
Preface

The analysis presented in this book considers key aspects of social security – defined to include labor market standards – in a world with regional integration and economic globalization. Recent theoretical developments, as well as novel ideas, are presented, and the new broader view adopted here is important for understanding the dynamics of social market economies in the world economy. Taking into account some basic theorems and new aspects of foreign direct investment as well as social standard setting, it is argued that part of the challenge of sustaining and improving national labor conditions and social security systems is related to the careful streamlining of social security systems, on the one hand, and the exporting of social standards – referring here to occupational health standards – on the other. Some EU countries are still good examples of bridging efficiency gains from market allocation with concern about fairness and solidarity; however, the euro crisis is undermining the reputation of the euro area countries in this regard.

Social security systems are a political way of dealing with individual risks in life, and such systems can be justified by referring to Rawlsian principles, particularly to the idea that in a hypothetical state of nature – in which nobody knows one's position in terms of income and status in the real world – individuals would be willing to accept certain principles of social security. This refers to unemployment insurance, health insurance, and pension systems. Private capital-funded pension systems have been largely discredited during the Transatlantic Banking Crisis as the confidence of private investors and households, respectively, in capital markets and banks has declined in Europe and North America. By implication, individuals in Europe – and possibly in the USA and Canada – tend to rely more on government for the funding of pensions, but this raises new problems, namely, the question whether political systems can be expected to deliver timely, adequate reforms of pay-as-you-go pension schemes (e.g., on the basis of increasing the retirement age) and whether the potential increase of social security contribution rates will undermine employment, economic growth, and welfare through higher tax wedges. The difference between gross wage and take-home pay is increasing in many OECD countries.

Moreover, debt-ridden governments in some countries have effectively nationalized privately organized capital-funded pension systems – a problem in both Latin America and Eastern Europe in the first decade of the twenty-first

century. Such political actions undermine the willingness of private households to invest in capital-funded pension systems, and this is to the disadvantage of ageing societies. In the presence of capital-funded pension systems, there is more capital accumulation and hence higher long-term per capita income and per capita consumption than otherwise (assuming that the golden rule capital stock which maximizes long-run per capita consumption is not exceeded, the decline of long-run capital intensity of an economic system with capital-funded pension systems is an economic disadvantage).

If one does not want to assume that utility of future income is discounted (or should be discounted), the neoclassical growth model is an adequate analytical basis for many issues of social security and economic globalization. Before one can consider an open economy growth model, it is useful to focus on a closed economy model and present new answers to some old questions: What is the optimum income tax rate in a growth model? A simple answer is derived in Chap. 2. A related question then concerns taxation of income in an open economy – with mobile capital. Moreover, the neoclassical growth model can be modified for the case of an open economy, and again the question of taxation, social security, and globalization can be raised: New answers are presented in Chap. 2 which also suggests a new link between the Phillips curve model and the medium-term government budget constraint. Furthermore the impact of the dependency ratio on the exchange rate, the interest rate, and the stock market price index is considered: A modified Branson model gives new insights on the role of a rise of the dependency ratio.

In the EU, a social market economy exists in all member countries, but there is the problem that the EU single market is not well organized when it comes to labor mobility and social security systems. Labor mobility in the EU is roughly one third of that of the USA (comparing mobility across states in the USA and across EU member countries in the case of the EU), but it has been increasing since the creation of the EU single market in 1992; and the euro crisis will further increase effective labor mobility in the EU as unemployment rates across EU regions have greatly increased. For workers willing to work in different EU countries for periods of time, it is difficult to reliably assess how entitlements from different periods of work in different countries really add up. Increasing global competition puts pressure on the EU to more intensively and more broadly use the EU single market with its four freedoms – free trade in goods, free trade in services, free capital flows, and free labor mobility (and mobility of people, including pensioners) – the EU countries should thus also create a common framework for social security.

There is a confusing discussion in the literature about the impact on economic globalization on taxation. It is noteworthy that Bretschger/Hettich have argued already in 2002 (and in a related paper of 2000) that the degree of openness should not be measured by the trade-GDP ratio since with that measure of globalization one obviously faces a distortion related to the size of the respective economy – small open economies generally are more open for trade than big countries since the share of domestically traded tradable products in a big economy is higher than in a small economy. The USA is relatively more open than the average of an OECD

country sample corrected for the size effect, and Sweden is relatively closed if the trade-GDP ratio is corrected for the size effect; the shock of the Transatlantic Banking Crisis has affected this picture to some degree. A considerable part of the empirical literature with a focus on the link between taxation and economic globalization is flawed, namely, to the extent that the trade-GDP ratio is taken as a proxy for globalization (only the residual of a trade-GDP regression on economic size should be considered). Moreover, the interdependency between corporate tax rate, income tax rate (labor taxation) and the value-added tax rate is ignored. One may find it surprising that the analysis of taxation, social security, and globalization is rather weak so far.

The rules of the game for companies and workers should be transparent and fair, and it is clear that the inadequate coordination of national social security systems could effectively undermine labor mobility in Europe. Access to health-care systems across countries is also not easy in the EU, but several decisions of the European Court of Justice have made clear that mobile sick individuals are allowed to avail health-care services in other countries and that health insurances – be it private ones or public ones – would have to reimburse individuals in most cases. However, private health-care insurance companies in several countries, including Germany, charge a top-up contribution for periods in which a citizen is living abroad, namely, in another EU country. This, of course, is not really in line with the idea of an EU single market, and the restrictions that are effectively imposed by national health-care systems on EU citizens of country 1 to use health-care services in country 2 (or n) are strange. EU integration dynamics could be reinforced and higher factor productivity generated through higher mobility of workers and fully integrated health-care systems, but here policymakers face a series of reform challenges, which so far have not been tackled.

With the reelection of President Obama in 2012, the US health-care system is being refined; indeed, it has become a bit more European in many respects: Its coverage is now broader, and this will certainly be a boost for the US health-care supply side. As regards government and private household, there is now an even bigger interest in more regulated competition in the health-care system than before – competition could bring major efficiency gains, on the one hand, while, on the other hand, if there is no adequate regulation of the health-care sector, there could be considerable inefficiencies associated with a more complex, less transparent, and more competitive system. It is still true that health-care markets stand for asymmetric information problems in the sense that the suppliers in the system are well aware about most relevant supply and product parameters, while the demand side typically is poorly informed and—if very old—often physically and mentally unable to fully play the normal role of a consumer who enjoys consumer sovereignty and competition in the market.

To the extent that labor is heterogeneous (say skilled labor vs. unskilled labor), there can be specific incentive problems or problems with principles of fairness – i.e., fair prices of unemployment insurance. However, it is not clear that fair prices are the natural benchmark for a public unemployment insurance system. Part of the relevant arguments to be discussed is related to political considerations and normative

considerations, respectively; as well as Rawlsian principles of justice. A specific challenge for Germany (and other countries in the euro area) is the introduction of a minimum wage which is assumed to reduce poverty – this, however, is a doubtful conjecture.

It is emphasized that social security elements, which improve long-term productivity and innovation dynamics, contribute to the enhancement of international competitiveness, and if policymakers and trade unions have a realistic view of the room to maneuver, they should not face problems with respect to globalization dynamics. Secondly, the issue of occupational health and safety standards is considered here, and it is argued that such a system would contribute to increasing long-term work safety in the South and would establish a framework that could be incorporated within long-term WTO negotiations and EU free trade area negotiations. We also deal with growth theory and demonstrate the ambiguity of efficient specialization, which exists in the context of the Golden Rule. Moreover, we are interested in understanding how current trends in globalization affect the relative wage of both skilled and unskilled labor. With the endogenous rise of safety standards in the South and the parallel pressure from OECD countries on the South—this could include OECD southern enlargement—to improve safety standards, one could devise a system, which generates higher safety standards in an efficient manner and on a global scale. It would be wise for EU countries to push for higher safety standards in the Doha Round of trade liberalization, and governments or trade unions of OECD countries should consider exporting higher safety standards to the South. One means by which to export higher occupational safety standards is through exporting trade unions to the South, but benchmarking and EU pressure in Free Trade Treaties as well as in its general trade policy could also prove quite useful. Considering China's demographic and economic dynamics, one may argue that a rise in social security contributions in the EU could lead to a competitive disadvantage in the short term, but in a longer perspective, China's graying is so fast that by 2050 it will have a similar median age as France, thus implying that China's expenditures on social security – relative to GDP – will similarly rise in the long run. Moreover, the graying of the EU will go along with an expansion of the relative size of the service sector, which in turn should facilitate reforms that gradually increase the retirement age. In this respect, the EU even has an advantage vis-à-vis China and other countries in the South for which globalization dynamics imply a high share of industrial output in overall value added. Assuming some degree of policy reform in EU countries, one may conclude that a modified European social market economy model will be able to survive. Labor conditions could be improved on a global scale in the long run; moreover, social security reforms within Europe will be necessary and should be adopted in a timely manner. The transatlantic financial market crisis raises serious issues for sustainable social security reforms. Economic globalization does not generally bring about international economic convergence across countries; this is not related to trade but rather to the role of financial globalization and the impact of information and communication technology. As regards the euro crisis, it is too early to derive clear conclusions, but the massive economic recession in southern Europe will

bring about major adjustments in the long run; possibly a leaner welfare state and more economic growth in the medium term – the growth equation is a key challenge for all euro countries. In all EU member states, there remains the challenge of an ageing society and hence of financing social security.

Deficits of the social security system are part of the deficit limits emphasized by the Maastricht Treaty; the maximum deficit-GDP ratio is 3 % except in cases of serious recession. The new Fiscal Pact requires a maximum of 0.5 % in terms of the structural deficit of euro countries. The new Fiscal Pact was adopted by 25 EU countries in 2012/2013 (EU except for the UK and the Czech Republic) – within a legal framework outside the EU treaty system. There can be inconsistencies with the new overlap of two deficit indicators as a country might exceed a structural deficit of 0.5 % of gross domestic product while remaining below 3 %. This makes the whole system even more confusing. The definition of the public sector is rather broad in the context of the limits of debt-GDP ratio – with a maximum of 60 % emphasized in the Stability and Growth Pact – and the deficit-GDP ratio, respectively: The social security system is included so that a surplus in the social security system in combination with a modest deficit-GDP for government, narrowly defined, will result in an overall surplus position (the case of Germany in 2012/2013, where falling unemployment rates have generated higher social security contributions and thus contributed to the surplus position). In the ageing societies of Europe, there is some risk that social security systems could generate rather high deficits in the long run.

Immigration could affect the pressure for social security reforms. The increase in intra-EU migration is another effect of the euro crisis. Germany, France, the Netherlands, Belgium, Luxembourg, and Austria will be winners in this respect: not so much in terms of higher immigration from southern Europe, but rather as the result of a diversion effect from eastern Europe as many immigrants, who normally would have preferred Italy, Spain, Portugal, and Greece under normal economic conditions, will now have a preference for other euro countries, particularly those in northern Europe. The euro crisis also raises the issue of creating a euro area political union and an integrated social policy in Europe. There are many aspects related to the topic of a euro political union, including the introduction of euro taxes, a stricter collection of taxes across all countries of the euro area, and an increase of government expenditures at the supranational level. Euro bonds are also a natural part of a euro political union. To the extent that part of social security expenditures would be shifted towards the supranational level, there is some risk that the aggregate government expenditure-GDP ratio (the ratio aggregated across all layers of government) might rise; this could lead to higher tax rates and that in turn would undermine investment, growth, and jobs. Given this potential risk, it is all the more important that a careful institutional design be adopted for such sweeping reforms of a social market economy in the euro area.

Among the problems faced in the eurozone, one may point out the weak organization of trade unions in some countries, including France; despite low union membership, trade unions often determine – together with the political system – wages in many sectors. This, however, raises doubts about key principles

of the EU, namely, democratic representation; at the same time, trade unions point out the problem of free-rider behavior of those workers who are not organized in trade unions. However, if government is not requiring adequate respect for the principles of democracy, democracy itself becomes doubtful. The euro crisis has already brought some weakening of the trust of EU citizens in the effectiveness of EU institutions – the evidence from opinion polls from the European Commission in 2011/2012 has been quite clear in this field. Thus, it is quite important to reconsider the problems and principles of long-run social security reforms. For insurance companies and banks, the very low interest rates associated with both the Transatlantic Banking Crisis and euro crises bring specific challenges in terms of yield management. The undermining of confidence in capital markets in recent years is also a specific problem. The pressure in the field of social security reforms will be lower if individuals have higher confidence in capital markets and if financial market stability could be restored in a sustainable way. There is some debate on how to remedy the fault lines of the financial systems in OECD countries (see in particular some contributions in the journal *International Economics and Economic Policy*).

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