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AUTHOR: MARCELO RESICO

A debate on models of capitalism and the Social Market Economy

With the Berlin wall's downfall, during the 1990s and early 2000s, a world was revealed that could be defined as unipolar, in which an extreme definition of the free market took shape – the idea of an entirely self-regulated market and hence of an economic policy based on deregulation – and confidence on the automatic progression of western-style democracy.¹

The international financial and economic crisis launched in 2007-2008, in good measure led to discarding this vision with regard to automatic social movements in history. The financial crisis, closely related to the col-

lapse of a speculative bubble in the mortgage markets, led to what became known as the international economy's "great recession," making clear the deficiencies of a model based on a "deregulated market." Under this paradigm, the economy's regulations were seriously slackened, in particular in connection with financial markets and upholding competition, concentration of property and wealth ensued and a financial system was created, vulnerable to recurring and systemic crises.² As a result, we currently see the social situation being degraded, in particular in the developed world, with a weakening of civic and democratic values in a number of countries.

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In addition, these events have brought to light a long-term process of the re-appearance of a multi-polar world in which there is competition by national or social-

¹ The End of History and the Last Man by Francis Fukuyama (Planeta, Mexico, 1992) promoted this vision.

² See Marcelo Resico, (2002) "Crisis en la nueva economía", *Revista Valores*, FCSE-UCA, December, No. 55; and "La crisis financiera y el debate sobre las regulaciones," *El Economista* newspaper, October 3, 2008.

ONLINE PUBLICATION

JUNE 2013

www.kas.de/brasilien/en/

cultural models of capitalism. The models of capitalism result from combinations of economic policies, a certain set of institutions and a given social-cultural setup. In addition, these structures apply to reality in the framework of a strategic plan, usually at the national level, which attempt to adapt the mentioned components to a situation in the economic backdrop and geo-politics in the short and medium terms.

The ongoing international economic crisis has broadly signaled the need for restoring the state's intervention in the economy, which has occurred in a large majority of countries to a greater or lesser degree, (including policies such as in support of financial institutions and companies by means of state participation, unemployment insurance and social policies, and a rise in public expenditures in infrastructure projects, among others). In addition, a discussion arose in connection with restating national regulations as well as international institutions. Anti-cyclical policies for greater state intervention in the economy abated the more extreme effects by the crisis, yet the "end of the tunnel" is not yet in view, and at the time of this writing the likelihood still persists of a double recession, that is to say, in the form of a "W."

On the other hand, currently several manners have begun to be felt of viewing state intervention in the economy. In the greater portion of the developed world this has been deemed a punctual and exceptional intervention, intended to recover the private sector economy, which is looked on as the primary driver of growth. In a number of emerging countries, intervention gives way to a new model whereby state intervention indicates that the state will manage the

economy over an indefinite term.³ Leaders in several countries are pragmatically venturing into a new model: "state capitalism," which is believed by some to be able to help in overcoming the financial crisis, and "deregulated markets," ensuring economic growth. In other countries, an intermediate situation is in place, expectations. In the light of these trends that have been taking shape, it appears to us that the discussion will be defined from here onwards on economic systems and their concurrent policies.

On the other hand, it will be perceived that the international system at a global level is in danger, not only owing to the economic effects created by the crisis, but also due to the various views of how it should be organized based on opposing models of capitalism. Changes in the balance of economic and political power, as reflected in the progress by the G-7 to today's G-20, lead us to assume that this topic is unavoidable in order to decide what form the new international architecture should acquire.⁴

This paper's central theme is that there is a third alternative between "deregulated market capitalism" and "state capitalism:" the "social market economy," which may result in an adequate response to national challenges, such as a contribution to restore the international system.

³ Ian Bremmer, (2009). "State Capitalism Comes of Age", *Foreign Affairs*, May/June, Vol. 88, Issue 3.

⁴ Bremmer, I., Roubini, N., (2011). "A G-Zero World", *Foreign Affairs*, Mar/Apr, Vol. 90, Issue 2.

II. State capitalism and its limits

State capitalism is a system whereby the government holds the role of dominant economic player and employs markets basically for its political benefit. To this end, it may combine political authoritarianism with state control of key segments in the economy. Governments that practice “state capitalism” are aware that following the experience of Soviet communism, sustaining economic growth is essential to preserve the monopoly of political power.

The economy in these countries may theoretically preserve private property and a pragmatic liberal attitude towards foreign trade, but at the service of the state and of their leaders. Government employs state companies or those controlled by the state, as well as other social players (trade unions and social movements, as occurs in Latin America), in order to implement its policies. In state capitalism, success in business will depend on close relations between businessmen and political officials. While enforcing a policy of broadening the state’s activities and attributions, further opportunities are provided to condition economic and social players.

According to analysts of these events, state capitalism relies on three key players, state-owned companies (oil companies, and others in relevant industries), allied private domestic corporations and public financial funds.⁵ The major state companies are usually monopolies in their industries, enjoy

better conditions and rely on state funding. Nonetheless, government employs selected private companies known as “national champions” to dominate key sectors.⁶ State companies or those controlled by the state usually enjoy a predominant position in the domestic economy and in export markets.

Public financial funds are geared to obtain strict control of the most relevant investment projects by means of the weight of long-term funding by the state. The latter in turn has access to capital by means of foreign currency reserves amassed by virtue of exports, taking over revenues from natural resources and those arising from large controlled companies. Motivations behind investment decisions are political as well as economic.

Government controls the economy while in a capitalist role (as defined by Karl Marx) by taking over surpluses from private enterprise for their subsequent investment. This “taking over surpluses” policy requires a productive system that is able to create wealth. Under the circumstances, the best strategy is not maximizing short-term returns, but stimulating the productive system as much as possible, in line with the preservation of a predominant position in the system.

The cultural traits of Latin America ensure that our predominant form of “state capitalism” has the shades of a personalistic or charismatic authoritarianism, in addition to

⁵ Adapted from Ian Bremmer, (2008). “The Return of State Capitalism”, *Survival*, vol. 50, no. 3, June–July, pp. 55–64, who names 4.

⁶ Large private companies depend on state sponsorship in the form of legal restrictions in order to eliminate competition, differentiated access to government contracts, subsidies, long-term funding for investments, etc.

ONLINE PUBLICATION

JUNE 2013

www.kas.de/brasilien/en/

the demagoguery of a state that shares resources in order to win elections and captivate sympathizers. This policy is asserted in a number of the region's countries based on the abundance of natural resources that currently enjoy very favorable international prices. Nonetheless this arrangement dilapidates valuable resources invested under questionable economic thinking and poorly devised policies, with no interest in motivating self-reliance and independence of the persons that are being assisted. Its outcome will depend on sustaining the international conditions that provide it with support (international prices) and that the level of inefficiency and contradictions created are not fully perceived by the population.

From a more general viewpoint, state capitalism as such is a system with many limitations that increase with time. Economic decisions made by politicians and bureaucrats add inefficiencies and make the economy less competitive, efficient and productive. Greater administration expenditures, inefficiency and increasing public corruption add costs to market activities. The mix of government business annuls competition, besides the fact that state capitalism – similarly to the “deregulated market” model – does not abide by anti-monopoly laws. Distortions in competition such as unbalances, misalignments, bottlenecks, etc., lead to a poor allocation of funds, which under state capitalism usually implies new interventions and the creation of a vicious circle.

Companies that maximize political aims are usually not innovative or productive, as political criteria often obstruct efficiency and entrepreneurship. Investments made based on political considerations do not comply with economic criteria and place at risk growth by the very companies that they benefit. However, official credit to reduce risks is provided to large corporations yet gets nowhere near small companies. Cor-

ruption becomes greater as the state grows larger, giving rise to degradation of public administration itself, of public services and infrastructure. With time, the state capitalist system erodes.⁷

On the other hand, making a political issue of economic relations leads to a mismatch in interests, expressed by constant and rising tension. Taking over surpluses confirms the “zero sum” logic whereby a person or group gains at the expense of another, encouraging intensified conflicts among them. This is how tension is produced within the dominant class or between the dominant class itself and the rest of society.⁸ Finally, the model that contains growing contradictions becomes inherently unstable over time.

III. Alternative current-day economic organization systems

“Deregulated market” capitalism has led to the current “great recession” due to economic concentration, occupation of regulating agencies by interest groups and unwise deregulation, which brought about subsequent financial instability. Nonetheless its current replacement by state capitalist systems only served to stress these deficiencies, creating an inefficient and concentrated economy in addition to social systems that are progressively authoritarian and opposed to participation by the citi-

⁷ Walter E. Grinder, John Hagel III, “Toward a Theory of State Capitalism: Ultimate Decision-Making and Class Structure”, *Journal of Libertarian Studies*, Vr.1. I. No. I, pp. 59-79.

⁸ Ibid.

ONLINE PUBLICATION

JUNE 2013

www.kas.de/brasilien/en/

zenry, which increases encouragement for corruption.

Though in recent decades serious abuse has been perpetrated on behalf of decentralized market capitalist systems, which to a large degree has weakened the vigor and controls of a democracy under the rule of law, these forms of organization, continue to be, when the economy is provided with a social function and a solid institutional landmark is established, restoring an active civil role, a system able to avoid abuse, creating lawfulness and economic growth. Even when democratic governments are not immune to the components of state capitalism, institutionalized and participative democracy with its rule of law, alternation of power, an active civil society, a pluralist and free press and other controls over power, whenever supported by consensus for effectiveness, make it difficult for them to thrive.

An example of this kind of system is what has been named Social Market Economy, a third alternative between the “deregulated market economy” that recently collapsed, and the “state capitalism” currently in the upswing.⁹

⁹ SME is a complete economic theory and a proved manner for organizing the real economy. This viewpoint was developed in Germany and applied successfully following World War II. Its results influenced similar solutions in neighboring countries at that time. It also contributed to the reunified Germany in 1989. It also influenced considerably the economic system adopted by the European Union as well as by emerging countries and other developing nations, including in Latin America.

IV. The Social Market Economy as a “regulating” system

The social market economy is a system based on a free economy, which cannot be considered without the concurrent existence of a solid institutional landmark to regulate it, and emphasis on socializing fairly the outcome of economic growth throughout society, in the form of social policies to encourage self-reliance by the people and communities. The institutional landmark in this system is based on the rules of a market economy, prevention of concentration of economic power or encouragement of competition, market regulation in order to avoid conduct in violation of justice and a fair competition system, and standards for the use of macro-economic policies that make room for their prudential use in case of exceptional situations such as the current crisis. The social policy array has been designed in a “subsidiary” function in support of self-assistance, and based on the encouragement and strengthening of civil society, with a state that will intervene in those cases in which these actions are insufficient. This social-economic model is intrinsically complemented by a participative democracy political system based on acknowledgement of individual and social rights, with alternating governments and the division of authorities in order to ensure them.¹⁰

The SME arose from the search for a new medium and long-term economic and institutional landmark capable of being explicit, respected and stable, as a basis for organizing an economic system. The different play-

¹⁰ Resico Marcelo, (2011). *Introducción a la Economía Social de mercado*. Latin American edition, Rio de Janeiro, SOPLA-KAS.

ONLINE PUBLICATION

JUNE 2013

www.kas.de/brasilien/en/

ers in the economy, such as consumers, investors, savers, trade unions and businessmen, require a clear and reliable reference point in the medium and long run in order to make decisions. This concept is known from the viewpoint of the SME: the "economy's regulating system."

The Social Market Economy is based on market organization as the best system for allocating resources, and attempts to correct and provide institutional, ethic and social conditions for its efficient and fair operations. When required, it will not refrain from offsetting or correcting likely excesses or mismatches that may be reflected by a modern economic system based on free markets, marked by a detailed and extensive division of labor and that in certain segments and under certain circumstances, may be distant from fair and effective competition. This definition of the SME as a social and economic model arises from the ideas developed by Alfred Müller-Armack, who created the concept as an open idea and not a closed theory.¹¹

The SME system arose from the conscious intention of detailing the social market economy's advantages: development of individual initiative, productivity, efficiency, trend for self-regulation, with basic contributions found in the social tradition of solidarity and cooperation, based on fairness and justice in a given society. Those that

¹¹ In his 1946 work *Wirtschaftslenkung und Marktwirtschaft* (Economic Guidance and the Market Economy), Based on the article "The Social Market Economy, Introduction" by Friedrun Quaas, in Hasse Rolf H., Schneider Hermann, Weigelt Klaus (ed.), (2008). *Diccionario de Economía Social de Mercado, Política Económica de la A a la Z*, 3rd. Ed., Buenos Aires, Konrad Adenauer Stiftung.

represent this concept work in a summary of the liberal, political and economic tradition in connection with "individual rights," "republicanism" and the "market," with the tradition of a social and Christian mentality that emphasizes "human dignity", "social justice" and "solidarity."

In order to place the social and political principles described to this point in a concrete economic reality, the Social Market Economy is based on a number of economic principles derived from the former. Their first list is due to the contribution by economist Walter Eucken, one of the Freiburg School leaders, who rated them in two groups: the so-called "structural principles" that are dedicated to ensure an environment of economic freedom, and the "regulating principles," which are those that prevent likely abuse of this freedom and ensure that the benefits created in the market will spread out in a socially fair manner.¹²

Structural principles imply the development of a market economy, which when correctly devised will provide the system with the most efficient stamina for production and economic organization. With regard to regulating principles, they have to do with the institutional landmark and the economic policy under the state, and are those required by a market economy to provide the benefits of its high productivity to serve society as a whole.

This complete set of economic principles assumes the existence, in contrast with extreme economic liberalism and authoritarian state control, of a "strong and limited" state. "Strong" in the sense of driving and applying the principles set forth and also penalizing persons or pressure groups that intend to undermine them by imposing their personal interests, and "limited" in order not to exceed its functions beyond the principles set forth, whether in the project or in

¹² See Eucken Walter, *Fundamentos de Política Económica* (Grundlagen der Wirtschaftspolitik), Rialp, Madrid, 1956; and Karsten Siegfried, Eucken's Social Market Economy and its Test in Post-War West Germany, *American Journal of Economics and Sociology*, Vol. 44, No. 2, April 1985.

ONLINE PUBLICATION

JUNE 2013

www.kas.de/brasilien/en/

its application. Nonetheless, this state's operation cannot be conceived from the viewpoint of subsidiarity, that is to say, in complete agreement with the delegation of functions and development of individual or organized civil participation.

Currently in Latin America there are examples of histories of countries based on a strengthening of institutions and the rule of law, with a market-based economy that made it possible to improve social indicators. This is demonstrated in those countries that have progressed more in the region regarding their economic and social indicators.¹³ Despite this, state capitalism seems to be on the rise in others of the region's countries, in response to the collapse of the "self-regulated market" model, a reaction that is already displaying its weaknesses.¹⁴

V. The issue of global level economic organization systems

¹³ French Davis, Ricardo, (2003). *Entre el Neoliberalismo y el Crecimiento con Equidad, tres décadas de política económica en Chile*, Ed. J. C. Saez.; Yañez Eugenio, (2005). *Economía Social de Mercado en Chile, Mito o Realidad?*, Hans Seidel Stiftung, Santiago de Chile; Fontenla Montes Emilio, Guzmán Cuevas Joaquín Eds., (2005). *Brasil y la Economía Social de Mercado*, Ed. Cáceres, Universidad de Extremadura.

¹⁴ See the Economics graduation thesis in the UCA Economics course: "Economía Política del Neo-Populismo de Izquierda. Los casos de Venezuela, Bolivia y Ecuador". Gonzalo Gutiérrez de la Fuente, March 2010.

Besides being a sustainable exit solution, the Social Market Economy model may be a relevant reference landmark as a contribution for reorganizing the international system. The international system is under a serious threat, not only owing to the economic effects created by the crisis, but also owing to the basic dissent on the shape to be given to the reorganization, due to opposing models of capitalism and jointly with the value of the institutions that compose them.

The global economy has always needed common values and institutions, in addition to the leadership of certain countries that provided concrete requisites such as a security network for markets, trade and capital flows.¹⁵ On the other hand, international bodies were created to solve conflicts by means of rules voted by their members, instead of resorting to force. There is no doubt that their representation structure refers to the end of World War II, clearly a changed scenario now, weakening their expressiveness. The relative decline of US leadership as a world level provider of public assets, plus the fact that China is engrossed in its own development and has temporarily postponed taking on greater

¹⁵ "Under the competitive market economic system as in any other economic system, economic integration cannot definitely go further than social and political integration based on laws, institutions and psychomoral forces. The latter is an essential condition for the former, which makes highly dubious that economic integration will suffice to automatically produce the required degree of social and political integration... [International integration] is a highly sensible artifact in Western civilization, with all the ingredients of Christian and pre-Christian morality in its secularized forms..." Wilhelm Röpke, *International Economic Disintegration*. London 1942, pg. 68.

ONLINE PUBLICATION

JUNE 2013

www.kas.de/brasilien/en/

global responsibilities, jointly with the differences between developed and emerging countries, are creating a vacuum in international leadership.

Changes in the balance of economic and political power, as reflected in the progress by the G-7 to today's G-20, lead us to assume that this topic is unavoidable in order to decide what form the new international architecture should acquire. Until the mid 1990s the G-7 headed an international following based on a core of values such as democracy and the market economy. Attempts have been made currently to endow the institution with greater representation by creating the G-20, which includes developed and outstanding emerging countries. Though this institution has acted in a relatively coordinated manner in the face of a severe crisis, it soon began to show difficulties to reach a consensus owing to differences in philosophy on its vision of democracy, government's role in the economy and the reconstruction approach for international bodies.¹⁶

This fragility is produced precisely at a time when they are most necessary to address the current agenda's topics, serious and urgent. The decoupling of China by means of its foreign exchange as a domestic market development strategy, the shock between different models of capitalism and competency for obtaining funds and markets will give rise to friction. Furthermore, an increase in trade conflicts in the light of global unbalances is a sign of this.

¹⁶ WEF, (2012). "Global Agenda Council on Geopolitical Risk", Davos-Klosters, Switzerland, January 25-29.

Under the circumstances, the need to enter into agreements is clearer and clearer, with assurances to regulate the global economy from here onwards. To this end, a landmark in common will be required defining the limits for state intervention with regard to international trade and environment.¹⁷ In the current scenario, this means that United States and China should strive to agree on positions in which the role of third parties will be increasingly important, which will require a relevant role for Europe, with its Social Market Economy model.¹⁸ In this line there is also a path in international politics for our region's nations, which leaving the weaknesses of the reforms of the 1990s, do not accept state capitalism but seek to ensure economic growth jointly with the distribution of social benefits in a backdrop of improved institutional quality of the state and public policies.

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¹⁷ Lehmann Jean-Pierre and Appleton Arthur, (2011). "Only the Rule of Law can Prevent a US-China Conflict", IMD, Lausanne, Switzerland, January.

¹⁸ Takenaka Heizo, "The Chinese Mirror", *Project Syndicate*, 03-02-2011.

ONLINE PUBLICATION

JUNE 2013

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ONLINE PUBLICATION

JUNE 2013

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