Globalization: Opportunities and Challenges for the World, Europe and Austria
Summary of the 34th Economics Conference

Jürgen Janger,
Markus Knell,
Wolfgang Pointner

The 34th Economics Conference of the Oesterreichische Nationalbank (OeNB), which was held on May 22 and 23, 2006, dealt with globalization and the opportunities and challenges involved for the world, Europe and Austria. The objective of the conference was to examine the short- and long- term economic and social effects of globalization from different angles and to provide a constructive, empirically oriented contribution to the globalization debate, which at times tends to be controversial and emotional. Among the speakers and discussants were high-ranking representatives from central banks and international organizations, academics, economists, and politicians.

JEL classification: F15, F42, F43
Keywords: globalization, economic integration, economic policy.

Globophoria or Globophobia?

In his opening remarks, *Klaus Liebscher*, governor of the OeNB, expressed his conviction that globalization, all in all, has increased prosperity in Austria, Europe and the world. Austria, especially, has benefited from globalization in general, and from the opening-up of Eastern Europe in particular. The continuous rise in the export share of GDP and the trend toward a surplus in the Austrian current account that started a few years ago are proof of these globalization benefits. To a large extent, these developments can be attributed to the success of Austrian businesses exporting to Central and Eastern European countries. At the same time, Liebscher emphasized that necessary structural changes had to be supported at the economic policy level. In particular, he referred to the importance of political measures taken in education, stressing that they involved a growing degree of forethought. Future job requirements and qualifications need to be anticipated in due time, and flexible forms of education must be offered. Such measures can also help bridge the gap between the "globophoria" prevalent in professional circles and the "globophobia" that large parts of the population adhere to. Concluding, Governor Liebscher pointed out that in an age of globalization, a stability-oriented, predictable and transparent monetary policy gained ever more importance: A stable macroeconomic environment is an essential prerequisite for a country to fully exploit the advantages of a dynamic economy and for facilitating structural change. Liebscher stressed that the creation of the Monetary Union and the successful introduction of the euro were important steps, not only for the European integration process, but also for positioning Europe in a globalized world.

Upswing in Europe Would Also Help Global Economy

Rodrigo de Rato y Figaredo, Managing Director of the International Monetary Fund, talked about the interrelation of globalization and economic growth, focusing mainly on the European situation. Apart from high and volatile oil prices, Rodrigo de Rato considered growing global imbalances the primary current risk for the global economy. For several years, the United States has been facing a significant current account deficit, while oil exporting countries and the emerging Asian economies have had just as large current account surpluses. Even if the European economies have more or less balanced current accounts, they must still keep an eye on global imbalances, as expected adjustments might result in changes in exchange rates or falling exports. Moreover, Europe has its own share of economic problems – in particular, weak economic growth and underemployment – which require comprehensive solutions and reforms. By implementing growth-promoting measures, Europe could support its own economy, as well as the world economy. According to Rodrigo de Rato, reforms should be taken on the product markets, labor markets, in the financial sector, and at the fiscal policy level. Product market reforms would boost productivity by encouraging competition, enforcing a more efficient use of resources, and triggering innovation. In the financial sector, a stronger degree of financial market integration could enhance competition, thus reducing capital costs and improving monetary policy transmission. Concerning labor market reforms, de Rato particularly underlined the negative role of low legal retirement age levels, employment protection regulations, and suboptimal unemployment benefit systems. According to Rodrigo de Rato, both justice and logic require looking for creative solutions to the problem of unemployment in Europe. In fiscal policies, a sustainable approach is needed to achieve nearly balanced budgets by 2010 at the latest. Finally, de Rato stressed that a coordinated international effort had to be made to eliminate global imbalances in growth and demand. He repeatedly laid out his conviction that Europe could play an important role in this adjustment process if it strengthened domestic growth and demand through successful reforms.

National Financial Institutions Retain Importance

Malcolm Knight, General Manager of the Bank for International Settlements, analyzed the interaction of globalization and financial markets. A key question in his speech was whether national financial institutions were still of relevance in a globalized economy. Malcom Knight presented several examples to demonstrate that central organizational elements of an economy such as the legal system or accounting and disclosure principles affect the long-term growth perspectives of an economy. One of the reasons why there is a persistently high degree of "home bias" in the globalized financial world (i.e. investors tend to hold more domestic financial assets in their portfolios than an efficient allocation would suggest) lies in the role economic institutions play in providing structured economic incentives. In the face of high agency costs and uncertainties about the enforcement of contracts, the mere removal of capital controls does not automatically induce a surge in cross-border capital flows. Malcolm Knight concluded by saying that national and international institutions would retain a strong influence on the future integration of global financial markets.

Euro Contributes to Global Financial Market Integration

Otmar Issing, Member of the Executive Board of the European Central Bank, discussed the role the euro plays in a globalized world. He started out by saying that the creation of the Economic and Monetary Union could really be seen as part of the globalization process. In a world of free capital movements, a system based on fixed exchange rates is constantly exposed to speculative attacks. Issing then turned to the increasing amount of cross-border financial transactions, which may heighten the exposure of the financial system as a whole to common shocks. On the other hand, financial market integration can also reduce the risks inherent to a global economy by causing stronger diversification. Data on portfolio reallocations from 1997 to 2001 indicate that the observed changes indeed show increasing international diversification trends. At the same time, Issing pointed out that there was still a substantial degree of "home bias" at the international level, both on the equity and the debt instrument markets. While the degree of "home bias" is declining only at a slow pace internationally, it has decreased significantly in the euro area since 1997. This underscores the positive influence the Monetary Union has had on financial market integration. In conclusion, Professor Issing emphasized that in spite of all the shocks that have occurred since 1999, the European Central Bank has been able to hold inflation expectations at a stable level and to guarantee price stability. According to Issing, both this internal stability and the higher degree of international portfolio diversification in the wake of globalization have contributed to protecting the euro area from possible speculative attacks. At the same time, changes on the product and labor markets are needed to help European countries fully exploit the opportunities of globalization.

After Issing's speech, *Josef Christl*, Executive Director of the OeNB, presented the Klaus Liebscher Award for academic papers on the topics of Monetary Union and European integration. *Ingrid Thurnher* from the Austrian Broadcasting Corporation moderated the presentation. This year the award went to *Petra Geraats*, University of Cambridge, for her paper on optimal communication strategies for central banks and to *Marek Jarocinski*, University of Pompeu Fabra, Barcelona, for his analysis of the effects of monetary policies in the new EU Member States.

The Real Danger Is Provincialism, not Globalization

Austrian Federal Chancellor *Wolfgang Schüssel* pointed out that globalization was happening, whether we approved of it or not. At the same time he made clear that by taking the right measures (investments in research and development as well as in education), one could fully benefit from all the opportunities globalization offered. Europe is currently experiencing "globalization on the small scale," where new Member States undergo a rapid catching-up process. This process has created a win-win situation, especially for Austria. According to Schüssel, the real danger Europe is facing is provincialism rather than globalization. The reasons why large parts of Europe have not been able to exploit their growth potentials for years are related to the following factors: tight restrictions on labor markets, a lack of innovation and research, an economic environment that is not business-friendly enough, a not fully developed common market and insufficient economic policy coordination among the individual Member States. However, the Lisbon agenda tries to deal with many of these problems. At the end of his speech, Schüssel discussed the future of the Constitutional Treaty and the need for establishing a common European energy policy.

Globalization from a Historical Perspective: Parallels to the 19th Century

Alan M. Taylor, London Business School, set a foundation for the discussion on the rising degree of globalization since the 1980s, in particular on the capital markets. He compared today's integration process with the economic integration that took place between 1870 and 1913 and drew the following conclusion: The increasing degree of integration that we observe today already took place to a similar extent a century ago. It was the Great Depression and the two World Wars that reduced integration to a minimum. Thus, what we see is a U-shaped pattern. As opposed to a century ago, foreign direct investment today mainly takes place between developed countries. Theoretically, however, capital should flow into countries where the employed capital is low compared to available labor and where returns are accordingly high (Lucas paradox). To some extent this phenomenon can be attributed to the historical role of the United Kingdom as a colonial power, which compensated for prevalent institutional differences that would otherwise have inhibited cross-border investment between poor and rich countries in the 19th century. Another reason lies in the level of total factor productivity, which still allows for a profitable employment of capital in developed countries. Since the financial crises of the 1990s another special trend has become evident: capital flowing from developing countries into OECD countries. This movement can be explained by the desire to build up foreign currency reserves to prevent future currency crises. At this point, Taylor drew his second conclusion from the historical comparison. Globalized capital markets have a constraining effect on national economic policies because they have to consider the so-called trilemma: Fixed exchange rates combined with open capital markets do not allow for monetary policy autonomy. Either the exchange rate floats freely or capital controls inhibit international interest arbitrage. All currency crises stem from the refusal to accept these restrains.

Caution Is Required When Opening Poor Countries' Capital Markets

Based on the trilemma and the Lucas paradox, Taylor analyzed that the costs and risks of opening capital markets are high for poor countries, while the benefits are low, as cross-border investments continue to be made predominantly between developed countries. A universally valid recommendation for opening capital markets can therefore not be applied to poor countries. However, emerging economies like China face low risks when opening their capital markets and can profit from international investment flows. An empirical overview of capital controls confirms that individual countries do take these considerations into account: Poor countries continue to maintain relatively strict capital controls. Countries whose development has progressed further consider opening their capital markets. In conclusion, Taylor voiced his hope that all countries would sooner or later improve the quality of their institutions. In his opinion, the globalization process will continue. After all, a setback as great as that caused by the two World Wars and the Great Depression of the 1930s is unlikely. Turning specifically to Europe, Taylor suggested reallocating agricultural subsidies toward universities. Taylor's calculations show that these means would suffice to finance 25 European universities of the same quality as the University of Harvard. Accordingly, he called for progress in the current Doha Round negotiations on the liberalization of world trade.

Weak European Growth not Caused by Globalization, but Proactive Economic Policy Stance Needed

Apart from Alan Taylor, the following discussants participated in the subsequent panel discussion: *Karl Aiginger*, Director of the Austrian Institute of Economic Research, *Christian de Boissieu*, President of the Economic Analysis Council advising the French Prime Minister, *Heiner Flassbeck*, Acting Director of the Division on Globalization and Development Strategies at UNCTAD, and *Dennis Snower*, President of the Kiel Institute for World Economics.

Aiginger presented a survey of globalization, discussing its costs and benefits, its effects on the world economy and the role globalization has played for Austria. In his opinion, globalization is a necessary but not a sufficient prerequisite for economic growth. Economic growth also requires political and macroeconomic stability, investment in research and development (R&D), human capital, lifelong learning, infrastructure, and a reliable legal system. Globalization even renders economic policies for growth and employment more important than they have been before. In order to cope with the more rapid changes and to create a win-win situation, a proactive approach that focuses on enhancing positive externalities and reduces subsidies to declining sectors must be taken. Preventing globalization, however, leads to a lose-lose situation. Developed countries are unlikely to experience disadvantages from globalization, although it is possible. Nevertheless, such disadvantages may occur before advantages do, and they may affect groups of society holding more political power than those benefiting from globalization. Poorer countries are more likely to experience negative effects from globalization. These can, however, be compensated for with the help of international organizations and appropriate national economic policies. Globalization cannot be blamed for slow economic growth in Europe. So far, Europe has performed well and has, for instance, maintained its share in the global export market.

De Boissieu claimed that Europe needed supply-side structural reforms to adapt to the globalization process. According to De Boissieu, demographic perspectives should be improved through consistent immigration policies, and labor supply should be increased by raising the effective retirement age and reducing youth unemployment. Instead of deflating wages, policymakers should accelerate productivity growth. The Lisbon agenda provides the appropriate tool. In De Boissieu's opinion, striving to reach the target R&D rate is extremely important, and so is promoting growth of smaller businesses. Simply relying on the market is not enough. The United States has conducted successful interventions as well, such as the passage of the Small Business Act in 1953. Finally, De Boissieu said that financial services in Europe had to be integrated further, and that, when it came to reforming the labor market, one might want to refer to Scandinavia (buzzword "flexicurity").

Flassbeck similarly opposed wage deflation as a means of influencing the real exchange rate. In his eyes, wage deflation is an overreaction to globalization and constitutes an erroneous economic policy. He said it was a paradox that countries like the United Kingdom and the United States, holding large current account deficits, effectively suffered from globalization to a much stronger extent than countries like Germany, having vast current account surpluses, while the public perceived the exact opposite. According to Flassbeck, Germany should make better use of its productivity growth to encourage consumption. Finally, Flassbeck called for an international exchange rate system that would bring a country's wage costs in line with its productivity and would thus prevent current erroneous trends such as developing countries stockpiling foreign exchange reserves. He stated that trade policies of any kind were ineffective without monetary stability.

Snower declared changes in the international division of labor to be the most important phenomenon arising from globalization. Whether this process produces winners or losers depends on two conditions: First, on whether workers from different countries complement each other or compete with one another and second, on how easily disadvantages of globalization can be evaded (e.g. by providing incentives and support for switching from stagnating into growing sectors). Like Aiginger, Snower claimed that national economic policies played an important role in coping with globalization. Measures that prevent rather than facilitate adjustment simply cause even more people to be opposed to globalization, as they are worse off because the respective political measures inhibit them from adapting. According to Snower, Europe as a whole is not struggling with problems, but France, Germany and Italy are. He said that protectionism was not the answer, as relative advantages should not be determined by governments but by the market. Our natural and human desire for financial security should be satisfied with the help of rather than at the expense of flexibility.

Karl-Heinz Grasser, the Austrian Federal Minister of Finance, talked about topical budgetary and financial issues related to the current Austrian EU presidency. He said that Austria had been able to improve the atmosphere and to reinforce the degree of optimism within the European Union. Globalization should be seen as an opportunity. Grasser generally approves of the Lisbon process. He hopes that the national reform programs will indeed facilitate implementing the Lisbon aims. Key issues are growth and employment, the reduction of unemployment and of administrative costs, and stability-oriented fiscal policies. Countries should use the economic upswing for structural reforms and budget consolidations. Austria should consequently continue on its reform path, as well. Grasser said the Austrian government was convinced of the effectiveness of increased flexibility, deregulation and privatization. Stronger competition and competitiveness were needed to maintain social standards. According to Grasser, some of the Austrian government's concrete aims for the end of 2007 are cutting the amount of time required to start a business to a week and reducing the time needed for an unemployed school graduate to find a job or a training position to a maximum of six months.

Economic Policy Challenges through Global Integration

Robert Holzmann from the World Bank started his speech on "Globalization, Integration, Demography, and Austria" by observing that the number of people living on less than a dollar a day had receded considerably over the past years and, according to World Bank projections, would continue to do so. This reduction of poverty can also be attributed to the growth-promoting effects of globalization. Globalization mainly affects trade in goods and services, the integration of financial markets, migration, and communication and information flows. It creates losers, as well as winners. How the profits of the increased international division of labor are distributed mainly depends on the respective country's national policies. Holzmann stressed that globalization did not inevitably lead to an erosion of labor market and social standards. Maintaining them for reasons of efficiency may also be in the interest of businesses.

With the participation of new states in the world market, effective global labor supply has doubled since 1990. Accordingly, there is a heightened relative scarcity of the factor "capital." Holzmann identifies workers in states that have only recently opened their economies to globalization and capital owners as the beneficiaries of this situation. He believes that workers in less developed countries that have been participating in the world market for some years, such as Mexico or Turkey, find themselves hit with a "double whammy." They have established a specific role for themselves in the international division of labor, producing labor-intensive goods with low technical input, and are now exposed to competitors from new world-market participants with even lower wage levels, which prevents them from continuing their growth strategy.

Holzmann sees integration problems mainly at a European, and not so much at an Austrian level, as Austria has clearly benefited from both its accession to the European Union and from the last round of enlargement. According to Holzmann, the European Union, however, has not been able to fully exploit its opportunities, as the lack of a common dimension of the Lisbon agenda demonstrates.

The World Bank's demographic projections show that, presuming there is no immigration, labor supply in Austria will significantly decrease until 2050. Holzmann added that a surge in the labor force participation rate in Austria to the currently highest level within the European Union, a rise in female labor force participation to male levels, and a significant working life prolongation could more than compensate for the decline in labor supply.

To prepare for the predicted challenges in the best possible way, Holzmann recommends setting up strategies in three areas: in education, where universities and colleges should increasingly be financed through private means and lifelong learning should be promoted more; in the health sector, where older people's employability should be extended; and in the selection of business fields, which determines domestic businesses' competitive advantages. Holzmann suggests that the social partners, who in his opinion have not acted proactively in Austria during the last few years, have an important role to play in all these areas.

Making Globalization Fair – Austria's Main Economic Policy Goal

In the following panel discussion, which was chaired by *Josef Christl*, the Austrian Federal Minister of Economics and Labor *Martin Bartenstein* explained that globalization was determined above all by the interplay of technical progress (in particular in the information and communication sector), the liberalization of world trade, and the "enormous addendum" of China and India participating in world trade. Austria, being a small, open economy, has so far been able to benefit from globalization and has significantly heightened its share of exported goods in GPD. This surge cannot merely be attributed to Austria's successful integration within Europe; in many cases, Austrian exports to other European states are used to produce goods for global markets. According to Bartenstein, social welfare systems do not inhibit global competition but are, on the contrary, a prerequisite for a country to successfully participate in globalization. In this respect Bartenstein considers Austria to be on a level with the Scandinavian countries, combining a high degree of social security with the necessary extent of flexibility on the labor market.

Rudolf Hundstorfer, Acting President of the Austrian Trade Union Federation, explained that the unions did not aim at reversing the globalization process, but that they wanted to make globalization fair. He identified strengthening domestic demand as one of the major tasks. Only if the government actively intervened could growth rates be raised sufficiently to reduce unemployment. He believes that existing working-time models provide export-oriented businesses with the flexibility they need and that the unions have always been willing to compromise in this respect. Nevertheless, in this context Hundstorfer clearly rejected abolishing overtime pay.

Christoph Leitl, President of the Austrian Federal Economic Chamber underlined the high share of exports in Austrian GDP and the consequent importance of being competitive on an international scale. He suggested rendering working hours more flexible by calculating them on an annual basis to increase Austria's international competitiveness. Leitl claimed that high social and environmental standards could not be maintained in the long run if growth levels were low. European companies are unable to beat competitors from emerging economies when it comes to producing at low cost. Yet, focusing on advanced technologies in production is not enough, as countries like India or Brazil have already obtained prominent positions in this market segment. Therefore, implementing innovations as quickly as possible is ever more important, and so is introducing further reforms in education and on the labor market. Leitl's demand for European monetary policymakers to also take into account other aims apart from price stability in the decision-making process was countered by Christl with the remark that guaranteeing price stability was the best possible growth promoter.

Maria Kubitschek, Head of the Economic Policy Division of the Chamber of Labor in Vienna, argued that the reason why many people were opposed to globalization was that social standards often deteriorated in the face of stronger international integration. Even though businesses have become more competitive, the unemployment rate has not fallen. The surge in exports has hardly created any additional jobs. Rather, it was "bought" at the expense of low increases in real wages in spite of rising productivity. This, in turn, weakens domestic demand. On top of that, higher unemployment causes precautionary saving, which also reduces private consumption. A decreasing wage share in GDP and simultaneously rising profits indicate who the Austrian winners and losers of globalization are. Kubitschek thus called for providing relief for lower-income households, for enforcing government investment, and for containing international tax competition.

Markus Beyrer, Secretary General of the Federation of Austrian Industry, considers Austria a clear winner in the globalization process. Only companies that have adapted to the international environment successfully can afford to raise wages. Furthermore, the labor market posts record employment. However, this only slowly reduces unemployment levels, as other special factors come into play, such as unemployed Germans entering the Austrian labor market or the larger number of women working. Successful exports by Austrian industry have created jobs, not only within leading export-oriented companies, but also with their domestic suppliers. In Beyrer's opinion there is sufficient working-hour flexibility in Austria. However, the negative attitude toward globalization or the European Union could turn into a negative business location factor.

According to *Bernhard Felderer*, Director of the Institute for Advanced Studies, globalization has resulted from falling transport and information costs, and not so much from decisions taken at the political level. It is possible to reject this process, but not without accepting significant welfare losses. The fact that technology is imitated and trademark laws are ignored in certain emerging economies puts European businesses at a disadvantage. Competitive advantages at wage cost level will recede in all regions. Some major Eastern European cities have already significantly adapted their wage and price levels to Austrian standards. Southern China has already achieved full employment. On a medium- and long-term basis, the scarcity of labor in Southern China will cause wage increases. Felderer attributes the decline in the Austrian wage share of GDP to high investments that companies made in the past which now result in high profits.

The following discussion, which was held in front of an actively participating audience, concentrated on labor market effects of globalization. *Helmut Frisch*, Technical University of Vienna, pointed out that a rising number of young people did not finish school and thus raised structural unemployment levels. Christoph Leitl strongly endorsed Robert Holzmann's suggestion to make training programs a part of collective wage agreements.