

Economic Policy Challenges for the 'Social Market Economy' in a Globalized World: Old wine in new skins?

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Social Market Economy: A Preliminary Definition (Handbook of Social Market Economy)

“...is characterized by the specific feature of private property and distinct property rights, federal structure, competition (law), free price formation and price stability, social security systems (public unemployment~, pension and health insurance) and basically freedom of labor, capital and services”.

My paper focused on the recent developments in financial globalization and the challenges of the Social Market Economy:

Key Questions:

1. What is known about the relationship between financial and economic globalization?
 2. What are the real and potential challenges regarding the “Social Market Economy” model?
- We develop some extensions: In particular,
- A.) Including international aspects
 - B.) Threefold sustainability, including economical, ecological and demographical

Outline



1. Introduction

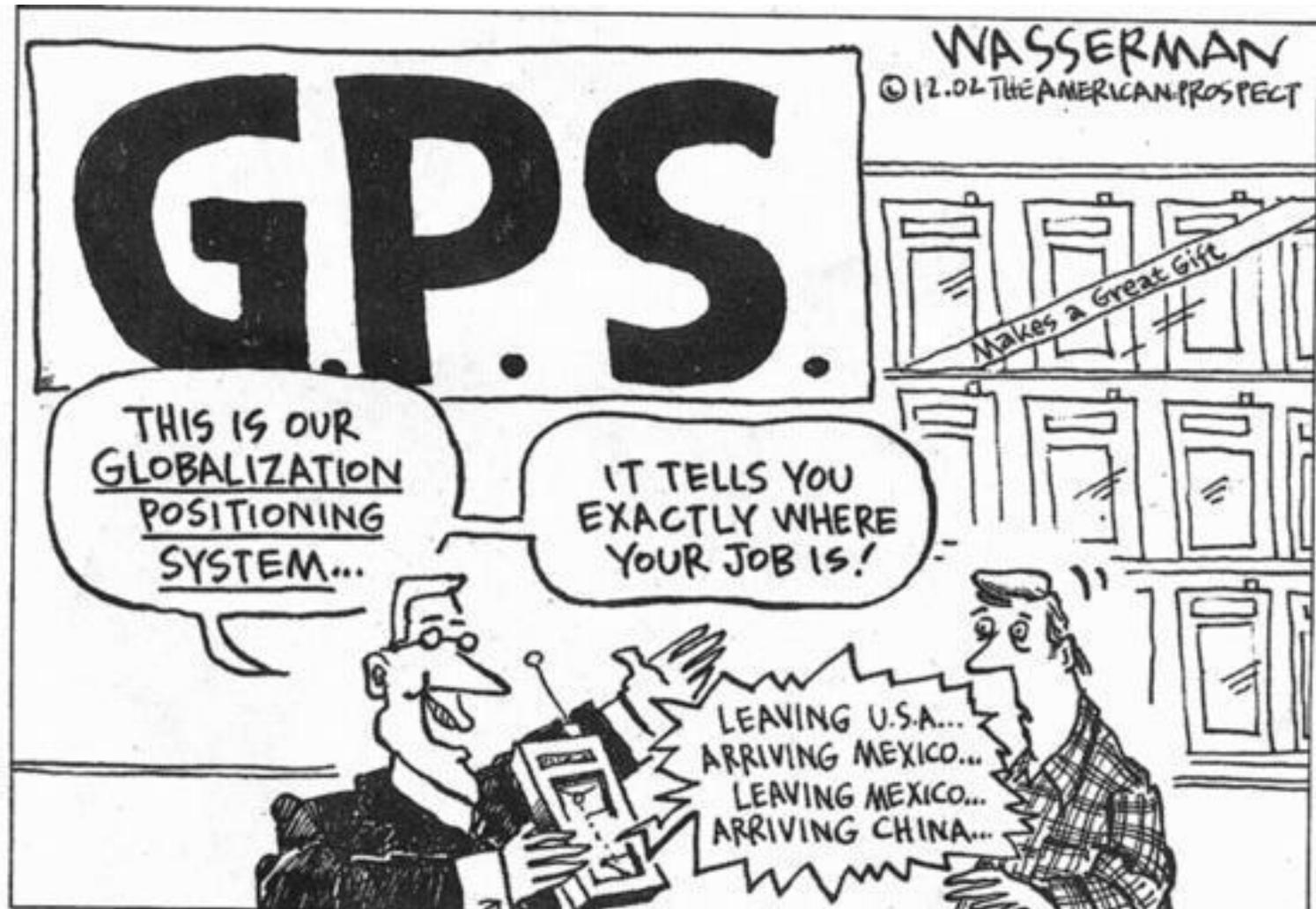
2. Experience of Globalization from a Historical Perspective

3. Financial Globalization and Financial Stability

4. Policy Challenge: Income Inequality

5. Policy Conclusions

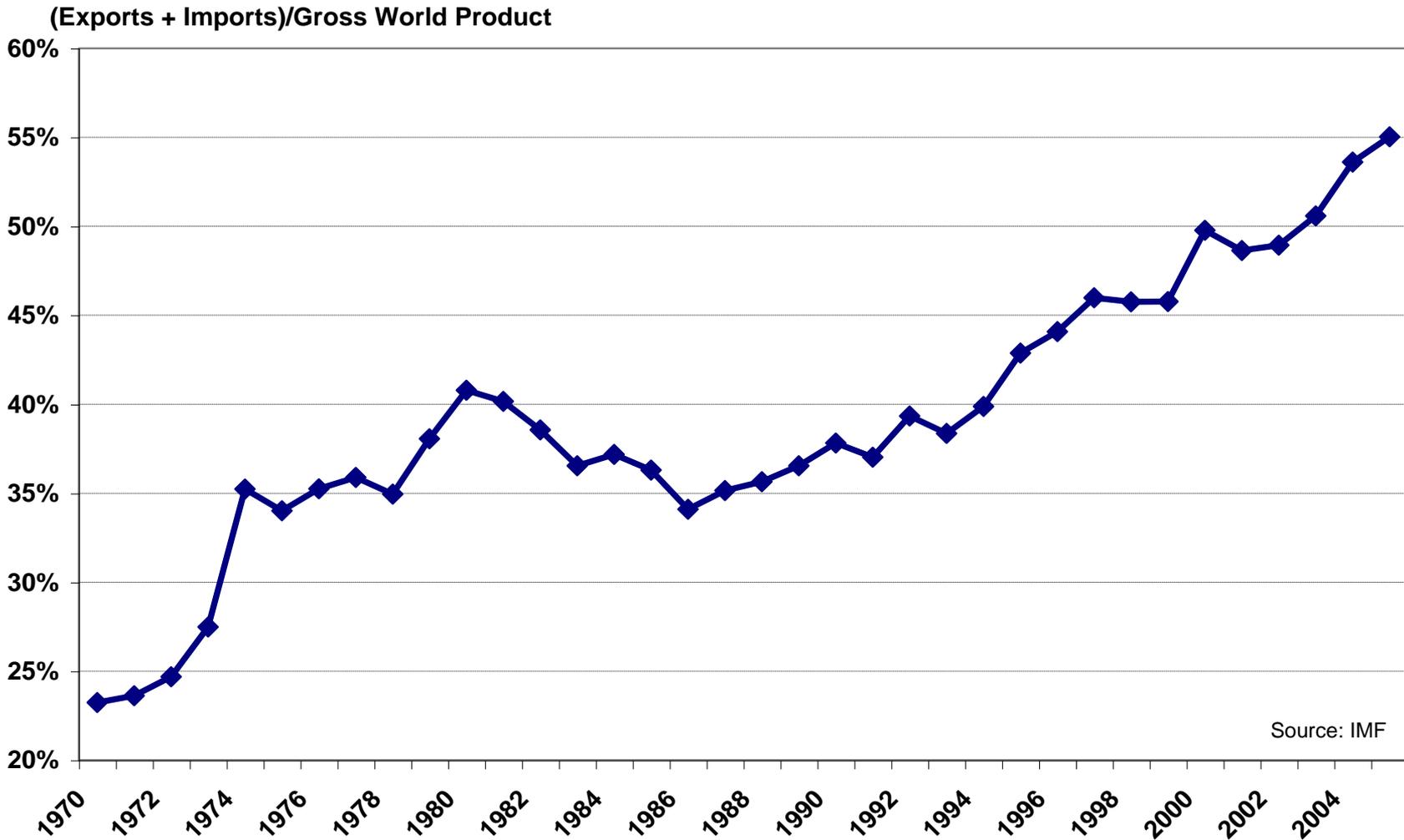
What is Globalization?



Globalization: A Preliminary Definition

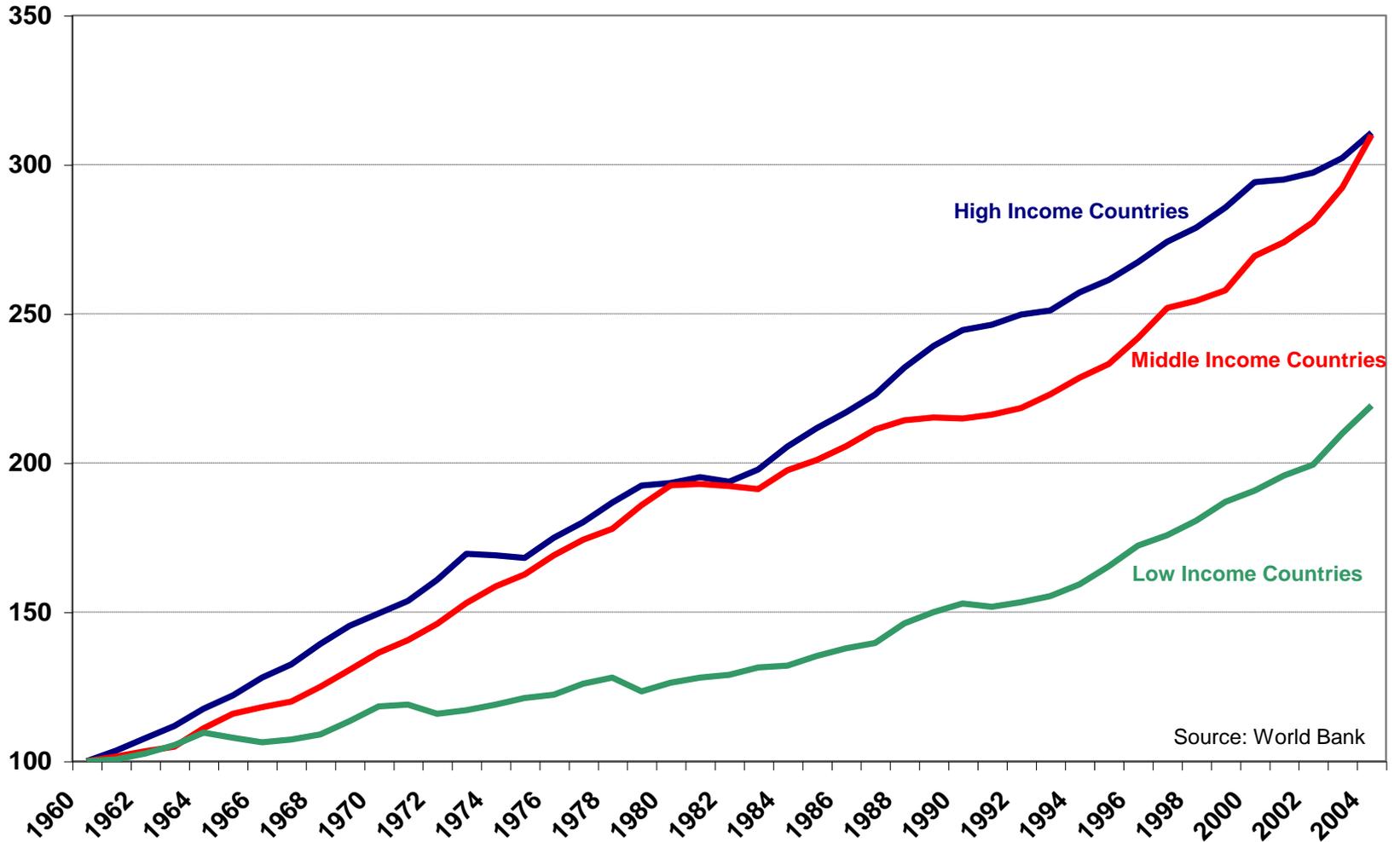
“an unprecedented compression of time and space reflected in the tremendous intensification of social, political, economic, and cultural interconnections and interdependencies on a global scale.”

World Trade on the Rise



GDP per Capita

Index 1960=100



Source: World Bank

1. The growing interactions of the real and financial economy – is one of the main features of trade and financial globalization
 2. However, globalization limits the domestic effectiveness of national policy decisions and thus the positive implications of government decisions in the ‘Social Market Economy’ are not realized
- **Potential benefits of the ‘SME’:** Illustrated by the historical growth performance after WWII and the current employment policy free from increasing unemployment rates despite the recession

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Historical Perspektive

- It is instructive to start and compare the post-1950 period of globalization with the previous phase of strong globalization that occurred in the late 19th to early 20th century
- The share of exports in world output reached a peak in 1913 that was not surpassed in 1970
- Growth in trade occurred partly as a result of reduced tariffs, but more importantly due to sharply falling transaction and transport costs and the technological process in this time period

Years	Ocean Freight	Cost of a 3-minute Telephone Call in US \$ (New York to London)
1920	100,00	
1930	65,00	
1940	67,00	
1950	38,00	
1960	28,00	60,42
1970	29,00	41,61
1980	25,00	6,32
1990	30,00	4,37
2000		0,40

Source: Baldwin and Martin (1999)

Historical Perspektive

- The late 19th century to the early 20th century period of globalization came to an immediate end with the outbreak of World War I.
- Additionally, the unsuccessful attempt to revive the gold standard, and the onset of the great depression nearly stopped globalization.
- Governments mistakenly thought that they could protect their citizens from an economic downturn abroad by raising tariffs and restricting imports.
- In fact, this just worsened the global depression and led to dramatic decline in trade, plunging output, and pervasive unemployment.

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3. Financial Globalization and Financial Stability

- Financial globalization is just one dimension of the complex process of globalization
- Driving forces of this process are technological advances in transmission of information, the decreasing cost of communication and the quickening pace of financial innovations – names as ABS CDO, MBS CDO, CDS

→ Problem of Diversification and systemic risk

3. Financial Globalization and Financial Stability

- Developments lead to a gradual shift from the government-dominated system to a market-dominated system
→ a key building block of the Social Market Economy is gone!
- Financial openness has clear benefits: Transfer of technology, financing, stability, improved diversification of domestic risks and lower moral hazard (Litan 2001; Mishkin, 2001)

3. Financial Globalization and Financial Stability

- Moreover, the evidence is strong that openness in international goods trade is a key ingredient of more rapid growth and world wealth (Srinivasan and Bhagwati, 1999; Lindert and Williamson, 2001).

Policy responses: How to preserve financial stability?

1. Definitive lack of institution-building in finance
2. Lack in control and no appropriate regulation for new financial innovations
3. Macroeconomic prudential regulatory scheme →

3. Financial Globalization and Financial Stability

Current Research:

Herzog (2009): “Risk Regulation – Determinants and Magnitude”

1. Financial regulation does not always follow an economic trade-off (costs and benefits)
2. If the potential damages (like asset bubbles or international crises) is accumulating, there is no trade-off and no interior solution
3. Hence, we develop a boundary solution – a systemic risk funds – optimal regulation is efficient

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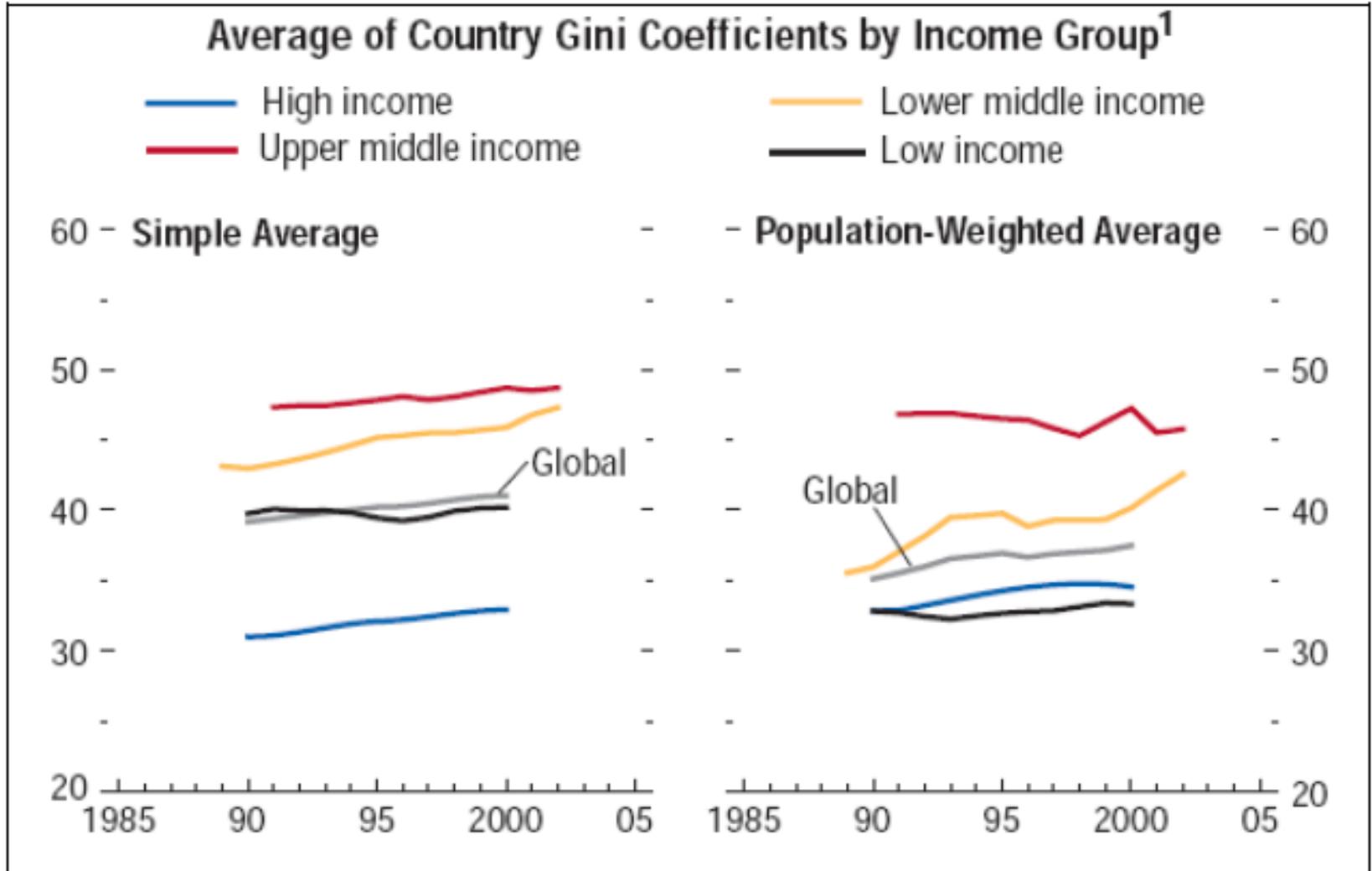
5. Policy Conclusions

4. Policy Challenges for the 'Social Market Economy' Accompanying Globalization

1. Jobs and inequality both within and across countries

→ Economic globalization is also associated with increasing disparities in wealth and power both between nations and between different groups within nations and between public and private sectors

Increasing inequality



Increasing inequality

Stolper-Samuelson theorem:

It implies that in a two country two-factor framework, increased trade openness in a developing country where low-skilled labor is abundant would result in an increase in the wages of low-skilled workers and a reduction in the compensation of high-skilled workers, leading to a reduction in income inequality (Stolper and Samuelson, 1941).

→ Opposite effect in high-skilled countries

→ **So what?**

Increasing inequality

Stolper-Samuelson theorem:

Problems:

- Non-competing traded goods → lower inequality
 - Multiple countries
 - A continuum of goods
 - Intermediate imported goods
- The empirical evidence on these channels has provided mixed support on inequality
- **We haven't learn the differences between Trade and Financial Globalization!**

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5. Policy Conclusions

What are suggestions for the Social Market Economy?

1. Keep in mind that issues formerly seen as national – including financial markets, the environment and economic accountability – are now seen to have international aspects.
 2. The ripple effects of actions taken in one country tend to be far greater and transmit faster
- A **purely national approach** doesn't solve the problem and merely pushing the problem across the frontier without providing a **lasting solution** even at the national level.

5. Policy Conclusions

- We need to ensure that internationally agreements are more binding
- We need to revisit the institutions, to establish mechanisms to implement global sustainable solutions to global problems
- Better attention must be paid to reducing the negative effects and ensuring that the benefits are widely and fairly distributed
- We have to distinguish between the impact and consequences of trade and financial globalization

5. Policy Conclusions

- The extended “Social Market Economy” model is a flexible and a insightful concept, that is ready to solve the challenges even on the international level
- Globalization that is managed properly has widespread benefits and is in line with the principles of ‘SME’
- The alternative, to do nothing wouldn’t solve the problems.
- In fact, it will more likely reduce prosperity and stability with unfavorable effects on both the rich and poor alike.

Thank you very much for your
attention!