

**Munich Economic Summit**

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**System Comparison: How Competitive is the Social Market Economy?**

*1. Globalization and System Competition: Is there still Room for Diversity?*

Globalization suggests the idea that especially given the international mobility of financial capital and skilled human capital, institutional conditions will align. Global markets offer the possibility to international acting firms to evade the requirements of national policy. This creates remarkable pressure to adjust national regulation. Globalization has replaced the primacy of politics by the primacy of the market. Privatization and deregulation are the trends that dominate in all open economies. In fact, we find that globalization does not write only a story of approximation, but also a story of differentiation. The six major puzzles in international economics shed light on the facts that despite of all the liberalization, deregulation and market opening, key areas of economic activity are not integrated, but follow very strong national patterns and structures. Nevertheless it is true: the significant congruence of territory, population and exercised power that characterized the emergence of modern states has come under pressure and sometimes becomes questionable. The crisis that started in the autumn of 2008 did not modify the trends in global structural change, but rather increases the pace of globalization. We are facing a new wave of internationalization in the division of labor and in the sharing of knowledge.

*2. Market Innovation and Institutional Change: How to Fill the Gap?*

The institutional arrangements can only be adequate and sustainable if they can be flexibly adapted to market-driven innovation. Inevitably, from time to time we will see a gap between the market development and market regulation. This was evident in the financial and economic crisis, when it became clear that the regulation of the financial market no longer engulfed every financial innovation. Through securitization

the liability principle was put at risk, therefore the new rules, which require the issuer of the security to hold five or ten percent of a securitization transaction in his own books, is important. A specific institutional order can only be flexible when its rules are factually neutral and free of privileges. Therefore, consistent incentive schemes are generally superior to discretionary prohibitions.

### *3. Historical Pattern and Varieties of Capitalism: The Principle of Institutional Complementarity*

Since the research carried out by Peter Hall and David Soskice in the beginning of the last decade, the discussion about varieties of capitalism has never ceased. Most important for our debate today are the findings that nations with particular types of institutions in one sphere tend to have particular types of institutions in other spheres. In other words: **there are remarkable institutional complementarities across spheres of the political economy**. A robust economic system must take into account this need for complementarity between for example labor market, vocational training, and social security.

Institutional imbalances respectively institutional inconsistencies are not viable in the long term, as they will affect the dynamic of the economy and weaken the ability to adjust to exogenous shocks. More than sixty years ago, Walter Eucken argued that there is a need to pay careful attention to the interdependence of the systems. He wrote: "We have to get used to the fact that solemn issues of the intellectual and spiritual existence of man are inextricably linked to very sober questions of the mechanism of economic governance" (Wir müssen uns daran gewöhnen, dass feierliche Fragen nach der geistig-seelischen Existenz des Menschen mit sehr nüchternen Fragen der wirtschaftlichen Lenkungsmechanik untrennbar verbunden sind). Thus the conclusion is justified that "the whole order should be such that it allows people to live according to the accepted ethical principles." This in turn opens up the perspective on the historical and cultural conditions of formal consistency concerning the institutional order.

### *4. Values and Moralization of Markets*

Eucken demands that regulations should be consistent with the relevant ethical principles. This suggests that values and attitudes that result from a differentiated cultural

process have the power to explain the varieties of capitalism. Globalization strengthens the consumer and therefore the consumer sovereignty. At the same time, regional consumer preferences keep being forged by the values and customs that predominate in that region. For example, different European countries have very different preferences for the way they produce electricity. According to Walter Eucken, the accepted moral defines the consistency conditions for the various spheres of economic activity.

A proof of the growing importance of regional values and attitudes is the increased desire of political participation. The increased demands of citizens for more intensive participation in political decision-making put the traditional democratic rights and state intervention to the test. The global crisis 2008-2010 was an important impulse, because the consistency respectively complementarity of national systems was subjected to a test of robustness.

##### *5. Path Dependency and Economic Change*

Economic order and the position in structural change are not independent from each other. Walter Eucken developed his ideas for an institutional order consistent with the experience of advanced industrial economies. Many regulations in Germany do still reflect this fact. Social partnership between trade unions and employers associations has, under such conditions, a different meaning than under the conditions of strong service-oriented economies, especially when those are dominated by the financial sector. In industry-based economies such as Germany, the primary issue for the institutional setting is economic power. Economic power needs to be countered by an effective competition policy. The integration of industry and business services proves to be particularly successful in the face of global trends such as urbanization, resource conservation, infrastructure development, demography, etc. It is also noticeable that the different kinds of value creation seem to bring out different importance of family businesses: At the beginning of the 21st Century, in France almost 34 (22) percent of the market capitalization of all listed companies are controlled by 15 (5) families, in Germany these are 25 (15.7 percent), in Italy 21.9 (16.8) percent and in the United Kingdom only 6.6 (4.1) percent. This leads to the much-discussed theory whether owner control is economically more successful than managerial control.

From all this, we can derive a second consistency condition for the question of the appropriate regulatory model: in addition to the consistency of the systems, **the consis-**

**tency with the position in structural change.** This dual consistency criterion does not require a standstill in institutional change, but calls the special attention of a two-fold interdependence. To sum up: There is no clear trend for a particular model of institutional order, but there is a need for national consistency in a general change of state activity from a national to a post-national constellation. Both the territorial change and the functional change of the state organization offer an enormous scope for differentiation.