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## Europe taking the lead in responsible globalisation

*Karl Aiginger and Heinz Handler*

### Abstract

Political opposition to globalisation has risen in industrialized countries, although the positive overall effects on the growth of the world economy and the alleviation of poverty are empirically verifiable. However, the effects of globalisation vary according to regions, professional groups, and education. In the period of intensive globalisation, unemployment and inequality have risen, and people feel their lives to be determined by forces they cannot influence. Since the many new challenges, such as climate protection, can be better solved by worldwide efforts, it is indispensable to avoid new national barriers and to strengthen the endorsement of globalisation and the concomitant welfare effects. However, it is also necessary to respect cultural differences in preferences and to view globalisation as a search and learning process. Instruments for the implementation of such a strategy may vary according to regional specifics. Social and ecological goals – gaining higher importance with rising per capita incomes – are well-represented in the European model, but for worldwide solutions other socio-economic models will offer preferences and solutions. Apart from the announced partial withdrawal of the United States from globalisation and the upcoming dominance of China in world affairs and large scale investment, Europe would be well-advised to take a greater responsibility if not the lead in determining the rules of globalisation. Based on an opinion-forming process within Europe, responsible globalisation can significantly improve the quality of life in Europe and its partners worldwide.

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## **1 Motivation**

Globalisation is a highly relevant issue for economy and politics and it evokes strong emotions among the population. Empirical research shows that globalisation primarily yields advantages, and polls confirm that this is also the view of the majority of Europeans. But globalisation also may have disadvantages for regions, groups and companies. This is especially the case when globalisation occurs concurrently with technological breakthroughs and weak demand and when economic policy fails to implement the necessary stabilising measures. Then globalisation can entail unemployment and rising inequality. As it is often experienced by citizens as an exogenous force to be endured without participation and protection, it may induce nationalist and populist reactions and may even be met with violent resistance. These in turn affect election results, strengthening illiberal tendencies and the call for protectionism.

Since important current problems such as climate change, water shortages or security issues can only be solved globally, Europe should remain open to globalisation, but also try to steer further developments according to intrinsic European values, such as liberal democracy, social balance and environmental sustainability. The partial withdrawal of the United States from these goals opens up the potential for Europe as a leader in shaping future globalisation. The current paper aggregates and organizes ideas for European policies that aim to achieve such broad welfare objectives.

## **2 Empirics of the “Third Wave“ of Globalisation**

### *Growth, dynamics, catching-up processes*

The positive expectations with regard to the dynamics of a globalising world economy have been realized. During the third wave of globalisation ("hyper-globalisation" starting in the early 1990s), the world economy grew by more than 3% per year. This output increase has been overwhelmingly due to the rise in labour productivity, which has in turn come about via technical innovations, their rapid dissemination through international economic relations, and the stronger global division of labour between countries with different factor endowments.

The growth acceleration has mostly been accounted for in emerging markets, which have experienced an average rate of growth in their real economic output of some 5% per year. In industrial countries the dynamics were roughly sustained, though largely due to the expansion of demand in new markets. As a general observation, countries with greater openness (as measured by export and import shares in GDP) tend to grow faster.

### *World market shares and the geopolitical perspective*

The catching-up process of emerging countries has been mirrored in declining shares of world trade and production by industrial countries. This shift is the positive consequence of globalisation for countries with relatively low income and high levels of poverty. However, it also changes the rules and institutions of the globalised economy. The developed world has established a number of international economic organizations and has dominated their bodies

and expert teams. Nowadays, emerging countries require a stronger say in these organizations, and they charter their own regional (and sometimes global) institutions, including development banks.

The EU 28 is still the biggest world economy with the highest percentage of world exports. In terms of value added, however, the EU is about to temporarily relinquish its leadership to the United States and in the longer term to China. Growth in the Euro Area (and in the “core” countries Germany and France) is even weaker. This loss of economic power could be slowed by extending the EU towards the Western Balkans and the Black Sea region. A wider “European region”, including Turkey, Russia and North Africa, could maintain a world market share of some 30%.

### ***Absolute poverty and relative inequality***

The long-lasting positive mood in industrial countries with respect to globalisation has been eroded in the face of rising worldwide imbalances and domestic inequality, as well as by the side-effects of immigration. A significant portion of workers in Europe and the United States feels threatened by globalisation, particularly if unemployment and migration coincide. To ward off the consequences, people are calling for protectionism and electing populist parties, while disregarding these parties’ socio-political concepts, which bring lower social security benefits and changes in the tax system that often favour the wealthy.

Absolute poverty (as defined by a constant dollar amount per day, but also according to other criteria of manifest poverty) has decreased worldwide, and particularly in developing countries. The globalisation of knowledge in general and access to medical supplies in particular have substantially reduced infant mortality. The increase in life expectancy is particularly strong in developing countries, but even in industrial countries it is rising by two to three months each year. In contrast, relative inequality – the relation between top and low incomes – is on the rise in many countries. In Europe, unemployment has increased in recent decades, but the employment rate has also risen. In the United States both the unemployment rate and the employment rate are significantly lower today than before the financial crisis. For decades, the median wage has stagnated in the United States. In Europe, per-capita wages have risen, though those in the bottom third have done so only slightly, while the wages of people with unstable employment conditions have stagnated or at times even fallen. Neither the United States nor Europe has experienced frictionless market equilibrium in the labour market.

Whether and to what extent the rising inequality within most countries has been related to globalisation is a rather controversial issue. Many studies find that the rise in personal inequality within countries may be chiefly attributed to technical progress and to a much lesser extent to globalisation. In most industrial countries it is the interaction of technology, globalisation and a weakening of trade unions that result in an empirically visible increase in inequality.

### ***Ecological development***

In the course of the third wave of globalisation, capital-intensive and energy-intensive parts of industrial production have shifted from advanced countries to emerging economies, where the emissions per output are higher and environmental requirements are lower. The corresponding

overall increase in emissions per unit of production (carbon leakage) has to be seen, however, alongside the increasing energy and resource efficiency in developed countries. It is also a fact, that the increase in resource efficiency has generally been lower than that of labour productivity.

Until the 1990s, the growth of total global emissions exceeded economic growth, but it has since got lower and carbon dioxide emissions are now absolutely stable for three years. The slowdown has been furthered by efforts in China, which has achieved the highest amount of investment in renewable energy. The announced exit of the United States from the Paris climate agreement is regrettable, although up to now no country has followed suit. Other signatory countries and even some US states have expressed intentions to increase their decarbonisation efforts. For Europe this opens up the chance to widen its technological lead in energy efficiency and low-carbon technologies.

### ***Welfare assessment***

The empirical results concerning growth, employment, inequality and ecology tend to favour the advantages over the disadvantages of globalisation. However, they also exhibit problem areas and the special need for economic policy action on national, European and global levels. A welfare rating must be broadly based on aspects of quality of life and its dissemination, which are based on comprehensive indicators, including Beyond GDP Indicators, Sustainable Development Goals (SDG) and the Human Development Index.

## **3 Critique and Resistance, Turn of Mind**

In the third phase of globalisation, the critique of globalisation has shifted from the exploitation of developing countries to the disadvantages for industrialised countries. “Unfair” competition from emerging economies (due to inhumane working conditions, the lack of environmental standards and its reinforcement through policy intervention) has been particularly lamented.

### ***“Secular Stagnation“ and “De-Globalisation happens“***

Long-term forecasts of GDP growth in industrialized countries yield rates of just 1-2% per year. The "Secular Stagnation Hypothesis" provides supply-side and demand-side causes for subdued growth in the future (Summers, 2016; Gordon, 2015). In recent years, world trade has increased less than global production. Whether this is a temporary phenomenon or the beginning of a de-globalisation phase remains open.

### ***Turnaround in the political discussion and criticism of international agreements***

In a number of European countries, newly-created "our country first" movements have had some success in parliamentary elections, at least until the spring of 2017. International trade agreements have collapsed at the multinational level (Doha round) and have been fiercely criticized at the national level (TIP, CETA, TTIP; ASIA, MERCOSUR). In the United States, the NAFTA agreement is hardly defended by the general public and China's admission to the WTO is considered a mistake.

### ***Causes of the turnaround***

Increasing inequality and high unemployment can be identified as the two central causes for sceptical assessments of globalisation and the call for protectionism and re-nationalisation.

Today the income and wealth distribution within most countries is more unequal than in 1990. From a global perspective, while low incomes in catching-up countries have risen substantially, incomes in the highest brackets have boomed as result of technological advances, "winner takes all" principles and a lack of government intervention. The "global middle class", comprising the working class in industrialized countries, has benefited least from globalisation (Milanovic, 2016). Most analyses emphasize that the effect of technology on the difference of income distribution is stronger than the influence of globalisation. As mentioned above, the problems may actually reinforce each other.

Unemployment is concentrated regionally and sectorally, mostly in former manufacturing areas with heavy industry, but also in regions with simple processing and delivery capacities and intermediate qualifications. For low-skilled people, an oversupply prevails despite extreme wage restraint and declining real wages in the long run. In contrast, skilled workers are in short supply, especially in technical professions. For highly qualified persons, competition is rather intense and headhunting and the outbidding of management salaries are commonplace.

### ***Amplification through policy failures***

First, economic policy has responded poorly to the disadvantages of globalisation which were well predicted on a theoretical level: In particular, globalisation losers – for example low skilled workers in high income countries – have not been compensated or re-qualified early enough.

Second, the financial crisis has resulted in a lasting distrust in the financial sector. Also the new regulations after the financial crisis have not stopped criticism, as they have not resolved a number of central failures. The presence of high-frequency trade, extremely high management salaries, the concentration of power, and profit transfers through tax havens has not been significantly diminished.

Third, the negative consequences of globalisation are more visible than the positive ones, because national policy and governments, but also private managers and companies tend to ascribe successes to their own merits, while failures are attributed to external forces.

Migration can have positive effects in the target country, if it matches the demand for labour, as well as in the country of origin, if it limits the brain drain by circular migration (Kanduth, 2017). However, if the negative effects dominate (resulting from war, famine or an excess of low-skilled persons in the target country), they are often exploited by populist movements in a distortive way. Economic fears may then be aggravated by fears of loss of cultural identity.

## **4 Principles and Instruments of Responsible Globalisation**

Reshaping globalisation is the only chance to continue this welfare-increasing process and at the same time mitigate and prevent radical populist opposition. This will be no easy task, given the

current rules of international trade and investment agreements, as well as the implicit dominance of the US in international organizations and political pressure from frequently US-dominated, multinational firms. The heterogeneity of partners and cultural differences are increasing. Weak governance and national agendas as well as lobbying groups prevent strategic reforms. The global economy is multipolar and political conflicts – often within countries – are increasing. Therefore we divide our strategy into principles and instruments. Basic principles are essential and will be easier to agree upon, but less easy to make operable instruments, which are necessary to change the game, but reflect a search process; and countries can and will take a very different mix of them.

***Principles of responsible globalisation under a European lead***

*Principle 1: Globalisation is no final goal, but a means of promoting well-being, increasing choices, dissipating technologies and promoting peace and has to be assessed according to these objectives.*

Whether globalisation has to be welcomed and its speed is too fast or too slow should be assessed in relation to the goals of society, using a cost benefit analysis. There will be on average more gains than losses, but the balance will be varying according to these goals, for groups and skill level, as well as regional disruptions and imbalances occur.

*Principle 2: Globalisation increases the set of choices for individuals and countries, and all the more if it encourages bottom-up elements, allowing for differences in preferences and mutual learning.*

With rising incomes, preferences become more heterogeneous and the freedom to determine one's occupation, place of work, work-life balance and lifestyle becomes ever more important for welfare. The ability to make these choices depends on the capabilities provided by the educational system. Countries will choose different strategies depending on the starting situation, some trying to catch up with richer economies, others going for a leading technology position or greater inclusiveness. The need for economic policy to accompany globalisation is well-established.

*Principle 3: Globalisation is fuelled by market forces and new technologies; and whether social, ecological and efficiency goals are attained depends on the accompanying policy.*

Even in closed economies economic policy has to correct market failures, internalize external costs and benefits and provide public goods and risk protection. These necessities change, but do not dissolve under globalisation. The same holds for the necessity of a simultaneous strategy for social, economic and ecological goals. If welfare is to be generated by a separate strategy for each of its components and increasing the benefits of globalisation still another, economic policy will be expensive and inefficient and the size of government and debt will further increase.

*Principle 4: The speed and burden of change accelerates in open countries and losers therefore have to be compensated, less skilled people be enabled to switch from the losing to the winning position.*

In the long run, the education and retraining system has to provide the capabilities to cope with changes in occupation, jobs, qualifications and the increased mobility demanded and supplied by globalisation. Investing in education, retraining, the creation of new firms and innovations is better suited to more heterogeneous preferences and problems. It is in the joint interest of all society members, and should therefore be a shared responsibility and obligation.

*Principle 5: The functions which provide quality of life (lodging, nutrition, travelling, communication, attractive environment) have to be defined and progress under globalisation must be continuously monitored.*

Life quality and well-being is a better and more comprehensive measure of economic performance than economic output and the growth of GDP. To make the measurement operational, the functions which constitute quality of life, even if somewhat different, have to be specified accordingly. Examples for doing so are given in the Better Life Indicators by the OECD or the Sustainability Development Goals by UN and EU (capabilities or functionality approach). This does not mean that the elements and their relative importance may not be different across cultures, but that societies have to define them and international agreements should respect the differences and not provide instruments to fight them in courts.

*Principle 6: Europe should try to shape globalisation more actively according to its values than it has done in the past, thus filling the gap opened by the retreat of the US; however, it should also learn from other cultures.*

In the past, Europe has profited from its openness and the speed of globalisation, and currently enjoys a positive balance of external accounts (in contrast to the US). However, it has not shaped the rules of globalisation, and many international trade and investment rules afford no priority to social and ecological standards, liberal democracies and the fight against corruption. Since these “European values” typically increase in importance in richer economies, it makes sense to call for upgrading standards instead of supporting a race to the bottom. With increasing incomes, for all countries competitiveness depends on a high-road strategy if welfare is to be enhanced. Climbing up the quality ladder – independently of the current position – increases life chances and the positive contribution of globalisation for choices and peace. This does not mean that goals and values have to become identical, since plurality and heterogeneity provide economic and societal advantages, as does learning from others.

*Principle 7: Looking for jointly advantageous solutions increases well-being and economic success, and shaping rules with “my country first” slogans will fail in the long run.*

Contracts are feasible for individuals, firms and nations if both partners have an advantage. Division of labour by open borders on a level playing field and providing capabilities for change is positive for all societies. The past international agreements and the agenda of international organizations were built on the principle of mutual advantage and as win-win contracts for all members. Securing social rights and the Paris agreement work in the same direction. The populist request for a strict renationalization of policy or the assertion that contracts should only

be obeyed or agreed if one partner wins at the cost of the other (or at least definitely gets more than the other – often the partner with the lower per capita income) will not lead to contracts, not internalize external costs and not provide global public benefits. And benefits will not be generated – neither in the short run, nor in the long run.

### ***Potential game changers***

Potential game changing instruments will support the attainment of the strategic goals, but also raise stronger opposition. Such instruments were up to now neither easy to implement nor undisputed in light of the less homogenous EU and euro area. On the other hand, not all instruments have to be applied at the same time and within the same intensity. Trial and error and national preferences on the choice of the instruments as well as their mix are not only possible but also efficient, given that the reshaping of globalisation is a search process in unknown territory and no one knows the best solution.

*1. New performance benchmark: The performance of an economy or region should switch from GDP to "Beyond GDP Goals" and "Social Development Goals".*

Economic dynamics remain important in solving problems such as unemployment, inequality and public debt, as well as giving migrants a chance to work and to get integrated. Broader indicators on performance of Europe are necessary if globalisation and enthusiasm for the European project are to be reconciled. People wish to have choices to determine their own lives; economic policy has to provide the resources and capabilities required for this purpose.

*2. Problem solving by empowerment: Common European or global solutions should not be bureaucratic and detailed, but provide a framework for better national or regional solution.*

The rules and benefits of globalisation must be shaped as a way to solve global challenges. The policy rules should enable countries to choose problems and preference-orientated solutions. Transparency and the closing of tax shelters, as well as common definitions for the tax base, allow countries to choose the rates and structure of taxes needed for increasing welfare, instead of taxing labour and leaving inheritances untaxed for reasons of tax evasion or tax shifting.

*3. Reduction of unemployment and inequality: Raising the net wages of less-skilled workers through a reduction of the social security contribution or through work benefits or training increases employment at the same time as it decreases income disparity.*

The social system should not be primarily financed by taxing labour, but by taxing activities that decrease welfare, such as emissions, or that prevent the equality of chances, such as large inheritances. This offers a win-win-win situation, increasing employment, reducing inequity and cutting the future costs of climate change.

*4. Switching from protection to social investment: The focus of social policy should switch from ex-post protection, after jobs have been lost and firms have exited, to investing in future capabilities, starting with early education.*

Social costs are already high in Europe, amounting to 40 % of government expenditures, and new challenges call for a higher burden. Investing in education, retraining and offering

capabilities for problem-solving and change increases choices and lowers the probability of not finding a new and better job, if the old one is lost due to structural change and globalisation.

*5. Refocusing public expenditures: Investment in education and innovation is increasing dynamics and employment in industrialized countries.*

Administrative expenditures and over-detailed regulation are detrimental to output, private employment and international competitiveness. Europe has an investment deficit and financing debt is rather cheap today, but this should not be used to invest in highway and construction projects, but rather in human capacities and increasing welfare. In general, a switch from tangible to intangible investment is needed, with tangible investment focusing on technologies for broadband and decarbonisation.

*6. Redirecting innovation: Technological progress should be shifted from primarily saving labour to focusing much more on saving energy and resources.*

Labour productivity is currently increasing much faster than energy and resource productivity. This supports the growth imperative (the rate of growth under which unemployment rises) as well as the future cost of repairing ecological damages and limiting climate change. The current trend is not determined by technological forces, but by the fact that labour is heavily taxed, emissions are not taxed and fossil energy is subsidized. A responsible globalisation strategy should support the change in economic policy as well as the technological trend.

*7. Internalizing the costs of emissions: The future costs of current emissions and polluting activities have to be included in the cost calculation.*

Bringing future costs into firm calculations is a complementary policy to environmental regulation. International trade and investment activities should press for internalizing external costs or setting more ambitious standards. This will not be equal between emerging and industrial countries, but both could upgrade the ambitions of climbing up the ecological quality ladder.

*8. Symmetrical flexibility for firms and employees: Flexibility of working hours according to demand fluctuations increases the output of firms; in compensation, workers should be able to shift working time according to work lifecycle demands.*

Firms in open and globalised economies need flexibility to adapt production to international demand fluctuations and are reluctant to pay overtime. On the other hand, workers want to work more in some stages of their lives, whereas in other phases, they long for leisure and ability to fulfil family duties. This demand could be traded and could include a general trend of reducing working time if desired by some groups. If these deals are symmetrical, they increase the competitiveness of firm as well as welfare.

*9. Coordination of international organisations: Several international organisations are shaping economic, social and environmental rules, and closer cooperation with each other would be essential.*

The IMF, WTO, UNCTAD, ILO, World Bank and IAO, to name just a few of the important organizations, have shaped globalisation. They never agreed on common priorities and no one

has analysed whether their rules and recommendations are compatible or one activity is hampering another. They should try to set a common agenda for a responsible globalisation linked to social goals. The agenda should be discussed with national governments and with non-governmental organizations. This is no easy task, but a conference prepared and inspired by the Paris summit of 2015 could be an example of how to do this. A common agenda by as many international conferences as possible would also require and enable intra-European commitment to a program of responsible globalisation.

*10. Redesigning trade agreements: The goal of new agreements should be to increase well-being while respecting cultural differences, and in general social, environmental and health standard should be upgraded.*

Current agreements are not linked to social goals. This may make it easier to write the agreements, but the consent of citizens is lost. If standards are lowered under the heading of the dominant goal of competing by price, a race to the bottom cannot be excluded.

*11. Democratic control for trade courts: Timely decisions on trade and investment disputes are needed, but the decisions should be integrated into in the hierarchy of the courts with the potential of recourses.*

The opposition to open markets comes from different angles. In emerging countries as well as in transition economies, it comes from domestic incumbents who are often intertwined with the ruling class and family elites. But on the other hand multinational companies often experience legal conflict and employ an armada of experts to influence the level-playing field in favour of large firms. The interests of a third sector of small and medium-sized firms, and an endogenous industry specialized in small-scale innovation, suffer. Courts must respect these different aspects and the interest of small, emerging local firms and local technologies has to be defined ex ante (infant industry argument), in addition to being respected by the courts. A European fund supporting European SME interests and international organisations which helps to define infant industry and regional technology interests is essential for responsible globalisation, paving the way for fast procedures without being dominated by unaccountable special courts.

*12. Ecological responsibility for multinationals: The act of polluting regions and committing irreversible damage should be just as intolerable as using child labour and production methods that lead to illness and death in the social sphere.*

To some extent it is inevitable that the technology used in emerging and developed countries differ with respect to energy efficiency, emissions and pollution. But these differences have a negative effect on the world climate and local environment (see the carbon leakage arguments). Similarly to the minimum standards in the social sphere, which have been continuously upgraded, rules should be established for environmental technologies. One driver for limiting differences in technology would be the mandatory reporting of emissions relative to output in the different plants of a multinational firm. Then investors as well as host countries, and perhaps also the media and international organisations, could increase the pressure to use best technology in countries whose rules do not demand this.

*13. European Neighbourhood Investment Program (ENP): European neighbours have a potentially high growth rate and this potential could be made effective if Europe invests more in the neighbourhoods, thus also limiting political conflict and the necessity to migrate.*

After World War II the US demonstrated that investing in a region with past political conflict can at the same time create a market and a political partner. European investment in the Black Sea area, in the Arabic countries and in North Africa may unleash growth and reduce conflicts. Free trade zones under US guarantee may be a possibility if local governments do not exist and cannot guarantee stability. Different international organisations might provide guarantees, while individual European countries can try different models.

*14. Knowledge transfer and intercultural learning: Cultural differences can be mitigated and learning accelerated through an exchange of researchers and qualified workers.*

The US Fulbright program offers an example of how European researchers can get the opportunity to study at leading universities. This leads to a common understanding of values and systems. In Europe, an Erasmus ‘plus’ program could be the start, based on which the elite of the neighbours is invited. This program should be extended to industrial and skilled workers, who are either trained in the neighbourhood or in Europe's system of dual education.

*15. Reaping the benefits of migration: The mutually positive effects of migration are less evident if migration is caused by problems in the country of origin; and specific support to integrate migrants into work early is necessary.*

Education and skill improvement increase the probability of work in the host country, circular migration – return of migrants after some time – benefit the country of destination and stabilize trade and investment relation between both.

*16. Recommitting finances to social needs: Negative spillovers from the financial system have to be stopped by fewer but smarter regulations, and the goals of all investment funds should be known to investors and regulators.*

Incentives for the financial sectors to effectively strengthen the real economy should be set. Investors should be motivated and enabled to include the needs of society into particular portfolio selection. Labelling funds according to their contribution to social and ecological goals and responsible globalisation could help investors selecting their portfolio.

## **5 Resume**

Following these principles and searching for the best instruments to implement them will hopefully make the welfare effect of globalisation increase for all partners. Europe should try to increase its impact on shaping the rule, but at the same time learning from its partners.

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