

OLD WINE IN NEW SKINS?

ECONOMIC POLICY CHALLENGES FOR THE SOCIAL MARKET ECONOMY IN A GLOBALIZED WORLD

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1. ABSTRACT

The growing interactions of the real and financial economy – one of the main features of trade and financial globalization – is increasingly alarming, since the aftermath of the financial crisis of 2007 and 2008. This paper analyzes the lessons and challenges of Germany's unique model: The "Social Market Economy". More and more countries notice that Germany has an interesting alternative due to its distinctive balance between the idea of free and competitive markets, combined with social systems and justice. The potential benefits are illustrated by the historical growth performance after World War II and the current employment policy free from increasing unemployment rates despite the recession. Achieving the primary goals within the Social Market Economy requires a strong government and a distinct economic framework including a property rights scheme. 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. Additionally, in a globalized world there is more competition, even between the different economic systems. To close the gap between the old German model and the chal-

lenges of globalization, we develop some necessary extensions. In particular, we take into consideration a so-called threefold sustainability model, including economy, ecology and demography. This triad fully encases the historical idea of the Social Market Economy and is in line with the needs of globalization. Finally, the paper analyzes the current conflict areas, and develops guidelines for the future challenges in a globalized world.

2. INTRODUCTION

In recent years and since the onset of the financial crisis, concerns have grown about the negative aspects of globalization and especially financial globalization. The belief that free trade and free markets favor only rich countries and rich persons is discussed all around the globe. The current crisis showed how volatile capital markets and frozen interbank markets hurt the country's economic growth performance and the citizen's well-being. The "anti-globalization" movement highlights the social costs of the crisis, the loss of local control over economic policy instruments and developments, and the disappearance of jobs. They also criticize the governments for moving too slowly in tackling these concerns. With the current financial crisis in mind, we would argue partly right.¹

However, in recent years both sides began to realize that the debate should center on how best to manage the process of globalization – at the national and international level – so that the benefits are widely shared and the costs kept to a minimum. There is no question about the challenges ahead, and that greater integration and coordination efforts in the world economy are needed. Moreover, the offering of a brighter future for all, provides perhaps the surest path to greater global security and world peace. This understanding should attract support for the work needed to address the remaining challenges of globalization, as it is necessary for the future development and diffusion of the Social Market Economy.

The rigorous economic theory represented by the old Heckscher-Ohlin or the Stolper-Samuelson model of trade suggests that a fully integrated world economy provides the greatest scope for maximizing human welfare. However, this proposition is based on strong assumptions. In the real world, we all know that there are still many barriers and market imperfections. Recent developments of increasing inequality and volatility

showed that model implications are only one side of the coin. Therefore to a greater extent people are skeptical and even critical to the globalization process. In addition, people have the same attitude towards Germany's Social Market Economy. In the last decade, there has been a dramatic decline in the acceptance of the Social Market Economy, despite the historical and current success: Catch-up process after World War II and the unique approach of short-term working hours during the current recession.

The following paper is organized as follows. The next section compares the historical and the recent process of trade globalization and identifies the driving forces. Section 3, analyzes the impact of financial globalization and the challenges of financial market stability. Basically the weak point during the current financial turmoil. In section 4, we derive policy conclusions to tackle the immense problems of – in particular – financial globalization. However, the current challenges and problems arise due to the fact that income-inequality and financial-stability are more international policy issues than domestic. Hence, we argue to extend the model of the Social Market Economy towards these international dimensions. The last section 5 concludes the main body of the paper.

3. EXPERIENCE OF GLOBALIZATION FROM A HISTORICAL PERSPECTIVE

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, as they are probably the two periods of strongest sustained output growth in world history. The turn of the century also exhibited rapid growth in particular in world trade. 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 (Table 1).

Table 1: Comparison of Transport/Communication Costs, 1920-1990 and 1960-2000

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)

In the 50 years before World War I, there was a massive flow of capital from Western Europe to the rapidly developing countries. At its peak, the capital flow from Britain reached nine per cent of GNP, and was almost as high in France, Germany, and the Netherlands. Capital importing countries, such as Canada, had current account deficits that reached 10 per cent of GDP. These levels of net capital flows were favored by the fact that the world was on the gold standard which ensured convertibility and stable exchange rates. Moreover, migration was also very large during this time period and equaling five to seven per cent of the population in several of the European countries sending emigrants, four to nine per cent in the United States, and much higher figures for other “new world” countries receiving immigrants.²

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. The post-1950 years of globalization and prosperity in particular in destroyed countries as Germany has been driven by the lowering of the barriers to trade and capital

flows erected in the 1930s, as well as continued decline in transportation costs and, especially recently, communication costs due to IT-revolution.

The current period of globalization is in several respects less pronounced than the pre-World-War-I period; maybe with some exception of the financial booms and busts in the past years. While the nature of technological innovations that characterize the recent period (such as computers, internet and mobile-communication) is no doubt unique, the earlier period was also characterized by major inventions (steamship and trains, telephone) that decreased communication and transportation costs. Even then technology change was a major force for increasing the inter-dependence among countries, thus catalyzing globalization.³ Conversely, globalization, in the form of the spread of information across borders, has allowed a far greater number of people to share in the benefits of those innovations.

Clearly, real GDP growth between 1950 and 1970 creates the means necessary for sharing the benefits of globalization among the population: Only with growth are the poor able to lift themselves from poverty. Cross country evidence suggests that incomes of the poorest 20 per cent of the population increases roughly one-for-one with average per capita income: Growth is good for jobs and the poor.⁴ The evidence is strong that openness in international goods trade is a key ingredient of more rapid growth and world wealth.⁵ However, it is a huge fallacy to believe that openness in financial trade and free financial markets – in other words financial globalization – have the same positive implications as trade globalization.⁶ Not surprisingly, recent economic studies and the recent experience of the financial bubbles and financial crises teach us the opposite.

4. FINANCIAL GLOBALIZATION AND FINANCIAL STABILITY

Financial globalization is just one dimension of the complex process of globalization. Without doubt, this process has changed the economic landscape worldwide in recent decades, and not only the economic landscape. The main changes brought by financial globalization are trends towards intensive cross-border financial and payment flows, greater risk-share of cross-border activities through a broader array of financial instruments, an increasing share of cross-border holdings of assets and an increasing international profile of financial markets,

market players and institutions.⁷ These developments in the global financial system are, to some extent, the source of the current crises due to the lack of regulation and rules. In this sense, we are now ready for a “second wave” of financial globalization – hopefully in a more sustainable manner and a framework embedded in the Social Market Economy.

The well-known 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 and so on.⁸ These developments lead to a gradual shift from the government-dominated system to a market-dominated system. Market-based financing has taken place as the standard tool and hence the banking core business has forced them to search for other opportunities both at home and abroad.¹

Undeniably there are several positive effects. For instance, FDI has clear benefits for host countries because it is often associated with transfer of technology as well as financing, and it tends to be more stable than other countries flows. Recent crises have pointed to the need to provide appropriate incentives for capital to stay in a country and not flee at the first sign of trouble. Generally countries with open capital accounts tended to grow faster. In the 1980s and 1990s some papers⁹ found that financial openness – i.e. not financial markets without appropriate rules and oversight over the institutions and financial market – brings significant more stability, efficacy, competition and improved diversification of domestic risks and lower moral hazard.¹⁰ Despite several positive effects the current crises illustrated the big negative points.

The trade-off of costs and risks were not accompanied by frequent supervision or regulation. Hence, the trade-off was imbalanced and increased the risks for financial instability. There is a definitive lack of institution-building, a lack in control and no appropriate regulation for some financial innovations. Financial instability implies that due to some shocks the financial markets are not properly performing their standard functions, i.e. effective mediation between creditors and debtors, spreading of risks and efficient allocation of resources over time.

4.1. Policy responses: How to preserve financial stability?

The main avenues for coping with the impact of financial globalization on financial stability which have not developed properly in recent decades are:

- (A) The departure from the pegged exchange rate regime of the Bretton Woods tradition and the shift to flexible exchange rates;
- (B) The problem of global imbalances and the massive development of currency reserves in particular in Asian countries;
- (C) The implementation of an extensive system of prudential regulation and supervision as well as a financial product control body;
- (D) The proper sequencing of liberalization and institution-building, an issue of particular importance to all economies as the current crises show.

Each of these approaches has its merits, but also its limits. Their contribution to the preservation of financial stability has proved to be only partial reality and, consequently, the search for further solutions inevitably goes on. In this respect, one issue of reasoning appears to open up for discussion: Should monetary policy also address financial stability?

The ultimate goal of price stability and financial stability are in principle mutually reinforcing. Data show that central banks and their monetary policies have been quite successful in keeping inflation in check in recent decades. A low-inflation environment has been sustained in most national economies, including transition economies and emerging markets. However, the frequent occurrence of financial imbalances, asset and house price bubbles and overt financial, banking and currency crises has proved that low inflation does not guarantee financial stability. In fact, several financial crises and asset price bubbles have developed in an environment of low and stable inflation. The US economy is the best example.

The ongoing debate on what role financial imbalances and asset prices should play in monetary policymaking can be classified into two opposing approaches. According to the first one, central banks should take into account information from asset price movements and financial imbalances if and insofar as they have an impact on the inflation figures and the goals of monetary policy. This seems to be subject to little disagreement.

The other approach suggest that central banks should respond to imbalances as they build up, even when the (short-term) outlook for inflation and growth does not seem to be affected and remains favorable. The argument is that growing imbalances will have adverse consequences if left unchecked. This will become true if and when these imbalances develop too far and prove to be out of line with fundamentals. The unwinding of such imbalances can be rather costly to the real economy as the current crises shows.

Therefore, many international economic institutions and advisory body's in particular the "German Council of Economic Experts" (for: *Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung*), an institution that supports the idea of the Social Market Economy, suggested the implementation of the financial stability target into the "Two-Pillar-Strategy" by the European Central Bank. The so-called pre-emptive or proactive approach should be used not only to cushion the consequences of financial imbalances, it should be used to decrease ex ante the probability of such imbalances and decreasing their potential magnitude, having a negative impact. Despite some disagreement among experts, even the International Monetary Fund (IMF) and the Bank of International Settlements (BIS) discusses this idea right now.

Regarding the issues listed from (A) to (D) above, we have an ongoing discussion on the national, the European and the International level – for instance during the last G20 meetings. The current and past crises illustrate the necessity of new international institutions in the field of financial markets. Each market needs an appropriate institutional framework – that is one key message of the Social Market Economy. The current national and international regulatory and institutional framework in financial markets is an absolute structural weakness for the globe.

According to the Social Market Economy model each free and competitive market needs certain rules of working to be in line with the principles.¹² However, due to the international aspects of financial markets all domestic policy solutions are neither possible and in most cases not appropriate. The German model does not offer any answer to the past financial dynamics. The key question based on an extended version of the Social Market Economy is: Who controls international financial markets?

The implementation of the Social Market Economy on the international level will provide an adequate analytical tool to detect such weaknesses along with timely possible solutions. Hence, prior to liberalization of (financial) markets we need sound macroeconomic policies, effective supervisory and new regulatory institutions like the German cartel office in the 1950s. These are the key lessons for policymakers at home and abroad.

Moreover, liberalized financial systems appear to be “inherently procyclical”, as Borio¹³ shows. Credit spreads, asset prices, internal bank ratings and loan loss provisions all move procyclically. Keeping this in mind, the regulation applied has also proved to be procyclical in nature, exacerbating cyclical developments in individual economies.¹⁴ To correct for this, a more systematic response to the expansionary and contractionary phases of the business cycle has been sought when devising prudential regulation instruments. The current financial turmoil shows the importance and necessity of a macro-prudential regulatory framework that putting more emphasis on the health of financial system as a whole, rather than the state of individual institutions, as was the case in the past.

To contrast these findings with the model of the Social Market Economy, we learn that the old Social Market Economy model is in the present period not entirely appropriate. Therefore, we argue, that we need an extension of the Social Market Economy in a globalized world. We identify two dimensions: Sustainability and international aspects. In the next section, we develop the modern version of the Social Market Economy that is ready to tackle the challenges of globalization.

5. POLICY CHALLENGES FOR THE SOCIAL MARKET ECONOMY ACCOMPANYING GLOBALIZATION

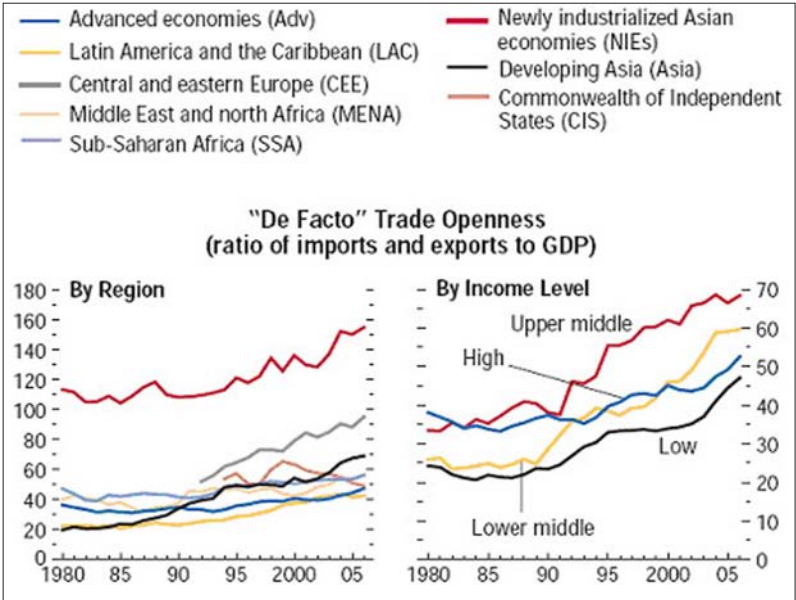
While globalization generally brings benefits, it is also associated with problems which have raised legitimate concerns.¹⁵ Apart from cultural, environmental, and political issues, which are not discussed here, the two principal areas of concern are both essential fields in the concept of the Social Market Economy: Firstly, inequality both within and across countries and secondly, stability and volatility in economic and financial markets. In particular, there has not been a narrowing of global income inequalities in recent years. This is proven by the large number of de-

bates in Germany, in the USA and many countries around the globe. Moreover, in the recent period volatility has increased dramatically as the large number of financial crises and stock market crashes illustrates. In both areas, there is lots of room for improving government policies and the operation of the international institutions in order to widen the access and acceptance to globalization, and in particular the acceptance to the concept of the Social Market Economy.

5.1 Inequality

World trade has grown five times in real terms since 1980, and its share of world GDP has risen from 36 per cent to 55 per cent over this period (Figure 1).

Figure 1: Trade Globalization



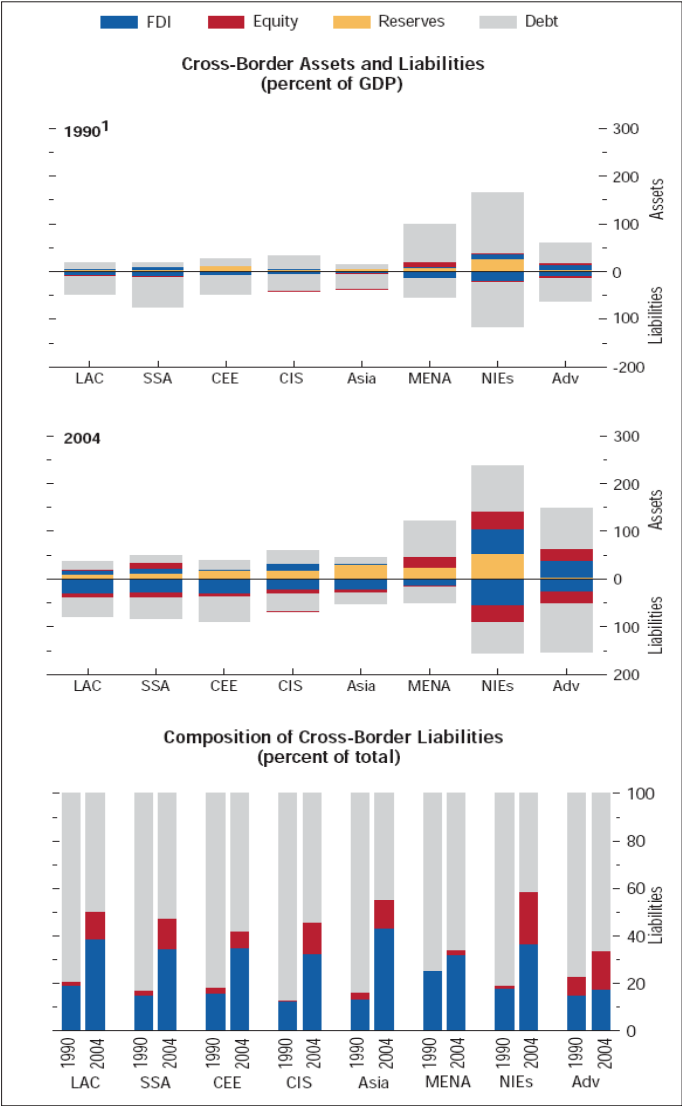
Source: WEO (2007)

Trade integration accelerated in the 1990s, as past Eastern bloc countries integrated into the world trade system and as emerging Asia – one of the most closed regions to trade in 1980 – progressively dismantled barriers to trade. However, it is remarkable that all groups of emerging market and developing countries, when aggregated by income group or by region, have been catching up with or surpassing high-income countries in their trade openness, reflecting the widespread convergence of low- and middle-income countries' trade systems toward the traditionally more open trading regimes in place in advanced economies.

Financial globalization has also proceeded at a very fast pace over the last two decades. Total cross-border financial assets have more than doubled, from 58 per cent of global GDP in 1990 to 131 per cent in 2004. The advanced economies continue to be the most financially integrated, but other regions of the world have progressively increased their cross-border asset and liability positions (Figure 2).

However, *de jure* measures of capital account openness present a mixed picture, with the newly industrialized Asian economies (NIEs) and developing economies showing little evidence of convergence to the more open capital account regimes in advanced economies, which have continued to liberalize further. The share of FDI in total liabilities has notably risen across all emerging markets – from 17 per cent of their total liabilities in 1990 to 38 per cent in 2004 – and far exceeds the share of portfolio equity liabilities, which rose from two per cent to 11 per cent of total liabilities over the same period. Reduced government borrowing needs have also contributed to the changing of liability structures, with the share of debt in total liabilities falling across all emerging market and developing country regions. Not surprisingly, the share of international reserves in cross-border assets has also risen, reflecting the accumulation of reserves among many emerging market and developing countries in recent years.

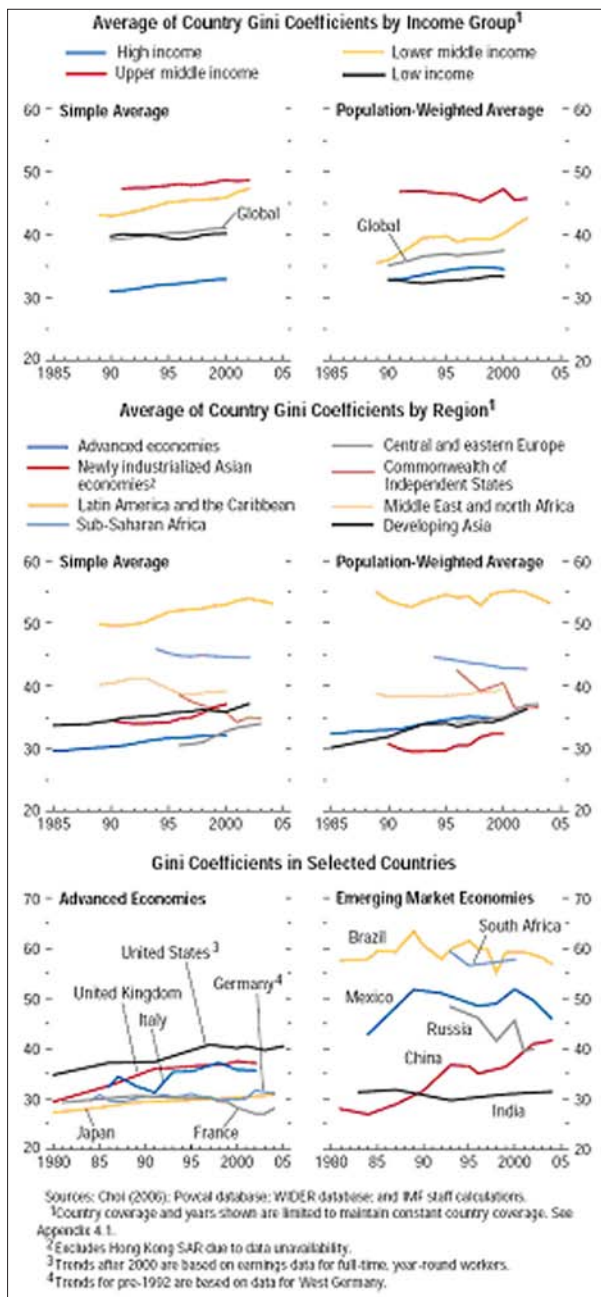
Figure 2: Financial Globalization



Source: WEO, 2007

Based on observed movements in Gini coefficients (the most widely used summary measure of inequality), inequality has risen in all regions except the low-income country aggregates over the past two decades, although there are significant regional and country differences (Figure 3).

Figure 3: Inequality



The channels through which globalization affects inequality are complex. The principal analytical link between trade liberalization and income inequality provided by economic theory is derived from the 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.¹⁶ After tariffs on imports are reduced, the price of the (importable) high skill-intensive product declines and so does the compensation of the scarce high-skilled workers, whereas the price of the (exportable) low skill-intensive good for which the country has relatively abundant factors increases and so does the compensation of low-skilled workers. For an advanced economy in which high-skill factors are relatively abundant, the reverse would occur, with an increase in openness leading to higher inequality.

An important extension of the basic model that weakens the dichotomy between advanced and developing economies in terms of distributional effects is the inclusion of “non-competing” traded goods, that is, goods that are not produced in a country and are imported only as a result, for example, of very large differences in endowments across countries. Tariff reductions would reduce the prices of these goods – and therefore increase the effective real income of households – without affecting wages and prices of other traded goods. If this non-competing good is a large share of the consumption basket of poorer segments of society, a drop in the tariff on the non-competing good would diminish inequality in that country. In general, in both advanced and developing economies, if tariffs are reduced for non-competing goods that are not produced in a country but are consumed particularly by the poor, it would lead to lower inequality in both advanced and developing economies. The implications of the Stolper-Samuelson theorem, in particular the ameliorating effects of trade liberalization on income inequality in developing countries, have generally not been verified in economy-wide studies.

A particular challenge has been to explain the increase in skill premium between skilled and unskilled labor observed in most developing countries. This has led to a range of alternative approaches, including the introduction of (1) multiple countries where poor countries may also import low skill-intensive goods from other poor countries and rich countries may similarly import high skill-intensive goods from other rich countries; (2) a continuum of goods, implying that what is low skill-

intensive in the advanced economy will be relatively high-skill intensive in a less-developed country¹⁷; and (3) intermediate imported goods used for the skill-intensive product. However, these extensions have presented additional challenges for empirical testing, and none of them has been consistently established.

This has led to explanations for rising skill premiums based on the notion that technological change is inherently skill biased, attributing to the observed increases in inequality (including in advanced economies) to exogenous technology shocks. Any empirical estimation of the overall effects of globalization therefore needs to account explicitly for changes in technology in countries, in addition to standard trade-related variables. An additional important qualification to the implications deriving from the Stolper-Samuelson theorem relates to its assumption that labor and capital are mobile within a country but not internationally. If capital can travel across borders, the implications of the theorem weaken substantially. This channel would appear to be most evident for FDI, which is often directed at high-skill sectors in the host economy. Moreover, what appears to be relatively high skill-intensive inward FDI for a less-developed country may appear to be relatively low skill-intensive outward FDI for the advanced economy. An increase in FDI from advanced economies to developing economies could thus increase the relative demand for skilled labor in both countries, increasing inequality in both the advanced and the developing economy.

The empirical evidence on these channels has provided mixed support for this view, with the impact of FDI seen as either negative, at least in the short run, or inconclusive. In addition to foreign direct investment, there are other important channels through which capital flows across borders, including cross border bank lending, portfolio debt, and equity flows. Within this broader context, some have argued that greater capital account liberalization may increase access to financial resources for the poor, whereas others have suggested that by increasing the likelihood of a financial crisis, greater financial openness may disproportionately hurt the poor. Some recent research has found that the strength of institutions plays a crucial role: In the context of strong institutions, financial globalization may allow better consumption smoothing and lower volatility for the poor, but where institutions are weak, financial access is biased in favor of those with higher incomes and assets and the increase in finance from tapping global rather than just domestic savings may further exacerbate inequality.¹⁸

Thus, the composition of financial flows may matter, and the net impact may also be influenced by other factors, such as the quality of financial sector institutions. In summary, analytical considerations suggest that any empirical analysis of the distributional consequences of globalization must take into account both trade and the various channels through which financial globalization operates, and also account for the separate impact of technological change.

5.2 Volatility

The second major problem in financial markets concerns the volatility that openness to global capital markets seems to bring, and more generally the volatility of economic activity. Since 1970, we have seen a series of financial crises affecting individual countries, regions, and even global financial markets. Recent international financial crises seem to be the result of home-grown vulnerabilities related to financial sector weaknesses, overvalued exchanged rates, huge current account deficits, and unsustainable fiscal positions. All of which are often accompanied by volatile market sentiments and contagion effects from other countries. But the experience of these crises has been that they brought dramatic movements in stock markets, exchange rates and current account balances that far exceeded any initial disequilibrium, and were associated with severe economic downturns. In fact, we have to realize that over the recent period the economic system was more in disequilibrium than in equilibrium which is not appropriately modeled within the “dynamic stochastic general equilibrium” (DSGE) models.

Another aspect of globalization is that the spread of the information technology (IT) revolution has strengthened real and financial linkages across countries.¹⁹ The prices of IT goods have gone through large swings in recent years, and as a result a number of Asian countries and others have been exposed to high volatility in their export earnings. In addition, business cycles, flows of foreign direct investment, and stock prices indices have become more synchronized as a result of the increasing importance of IT goods for many countries.²⁰ Volatility derived from exposure to the global market for IT goods, combined with the uncertainty concerning underlying productivity growth, call for greater prudence in setting macroeconomic policies.

5.3 New Policy Response

Governments, with the help of the international institutions, need to address both problems boldly and swiftly. However, the political credibility to change both problem fields is of equal importance because nobody can easily change these issues alone. Moreover, it needs a longer time horizon and a sustainable approach.

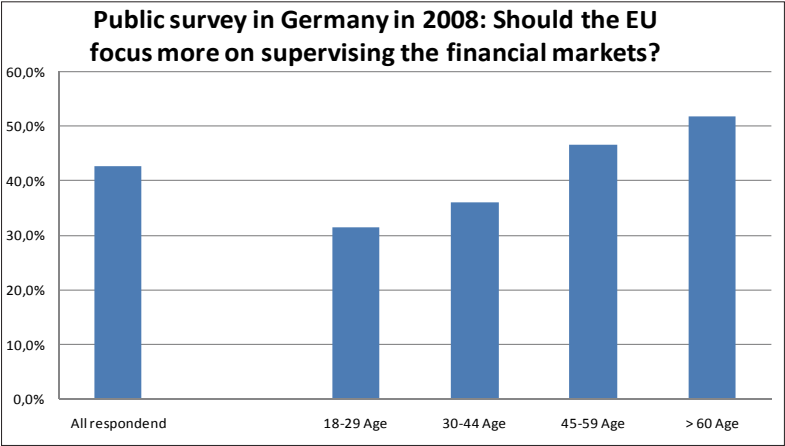
The persistence of poverty requires adequate social safety nets to mitigate negative effects on the most disadvantaged, as well as government spending on public education, health, and security, which helps to equalize opportunities. Tax competition and the growing debt level, however, limit the scope for governments to raise revenue. Hence, international coordination is necessary not only to tackle the current financial crisis, it is also necessary to solve the big problems in a globalized world. Policies aimed at maintaining macroeconomic stability can help moderate the unemployment and wage losses associated with economic contractions, as well as the unfavorable effects of inflation, which has a disproportionately heavy impact on the poor.

Another important step is the further opening by rich countries of their markets to exports from developing countries by reducing tariff and non-tariff barriers and domestic subsidies so that the less developed countries can get the full benefits of the global trading system. Calls in rich countries for environmental and labor standards in developing countries are often presented as being motivated by a concern for limiting the adverse impact of globalization on poor countries. In fact, their effect would be to create barriers to the growth-creating trade that permits poor countries to narrow the gap with the rich countries.

Currently, improvements in the international financial architecture are of highest priority. The ultimate goal is a decreasing likelihood of crises and mitigation of their costs. We need appropriate regulatory institutions for the financial markets (at least at the European level), enhanced early warning systems and improved rating schemes, transparency, and appropriate equity insurance schemes in particular for systemic institutions.²¹ In a public survey in 2008, the *Institut für Demoskopie Allensbach* asked German citizens to assess the perception towards the Social Market Economy and to evaluate a solution concept to tackle the current financial turmoil in line with the Social Market Economy (Figure 4).

Surprisingly, more than 40 per cent are in favor of more European (or international) institutions regarding the financial markets. However, at the same time roughly 30 per cent are in favor of the Social Market Economy and have a positive opinion about Europe. Moreover, older people with more historical experience have even a higher support for European institutions. Without doubt, the German citizens see the necessity to extend the old Social Market Economy for a globalized world. It's now time for politics to support this positive judgment and to change the Social Market Economy towards globalization.

Figure 4: Public opinion in Germany about the international dimension



Source: *Institute für Demoskopie in Allensbach* (2008)

Firstly, besides finding solutions to the above mentioned problems, we need to find ways to effectively implement all of these solutions. This means keeping in mind that issues formerly seen as national – including financial markets, the environment, labor standards, and economic accountability – are now seen to have international aspects. The ripple effects of actions taken in one country tend to be far greater and to travel faster than ever before. A purely national approach to solving some problems risks merely pushing the problem across the frontier without providing a lasting solution even at the national level. Secondly, we need to ensure that measures are taken to meet internationally agreed explicit targets. Failing to reach the targets should have an immediate impact to politics. Thirdly, we need to revisit the institutions of global governance, to establish mechanisms to implement global sustain-

able solutions to global problems, and to ensure that governments become responsible and more accountable. The fact that countries usually participate in open and cooperative multilateral systems when it comes to economic issues is reflected by the now virtually universal membership of IMF, World Bank and G20. These lessons add up to a heavy agenda for the international and European community. Globalization holds the promise of enormous benefits for all citizens of the world. To make this promise a reality, however, we must find a way to carefully manage the process. Better attention must be paid to reducing the negative effects and ensuring that the benefits are widely and fairly distributed. The revitalized and extended German model of the Social Market Economy is one of the best alternatives to capture the future challenges of globalization even on the international level due to the predictable structure and universal values and the success during both periods of globalization.

6. CONCLUSIONS

In a nutshell, the first step is to strengthen the macroeconomic and financial stability in a sustainable way. Indeed, globalization that is managed properly has widespread benefits and is in line with the Social Market Economy. However, politicians must become aware of dramatic global changes – huge financial integration without any regulatory and supervising framework at the international level. Hence, we have to include the new globalized dimension into the concept of the Social Market Economy. An excellent way to grip the extension of the old Social Market Economy model is straightforward: (A) economical, ecological and demographical sustainability and (B) higher degree of internationality in respect of the solution concepts.²² These newly designed policies, can be harnessed to reduce the negative aspects of globalization while at the same time keeping financial markets in check. Moreover, it strengthened the credibility of the “Sustainable-International Social Market Economy” in a responsible manner. The alternative, to do nothing and keep the old Social Market Economy model wouldn’t solve the current national and international problems and challenges. In fact, it will more likely reduce prosperity and stability with unfavorable effects on both the rich and poor alike.

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- 1| Herzog (2009a).
- 2| Cf. Baldwin / Martin (1999).
- 3| Cf. Imbs (2006).
- 4| Cf. Dollar / Kraay (2001), Matusz / Tarr (1999).
- 5| Cf. Srinivasan/ Bhagwati (1999), Lindert / Williamson (2001).
- 6| Cf. Rogoff et al. (2006).
- 7| Cf. Lane / Milesi-Ferretti (2001).
- 8| Cf. Gordon (2008) and Herzog (2008).
- 9| Cf. Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung (2007/2008).
- 10| Cf. WEO (2001).
- 11| Cf. Litan et al. (2001), Mishkin (2001).
- 12| Cf. Abelschauser (2009).
- 13| Cf. Borio et al. (2001).
- 14| Cf. Rochet (2004), Kahn/Santos (2005), Mitchell (2000), Boot/Greenbaum (1993).
- 15| Cf. Matthes et al. (2008).
- 16| Stolper / Samuelson (1941).
- 17| Cf. Feenstra / Hanson (1996).
- 18| Cf. Prasad (2007), Claessens/Perotti (2008).
- 19| Cf. WEO (2001).
- 20| Cf. Bordo / Helbling (2003).
- 21| Cf. Herzog, (2009a), Herzog (2009b).
- 22| Cf. Herzog (2008).