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**Open Markets for Investment**

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**Opening Remarks**

Ladies and Gentlemen: all of us here know that by dismantling barriers to the free flow of goods, of labour and of capital, trend world output growth has shifted upwards. This additional output has the potential to raise living standards in all countries involved. We politicians must make this happen!

The drivers of the current wave of globalisation are also clear. Let me mention them briefly:

- technological progress, in particular in communication and information technologies and their applications;
- political changes, in particular the collapse of the former Eastern Bloc and the world-wide move towards a variety of market models;
- the insight over time that too interventionist an economic policy may be counter-productive; we have learned to analyze government failure in addition to market failure;
- as a result, the liberalisation of product and financial markets, most prominently the opening of the capital accounts of countries, going hand in hand with appropriate exchange rate regimes;
- and not least – but maybe most important – the absence of a global war and a deeper global economic crisis.

All these factors have jointly contributed to the quasi-explosion of world trade and, even more so, of cross-border financial flows.

You are all familiar with the channels that work in creating this "globalisation surplus": by dismantling national boundaries, formerly scarce capital finds new labour, and formerly scarce labour finds new capital to work with. The increased economic interaction releases lots of technological and other spill-overs. It is the task of economic policy to facilitate this process, if not to promote it; state intervention needs to be targeted to framing this process and correct it, if necessary – I will come back to this in an instant.

My country, Austria, is currently in the process of reaping the gains from globalisation: Until 15 years ago, Austria was locked into a geographical corner where half of its neighbouring countries were barely participating in global trade. As a result of this and other misguided policies, their economies had fallen far behind the technological frontier, especially after the first oil price shock.

The fall of the Iron Curtain brought about an abrupt change in this situation. By embarking on an open and pro-active trade regime with our former communist neighbours – with whom Austria already had a long history of strong cultural and economic ties – we were able to benefit dramatically from this new world order:

As of today, one seventh of Austria's exports go to Middle and Eastern European countries; some 15 years ago, that fraction was less than half. From 2000 until last year, Austria's total export ratio has increased from 45 to 58 percent of GDP! Austria today is the foreign direct investor Nr. 1 in Bulgaria, Bosnia, Croatia and Slovenia and it ranks second or third in a row of other countries of the region. Inward FDI have surged, too:

Austria's largest bank is now owned by a foreign entity; foreign holdings of Austrian listed companies have more than doubled since the year 2000; only recently a large US-investor purchased the Nr. 4 Austrian bank, formerly owned by the trade union; and the largest Austrian supermarket chain is now foreign owned [REWE].

And yet, public awareness of this brisk wind of fast economic internationalisation is accompanied by fear and distrust. I am convinced that Austria is rather a *standard* than an exceptional case here: From 2000 until 2006, real wages have increased by a meagre 0.6 % in total [the respective figure for the Euro-Area is 1.48%]. As a result, the Austrian wage share dropped from 59.6 % to 55.8 % of GDP.

If the majority of the population receives only lip service by politicians that globalisation should improve living standards some time in the distant future and if people do not see such improvements to materialise factually, then their support for further liberalisation will very quickly fade and turn into opposition!

Any meaningful discussion on globalisation must include a close look on how its gains are distributed in reality. It is true that prices are currently low as a result of cheaper products imported from emerging countries. Yet this effect is over-compensated by the compression of wages.

Some argue that this is necessary so that a country does not lose ground in terms of external price competitiveness. Both economic theory and empirics seem to show that a larger number of workers might be worse off for quite some time before the gains of globalisation start to trickle down to them. Should this process take too long, further trade liberalisation could lose support and an undesirable backlash of protectionism would follow.

It might sound paradoxical: In order to maintain the dynamic of globalisation, we might have to design accompanying measures that may even decelerate it slightly.

In the final analysis, the task of policy makers is not to maximise the growth of aggregate income, but rather to maximise the living standards of all people. Of course, both concepts are related to each other, yet they are not identical.

The OECD papers preparing this year's Ministerial Council Meeting make it clear that the integration of labour abundant countries into the global economy (which was so far dominated by capital abundant countries) will inevitably put a downward pressure on wages in capital abundant countries, until a new global equilibrium price of labour [i.e. real wages] and capital [i.e. real interest rates] is reached. This adjustment process will not only affect those directly involved in the globalised activities, but also workers in the non-traded sectors. This means: it will not only affect foreign investors and dislocated workers. It will *also* affect domestic investors and workers in so called, hitherto, "protected industries" because, like already mentioned, the *equilibrium* factor compensation will have changed.

Instruments like the EU Global Adjustment Fund or the US Trade Adjustment Assistance programme [TAA], in which "affected losers" are targeted and assisted temporarily, go in the right direction. But they are inadequate in so far as *these* instruments do *not* offer a response to the *entire distributional dimension* of globalisation. If you look at the wage shares in national incomes which decline all over OECD despite *rising* (!) rates of labor force participation and employment, and if you look at the rising inequality indices across OECD- and even Non-OECD-countries, then, it becomes clear that selective quick-fixes cannot work.

What we need is a more systemic market intervention approach which corrects the primary market outcome in a way which will distribute the gains from globalisation more equitably and make people look upon globalisation in a positive way. This, of course needs to be done without creating disincentives to work or invest.

How to finance such intervention and what shall it look like?

The principle is one rooted in the solidarity associated with democratic societies: the winners must compensate the losers.

In the OECD countries the burden of globalisation is primarily borne by medium and low skilled labour. This calls for some kind of in-work benefits or negative income tax, financed by closing some loopholes for better-off persons.

Another contribution could come from capital, be it residing in, and/or be it owned by residents from, the OECD countries. Allowing capital to flow to capital scarce economies raises domestic capital's return. Part of this excess return could be taxed as a contribution to finance the minimisation of social distress at home. The after-tax return of capital employed will still remain substantially higher than before, albeit a bit less so.

Can such an approach be sensibly undertaken unilaterally by any single country? Not in the present situation of competition plus capital mobility. Rather, strong international coordination of capital taxation is needed. Given the very limited success at the EU level so far, I would like to call for a very strong coordination of countries with similar capital/labour-ratios.

In this context it is clear that a certain level playing field must be established that shall prevent one country to free-ride on the others' attempt to respond in a measured way to the social dimension of what comes with globalisation.

It seems to me that our European model of market economies supported by strong welfare state provisions is well suited to meet the challenges of globalisation. We can build on that, but must go further: both the activation and capacity building of our labour force *and* temporary provisions to help persons displaced through outsourcing or globalised competition can meet these challenges. Welfare state provisions which take away (or at least reduces) from our citizens the risks of modern life (unemployment, poverty, illness, premature death) must, however, be re-examined as to their incentive effects and their appropriateness under changed circumstances.

Dismantling the welfare state as a result of (real or perceived) competition from globalisation would be the recipe for open rebellion from our citizens, retrenchment of globalisation and the recurrence of protectionism. It is only 90 years ago when this occurred, the results were disastrous.

If we want to guarantee that public support for globalisation does not wane, we *must* address *these* issues *now*, urgently. Thank you.

## **Closing remarks**

Maybe you had the impression that in my opening remarks I did not sufficiently address policies that aim at maintaining an open international investment environment. I did not talk about the importance of competition rules, spells of nationalistic interventionism during cross-border take-over battles or the positive effects that come with FDI and increased trade. I did not talk about structural change, liberalised labour markets, life-long learning.

Yet in some sense I did just that, by addressing the misgivings and worries many of our citizens have in the fact of the current wave of globalisation.

I recently stumbled across a new working paper by economists who found that in countries with higher levels of government expenditure risk aversion associated with anti-trade attitudes tends to be much lower.

In my reading this means that a population that knows that it is not left alone but supported by the government during times of increased international trade interaction is much less inclined to have its politicians engage in anti-trade rhetoric and action.

Guaranteeing a decent education and training as well as a functioning labour market alone does not suffice to mitigate the potential distributional effects of globalisation.

Protectionism would be the logical – albeit unwanted – consequence.

I am also not sure that voluntary codes of corporate social responsibility conduct will be successful as all of them suffer from one or the other game theoretical and institutional shortcomings.

We need more international coordination and more level playing fields in economic, environmental and even social interaction to make globalisation sustainable and palatable to our citizens.

This reasoning builds on the insight that globalisation lays the ground for national and multi-national companies to be better able to arbitrage comparative advantages which they may find in any country. But for this to happen in the overall international public interest, an *international approach* can be the only solution. For this to happen, *these* suggestions must come from ourselves, from the politicians, and after consultations with the companies and our citizens. We must talk about fair competition rules, about full pricing of environmentally damaging transport and other activities and about the social conditions under which services and products are produced. In this way we must combine economic thinking with the concerns of our citizens. Thank you.