

## Resilience and regulatory policy

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It has become a fashionable word: Resilience (of the economic system). The term became popular during the COVID-19 crisis, as disrupted supply chains created problems for the manufacturing sector. This was quickly followed by political recommendations for preventing this situation in the future: Reshoring - the strategy of returning critical production processes and critical products to Germany, or at least to the EU. Several of today's hotly-discussed political measures have their origin in the debates of those days (such as subsidies for microchips or battery cells). These ideas were also driven by policy-makers wanting to take a more activist stance in terms of industrial policy.

Resilience is a concept that is already well known in psycho-medical research, in ecology and in the material sciences. Even though these fields are very different, they also have something in common, namely the presence of an external shock that requires the system to respond. A system is resilient if it is able to manage the shock rather than just absorb it, and if it knows how to utilise the shock for its own purposes. In contrast to robustness, resilience is characterised by a certain level of flexibility: An oak is robust; it can withstand storms until a certain point, and then it breaks. A willow, on the other hand, sways in all types of weather and generally returns to its growth process after it has been freed of dead twigs and branches. In psycho-medicine, resilience refers to how a person manages and emerges from a crisis. Ecosystems are resilient if they can successfully manage stress, such as extreme weather events.

At the economic level, resilience is an interesting concept due to important role of shocks (particularly in the economy). Economic fluctuations are usually the result of shocks. In particular, the crisis-related characteristics of an economic system raise the question of its ability to manage such crises. The global economic crisis was the last great financial crisis before the bank and financial crisis of 2008/2009. The way in which the shock during the global economic crisis was handled with economic policies actually exacerbated the crisis and led to mass unemployment - with the well-known political consequences for Germany and the rest of the world.

Therefore, the resilience of an economic system is initially a function of its ability to manage crises. It is

comparatively simple for governments in situations such as the financial crisis or the COVID-19 crisis: an expansive monetary and financial policy can absorb the shock. However, the ensuing developments usually show whether these measures are actually sustainable. Not all countries were able to handle the increase in government debt during the financial crisis. The highly-indebted member states of the European monetary union subsequently experienced a debt crisis. The financial and economic policies during the COVID-19 crisis lasted too long and therefore also contributed to inflation. As a result, the basic structure of an economic system is the key to resilience.

What does that mean? The flexibility to respond requires flexible markets. This applies to the labour market, because workers must be able to adapt to new environments and a structural transformation. This requires education, in particular non-specific human capital that can be utilised in other companies. Flexibility also applies to product markets and is encouraged with a lot of competition. At the same time, companies must also have the right prerequisites for innovation. Government regulation is particularly damaging in this regard. A high degree of competitive intensity requires internationally open markets. Reshoring is the wrong response; what is required is international diversification.

On the financing side, a resilient system is characterised by companies with a solid equity base and relatively low government debt (or more precisely: manageable public debt). Equity requirements for banks or fiscal rules are examples for resilience-strengthening institutions.

Reading through this list, it becomes clear what an economic policy designed to strengthen resilience would have to look like: it must be regulatory policy.

Sincerely yours



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