Actually, some of the spending addressed to elderly people in the form of pension benefits, essentially fulfils quite different functions. In this context one can point at the example of the Scandinavian countries, which all feature a high rate of employment of more aged persons.

This state of affairs is certainly the outcome of numerous factors, but it seems that one of them consists indeed of the availability of institutions providing care both for small children and for handicapped and elderly people. There is no need, therefore, for fit persons in older age to take on family duties concerned with providing care for others. I believe that this important pull factor extracting older persons from the labour market does not play a role to speak of in the Scandinavian countries. However, it is likely that also in Poland the development of institutional care establishments would result in similar positive consequences.

Krzysztof Gulda (Economic Development Department, Ministry of the Economy). Social policy is not within my remit and I do not usurp the right to pronounce any judgements on this topic. The mindset and the observations presented by Mr President Rybiński are close to mine, and on

this basis I would like to voice two comments. From the point of view of civil servant, who is placed on the highest rung of the administrative hierarchy, just below the political level, the sense of this discussion is limited to the answer to the following question: How whatever results or might result from all these discussions among experts, in the conceptual domain, might be transferred to actual behaviour, not just government programmes or strategies, but real actions, which must be taken up by politicians. My experiences in this regard are not very encouraging. On the one hand, a slight note of optimism is such, that contrary to what Mr President has indicated, in the public administration, in non-governmental institutions and academic centres, the intellectual and expert resources exist, allowing to undertake the discussion and to work out a vision and strategy. The only difficulty is that we are stuck in the situation, which I describe as “having too much to die, but not enough to live”, namely that we have the possibility to act and the capacity to create certain documents, which are never forged into real actions. A good example is provided by the debate concerning the issues of competitiveness of the economy, of innovation. Documents, analytical studies and strategies may be created in this regard... But (at least to date), that discussion has not even become a point in any electoral campaign.

The problem of modernity of the state, of modernity of the economy, investing in knowledge or development in Poland of a knowledge based economy, is not the object of political debate, but the topic of a debate among experts. For me the question is not how to create a vision, how to reconcile economic policy with social policy, but how the outcome of such reconciliation at the expert level can be transformed into the possibility of real action and of being taken up as part of the government programme, but not just written down on paper, but also implemented as a real programme. For me this is a fundamental question.

The reflection, which comes to my mind after having listened to the interesting statements of the panellists, is that perhaps the presentation has missed out the one slide concerning the quest for the correlation between the rate of growth and the social model. The bold stipulation raised by Mr President is such, that it is democracy that blocks development. Perhaps not democracy, but the chosen social model and the chosen way of implementing the social policy? It seems that all those, who are now the leaders of growth, function in a different cultural and social reality than the countries

of the European Union or even the United States, which differ from Europe, and perhaps the huge gap between the United States and Europe results from that. Certainly the Union and the United States differ from the fast developing countries of Asia or China. Thank you.

Piotr Serafin (Economic and Social Studies Department, Office of the Committee for European Integration). I will ask a question as a private person. I work at the Office of the Committee for European Integration. I must admit that I am even scared by the question, which I wish to ask. It has emerged from the clash of the statements of the panellists with the presentation by Mr President Rybiński, which transpired with fascination by the effectiveness of the Chinese model of development. If we assume that global competition in the economic dimension consists to a certain degree of the competition of value systems, and the panellists have referred to our value system, not only as the European one, but as the value model of our civilization, in which the central point consists of the human being and the dignity of the human person, I have the following question to Mr President: According to his view, does the central point of the Chinese value model also consist of man and the dignity of the human person? My second question is: If to take up the competition with China should imply that we undermine this very foundation of our civilization, is it worth undertaking it?

Aniela Dylus (Cardinal Stefan Wyszyński Institute) ...I wish to speak about the model. The main title (of the conference — ed.) is: “The social market economy”. I address my question mainly to Mr Stephan Raabe. Is it not so, that the social market economy is a special magic incantation today, that is essentially over now, that it was an appropriate model for the industrial age? Taking into account the present day trends and the age of globalization, the decline of the nation state, we must remember that it now disposes of less resources than it used to have in the past, it is tax starved by multinational corporations, according to Peter Drucker. If we take into account that the role of large business enterprises is declining, the role of trade unions in large companies, the role of participation, do we not need to seek some other model, which would reconcile the economic and social challenges? It seems to me that this model does not fit with these challenges. Also in Europe some of these tasks are taken over by the European Union as part of its policy. The competition system of the European Union has been an

important element of that market order. This is not the role of the state any longer. Thank you...

Łukasz Hardt. I wanted to answer our Moderator. After my first statement the question was raised, where these greater social expenditures should be channelled to. Of course, they should be applied to unblock, to gain the consent of the persons who were losing out owing to the reforms, so as to enable these reforms to be realized. In no case is it a matter of providing social aid. It is not the point to buy these people with hand outs... The example of French youth, who yet another time today is demolishing the suburbs of Paris, is obvious. Social welfare benefits alone do not produce the effect, which I would like to achieve... The intention is to enable these people to find work more promptly, to have the certainty that they are not left alone. Today, if we look at the expenditure from the budget of the European Union, the answer to globalization for the benefit of these losers consists of greater spending on research and development. The question remains, where should these greater outlays on research and development be invested? This was very clearly visible in the statement of Mr President. An increase of expenditure in Poland would cause — on that graph — a shift on the horizontal line, but not on the vertical one, as the additional money would probably be wasted. The point is that we should spend money on those measures, which will bring us tangible effects.

On the one hand security... For a person to be able to say: “Probably I will manage to find another job, because there is a state system and a system of the employers, who will be able to help me in some way to find my place on the labour market again.” If this will be the case, the acceptance of these reforms, which will have an impact on greater flexibility of the labour market, will be greater. So today, in the case of the EU, which is blamed today for many “plagues”, for certain difficult situations of certain people, the answer is: research and development. These people do not accept this and they show it by way of million-strong demonstrations in Brussels. It is necessary to find something else for them, greater security, and above all greater active security, which will enable them to find their place and not to protest in such manner, that the politicians will be scared of reforms and will not implement them.

Michał Boni. Let me come back to the relationship between younger and older people, because this is very important. If we accept the concept of

solidarity across generations, it must also imply some phase, before specific decision will be made, for presenting different arguments. I agree with what Mr Łukasz Hardt has said, and I am aware that this needs to be thoroughly analysed. I would prefer to improve access to institutional child care in Poland, and to improve the indicators, which are horrendously low in comparison with the EU, rather than to assume that 52-year old women have to retire in order to take care of their grandchildren. For me the answer is clear, this has to be done first. For public opinion, for the young generation, it will thus become clear that this is exactly what we are doing.

With regards to older people, there are two dimensions. First, the people between the age of 50 and 60 years (by presupposition), who have chosen the strategy of adaptation. Three and a half million people in this age group are passive. One and a half million are on disability pensions, one million is on early retirement pension, half a million have pre-retirement benefits. About 40% of these people participate in occupations pertaining to the broadly conceived “shadow economy”. They have chosen the model of individual industriousness, afraid of losing their jobs, they decided that they prefer to have “some” income, to survive “somehow”. This is deadly from the point of view of the future retirement pension, and also from the point of view of the employment rate in Poland. One needs to be aware that in the context of this solidarity across the generations we are dealing with two social phenomena. They consist of concerns of young persons, especially women, that they will not make any professional career, at the time when they would rather prefer to dedicate themselves to family functions. And also the anxieties of the more aged: “I am older, so they are pushing me out of the labour market.” If something like “anxiety management” can be transferred to the domain of social policy, what should be done with this phenomenon? What answer can be found both for the young and for those in more advanced age? This is also a matter of investment in the education of these older people. The Finns have done that in the nineteen-nineties, radically improving the employment rate of the group above the age of 50 years. The second group consists of those who have lost and continue to lose. I would also consider one more thing. In the shadow of this transformation model we use the term “reform”, every time vesting it with the imprint of suffering, threat, being scary.

Yet, we need to seek to show that we get something from change, but that they also get something out of it. If we are to think that the rural inhabitants are to participate in the health insurance system, we need to be able to demonstrate how the accessibility of the health care system will improve for that community. It cannot be done otherwise. One cannot say: “Now you have to pay, but how the health care system will work is as yet unknown.” I believe that thinking about these reforms in “win-win” categories is very important.

The last thing, which Mr President has mentioned, is that Poland in 1989 had something that for a part of its society was an important civilisation building project. This was the transition. Later on this project came to consist of EU accession, later still, in a certain vacuum, the civilisation project called the “Fourth Republic” arose — I present here my personal opinion about this subject. I believe it is necessary to find a formula for finding the civilization project that would lead Poland and the Polish people in a direction, which will enable us to compete, to improve the quality of life. In the contemporary world the process of individualisation, which might imply solitude, but also empowerment, if values are not confused and lost, but if one persists in thinking about man, in this sense this civilisation process with its hard and soft aspects, could be an organising factor for some part of society... If adequately fuelled by energy and energy consuming leading groups will share such a vision, we will be able to think of moving on to specific matters, for which we do not have the time.

Piotr Dardziński. Just a brief response ad vocem to Mr Boni. I have been presented here as a conservative, but this is not quite true. I will now speak more with a liberal twist. I usually get a bit anxious when I hear phrases like “institutional systems increasing accessibility”, etc. It seems to me that this very non-liberal language. Liberalism has been very often criticised and it is criticised from John Paul II point of view. For ascribing subjectivity to what should not be made subjective. This implies that the individual usually does not allow himself to be made a subject. According to the papal concept, the subject consists of the family, and this provided the basis for social market economy. It shifts responsibility. I would not like the state to be the decision maker as whether a 52-year old woman is to amuse her grandchildren or to function on the labour market. The goal is the same, but we could argue about the instruments. This is a matter of language.

Krzysztof Rybiński. If I had known that I would have more time than originally planned, I would have added a couple of slides, in fact I have some of them with me. Especially those concerning migrations, as we conduct important studies on migrations at the National Bank of Poland. As a country we have an incredible capacity for generating strategies. At the occasion of the drafting of the national development strategy, Minister Kwieciński has summed them all up to find that four hundred of them existed at the time, including 200 active ones. Let us close the process of destructive creation and focus on strategy. My next point: I was moved by the question raised by Mr Piotr Serafin, whether we must discard values: of humanity, of human dignity. We get emotionally moved by the issues of child work, etc., but if we look at the Millennium Goals, the only region where radical progress in their implementation is actually the case in the domain of combating poverty is Asia. Thanks to intensive growth they have managed to get away from it. One should not forget that. It is the only region, which actually realizes the Millennium Goals, others have no chance whatsoever. Over there, man conceived in that way gains a lot on what is going on there. I believe that it is necessary and possible to implement a strategy reaching out to the year 2050. Strategy implementation does not consist of predicting everything that will happen. I can say with a high degree of probability that we are wasting money on motorways, because in 20–30 years time we will invent a method of displacement over distances without driving on motorways. In the meantime we will cover the country with asphalt lanes completely unnecessarily. Of course, I do not propose not to build the motorways, because I do not know whether in 20–30 years this will surely happen. Such are our dilemmas. However, the development of strategy consists of taking the trends, about which we know that they will exist — demography has appeared here, assuming their subsistence and reacting to them, whereas in other areas it is necessary to try to anticipate what capacities we will need to have in order to be able to react flexibly to the events. What does a large incumbent telecommunications firm do when a competitor enters the market? It throws away all the existing business plans, a crisis management group is convened to react. The firm builds up its capacity to react and this is part of the respective strategy. I believe it is possible and necessary, reasoning in these categories, to build such a strategy. I believe it is necessary to be able to call things by their proper names,

because failure to do so leads to absurd decisions. Studies exist, which confirm that in the modern economy certain categories of remuneration belong to the domain of investments, not of operating costs. For example, I believe that Poland is currently rapidly losing the opportunity to become a country able to provide medical services to the ageing Europe, because we are incapable of labelling the pay of doctors as investment in that sector. Because we insist that it is a cost. This is nonsense. This is investment in the development capacity of the Polish economy, which should be a centre of exports of medical services on a pan-European or even global scale; yet Poland is just losing this chance. Nevertheless there is no determinism in development. We have made many mistakes and we can still promptly correct them.

Answering the question of our Moderator: How to do it? I have shown on one of the slides that there are several steps that need to be made. A strategy needs to be developed, it is necessary to understand who has succeeded and why, and also, among other things, to gather the experiences of global corporations. This can be done.

Finally, there is one area, which we have not discussed: communication. We communicate with each other and with the general public nightmarishly. An exposé is a classical example of public communication. If you wish to see how to communicate to society the vision of development in a model way, just look up the website of Singapore: www.iN2015.sg. That is an Innovative Nation web-page, showing how the government of Singapore communicates to the population what it intends to achieve, how it can be done in a modern and very clear way. We are a country, which is able to muddle up and confuse everything, we lack the skills of communicating clearly.

Especially if we wish to maintain the drive, we must be able to communicate what we wish to do, in a way which will be understood. Unfortunately, we do not possess this skill... In spite of what I have said, I am optimistic. I believe that we are an incredibly creative nation, which is reflected in many statistics. It is just necessary to create the right incentives, to mobilise this. I do hope that in the new vision mentioned by Mr Michał Boni these incentives will be provided, causing the private sector to react in such manner, as to eliminate all the backlogs that I have presented to you as a matter of just a few years.

Stephan Raabe. Referring to the statement by Madam Professor Dylus, I believe that the social market economy is actually a very up to date concept. Globalisation and economics are not natural forces, after all. In the concept of the market economy, which I have sketched, a certain policy priority is the point. The point is that states, and also a community of countries, create a certain framework for economic development. The point is to recognise the primacy of politics with due respect for the independence of the economic sphere. When we talk about the social market economy, we do not have in mind the welfare state, which appropriates many areas. Also in Germany we have this problem, so we need reform, adaptation, adjustment.

The relationship between democracy and social market economy is very interesting. Democracy does not imply, after all, that we will achieve affluence and economic freedom. Affluence does not necessarily have to be connected with democracy. In Germany we first had the state of the rule of law, and only afterwards came the welfare state, whereas democracy emerged later... This is of crucial significance if we talk about development issues concerning Africa, Asia or China. You have raised the issue of values providing the basis for the discussion on the economy. Mr Piotr Dardziński from the Centrum Myśli Jana Pawła II was present here, and I would like to refer to certain theme concerning the pope. In his encyclical from the year 1991 he strongly stigmatised liberalism and capitalism. In the centre of his reflection he placed man and individual responsibility. So certain ethics of entrepreneurship emerge from that encyclical. Earlier on, in turn, he wrote in his encyclicals about work ethics, and also about the ethics of family life. All these concepts were combined in the concept of human ecology. I have a certain proposal now. Perhaps the Gdańsk Institute for Market Economics could initiate a certain working group, comprising representatives of Poland, France and Germany. Perhaps in such a circle we could reflect on how in our times the humanistic concept of human ecology could appear. This fits in with the concept put forward by Mr President Rybiński, who talked about the release of human intellectual potential, and the Konrad Adenauer Foundation would be keen to support such an initiative... But work and reflection is the part that belongs to you.

Krzysztof Bień (Gazeta Prawna). To wind up, I would like to thank everyone also for not claiming that the media are to blame for everything,

as one can always say that it is the journalists that are to blame for the lack of communication in society. The theme of the press appeared in the statements of Mr Michał Boni and Ms Aleksandra Wiktorow... It is true that it is very significant what message is transmitted through the media, what kind of knowledge and experience is communicated to society. To be self-critical, indeed the situation in this regard is becoming worse and worse. If we would invite the authors of the "Contact Lens" programme to this meeting, they would probably not draw any inspiration from it, as there was a lot of reflections here and very valuable and interesting comments on the future and the creation of social policy, but unfortunately this is not attractive for the mass media. So we have a certain problem here, of how to communicate this, how to try to reach the public with this knowledge. Let us hope that democracy, in which I believe, is able to solve many issues and is capable of finding the solution concerning the role that the media ought to play. Thank you very much for the opportunity to take part in the discussion, and I wish us all more opportunities for such discussions.

