SOCIAL SECURITY SYSTEMS IN THE SOCIAL MARKET ECONOMY

BETWEEN THE POLES OF SOCIAL POLICY AND MARKET FORCES? AN ANALYSIS OF THE STATUTORY HEALTH INSURANCE IN GERMANY IN THE CONTEXT OF THE SOCIAL MARKET ECONOMY'S FOUNDATIONAL PRINCIPLES

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1. SUMMARY

In this article we present fundamental principles of the Social Market Economy and analyze their role for the design of social security systems. The great potential of the Social Market Economy lies in the simultaneous provision of an efficient allocation of resources and of an efficient, that is, accurate redistribution in the tax-transfer-system. The resulting efficiency gains contribute to social welfare.

The advantages of the Social Market Economy are decreasingly appreciated by the German society. Besides the uncertainty caused by the financial and economic turmoil, the growing need for higher contributions to the social security systems with simultaneously shrinking coverage lead to a loss of reputation of the Social Market Economy.

Trust in the market mechanism is especially lacking in the German statutory health insurance system. Health is re-

garded as “special good” which should not be supplied by anonymous market forces. Despite the – consequently – massive public interventions in the health care sector, the design of the statutory health insurance is perceived as unfair. More public action has thus not led to more social justice.

We will show in this article that the inconsequent implementation of the Social Market Economy’s fundamental principles contributes to the current problems in the social security systems. Since social security is seen as one of the fundamental pillars of the Social Market Economy, their unsystematic design leads to an erosion of trust in the economic system itself.

Trust will only be regained by a systematic implementation of the Social Market Economy’s fundamental principles. In this case, the Social Market Economy can serve as an example and act as an instigator in the debate over different economic orders.

2. PRINCIPLES OF THE SOCIAL MARKET ECONOMY

Whereas German politicians praise the Social Market Economy as a means to overcome the international economic crisis[1], the population loses its trust in the economic system. Even before the economic crisis, there were doubts if the Social Market Economy was indeed a social economic system, because German people are under the impression that the number of the systems’ losers is rising.[2] In this paper it is however put into question if people are really criticizing the system as a whole or its imperfect design. In the following we will present our view of the foundational principles of the Social Market Economy.[3] After this theoretical foundation we will analyze if these principles are adhered to in the German health care system before suggesting a reform that combines competition in the health sector and social security measures to help the needy.

2.1 Individual Liberties

The normative base of a market economy is the freedom of individuals, i.e. the realisation of their preferences and ways of life. Therefore, voluntary individual exchanges can be interpreted as a mutual betterment and an increase in social welfare.[4] The price mechanism coordinates individual interests and goals: Prices mirror the individuals' subjective appreciation of products and services and thus coordinate the different interests of consumers and suppliers.

Individual freedom (negative rights of freedom) can only be guaranteed if individuals do not harm others by their actions.[6] The protection of individuals from the negative consequences of others' actions is a constitutional characteristic of a state of law on which a free society builds on. Within this constitutional framework individuals can assume their civil rights and liberties. Their freedom will only be curtailed if they act against others civil rights and liberties. In contrast to socialist societies, the Social Market Economy does not intend to educate people or change their values, that is, it does not have any interest in forming a "good citizen".[7] The rules are set in a way that the system is robust even if people act exclusively egoistically. The focus on potentially egoistic people can be thought of as a preventive, worst-case oriented set of rules. The assumption of egoistic behaviour is a "social-technical" assumption[8] which is necessary to protect the society from exploitation by members who do not act altruistically.

The orientation on potentially egoistic individuals does not imply that moral behaviour[9] is neither wished for nor possible in a market economy. The "moral" is integrated in the rules of the market economy. Moral behaviour does therefore not need to be an extraordinary individual achievement, but is binding for all individuals through its institutionalisation in the market rules. A systematic integration of moral elements in the rules of the market economy combines the advantages of competition with ethical social values. Due to the rules, originally intrinsically motivated moral behaviour becomes egoistic behaviour and is therefore more probable. Environment harming behaviour would thus be penalized and consequentially reduce company profits, while "morally right", environment protecting behaviour would be maximizing profits.[10]

2.2 Competition on the Merits

In a world of scarce resources, the realisation of individual goals and the coordination of individual actions can only be attained by market competition. By contrast, the allocation of scarce resources by a central planner is incompatible with individual liberties, since considering all individual preferences at once and creating a hierarchy of needs is impossible even for a benevolent planner. A central planner will therefore always violate some people's preferences, thus exerting coercion. By contrast, individual goals can be achieved by market competition in due consideration of scarce resources: The price mechanism reveals scarcity and individual needs, thereby ensuring the coordination of demanders and suppliers. Competition forces providers to satisfy demands at the lowest possible cost and consequently avoids any waste of scarce resources.[11]

In a market economy, remuneration reflects the other individuals' appreciation. Competition thus forces individuals to direct their actions into those areas which are most important to their fellow citizens. This principle of competition on the merits that has been promoted by the Freiburg School corresponds to the ideal of consumer sovereignty.[12] All actions are directed towards fulfilling the consumers' demands. The consequent orientation of the production process on consumers' interests can guarantee a social order free from privileges and therefore a social order on which consensus might be reached behind the veil of uncertainty.[13] Sovereignty of producers by contrast would be an obstacle to a privilege free order since producers' interests often lie in protectionist measures.[14]

This ideal form of competition is rarely achieved in practice. It is however important to bear this ideal in mind as a reference order for the analysis of and the debate on current economic and social issues.

2.3. No Competition Without Rules

Competition as discussed above can only be as good as the rules under which it operates. This implies that cartels and monopolistic structures are incompatible with competition on the merits and act against consumer sovereignty: Under cartelistic or monopolistic structures, remuneration does not reflect consumer's appreciation: Monopolists can set prices autonomously and preclude other competitors from market entry.[15] Even if a social order's benefits are generally accepted, it is nevertheless constantly at risk, because the violation of rules and the achievement of power can be an attractive strategy for some members of the society.[16] Without rules of law channelling individual actions, individually rational behaviour can produce drawbacks for the society (market failure). The well-known prisoners' dilemma clearly depicts the discrepancy between individually desired goals and the final outcome in the absence of general rules.[17]

Market failure should however not be the sufficient requirement for public market interventions, since there is the risk of a government failure: In the latter case, public action does not lead to welfare gains but welfare losses.[18] Therefore the need for and the advantages of public interventions must be thoroughly analyzed.

If the market mechanism is accepted as an efficient means to coordinate individual and free actions, only the rules of competition and not its results can be evaluated.[19] If the society has agreed on fair competition rules then its results can be regarded as fair under the perspective of performance-based justice (for: Leistungsgerechtigkeit). This result does however not necessarily imply that the market mechanism ensures a life in decent conditions for all members of society. That is why market competition has to be complemented by social policy measures outside of the market.

2.4 Social Policy Without Intervening in the Market

The fact that remuneration is determined by the other individuals' willingness to pay implies that without this willingness, even basic human needs are not taken into account by the market. An individual can therefore only achieve a decent standard of living if the other individuals have a sufficient willingness to pay for her performance. Furthermore, neither prestige nor social status determines the level of remuneration.[20]

There is a general social consensus that each individual should be offered a decent minimum living standard. Without the guarantee of a minimum income, a competitive market order would probably be less accepted by society. If an individual can not accomplish enough to satisfy her basic needs, solidarity requires helping her to live a decent life. This is not to say that there is an entitlement to keep a certain social status. The risk associated with competition to lose one's social position cannot be compensated for by society, since this would imply privileges for some at the expense of others. What the society can guarantee is a minimum income, the amount of which is defined in the political process. Its amount is therefore theoretically indeterminate, what matters is the guarantee for every citizen in need that she will not be forced to live below a decent living standard. The provision of this minimum standard is however no unilaterally binding contract: Even people in need do have to help themselves as far as possible, thus avoiding overburdening the society.[21]

Protectionist measures, such as maximum prices or minimum wages are to be avoided. Prices lose their signalling function when they simultaneously have to serve distributional goals. Curtailing the signalling function leads to a waste of social resources. The conservation of scarce resources however works especially to the advantage of people in need since it increases the margin of distribution. Likewise, price interventions do not take into account social status. Price interventions affect every citizen regardless of her income and wealth with exception of the most needy: Without any market income, they cannot take part in the market and thus not profit from “social” prices. Means-tested transfer payments by contrast are a targeted and resource-protecting means to achieve social security outside of the market.[22]

2.5 Justice of Rules and Procedures Instead of Protection of Vested Rights

The overview of fundamental principles of the Social Market Economy has shown that a liberal order does not preclude solidarity, that is, helping people in need. On the contrary: Guaranteeing a minimum income is essential for the functioning of a liberal society. The liberal order can however not guarantee absolute security. The freedom to choose one’s activity and to reap the fruits of one’s labour always goes along with the risk to fail. The society cannot avert all individual risks: Individual losses have to be answered individually and are not to be socialized. Otherwise there would be no incentive to assume responsibility for one’s actions.

Guaranteeing social status for some would go at the expense of others: If for example certain jobs are preserved by subsidies the latter have to be financed by taxes. Thus, citizens are forced to pay for the preservation of a company for the products of which they did not have enough willingness to pay in the first place. Likewise, the tax burden leads to job cuts in other companies and/or hinders the creation of new jobs.

Justice can only be understood as justice of rules and procedures if all individuals should be treated equally and if their liberties should be respected. If these general rules are accepted, the only important action is to guarantee a minimum standard of living for the needy. This minimum living standard is financed by taxes which are paid in accordance to the respective individual ability-to-pay. Further redistribution would create privileges for some groups of society at the expense of others without justification.

As discussed in the following chapters, there are good reasons for supplying the needy not only with subsistence aids but also with access to medical treatment. Both have to be financed by society. It is however important to bear in mind that this can only mean equal access to a minimum health benefits basket defined by society. Equalizing all health status is neither possible nor desirable in a world of scarce resources.[23]

Solidarity with the needy should however not imply governmental intervention in the health care sector at the expense of market forces. On the contrary, relying on market forces with the resulting improvement in efficiency can lead to more justice in the health sector.

3. SOCIAL MARKET ECONOMY IN PRACTICE: STATUTORY HEALTH INSURANCE

In reality, many principles of the market economy are violated, not only in the health care sector. The breach of fundamental principles generates feelings of injustice. Therefore many citizens lose their trust in this economic order. The question is if this opposition is directed against the ideal form of Social Market Economy or against its flawed implementation. Especially in the emotionally-charged realm of social security, the unsystematic implementation of Social Market Economy principles results in an inexplicable redistribution which in turn leads to problems of acceptance of the whole economic order.

Germany has a long tradition of Bismarckian Social Security Systems by which over time, more and more risks have been shifted from the individual's area of responsibility to the society's area.[24] The willingness to assume responsibility for individual risks has declined substantially during the last decades because the state assumes more and more risks by forcing its citizens in public insurances against unemployment, illness etc. With statutory insurance, the freedom to choose is curtailed in favour of an alleged security, without ensuring "social justice" in these insurance systems. This leads to an erosion of trust in the social part of the market economy.

The seeming contradiction between freedom and security – or rather between freedom and social justice – is cited as the reason why "special goods" cannot be traded in the market but have to be supplied by government interventions or at "social" prices. Health services are regarded as special so that many do not trust anonymous market forces for their supply. If health services are special, it is however important – given the scarce resources – to produce these "goods" in an efficient way, that is, using market forces as far as possible.[25]

As shown in the following sections, the problems of the current institutional setting in health care can be analyzed by reference to the principles of the Social Market Economy. Within this framework, approaches for an efficient and systematic implementation of social security systems can be found, which take into account the interaction between social security and market mechanism.[26]

3.1 Compulsory Insurance

Following the principle of consumer sovereignty, citizens should principally be free to choose which risks to insure and in which way. However one can find reasons for a compulsory insurance in the health care sector. Compulsory insurance is a means against unjustified utilization of minimum benefits. Otherwise citizens could have the incentive not to provide for illness, despite having sufficient financial means for insurance. They count on help from society in case of emergency.[27]

Compulsory insurance requires no government intervention in form of a statutory insurance. It can be left to the individuals which insurance to choose. Governmental action is only needed for the definition of the minimum health basket which has to be insured to prevent underinsurance. Citizens who are not able to pay their insurance premium receive financial support.[28] Thereby they are able to act independently in the market. Renouncing totally to individual freedom to choose or to a market solution is therefore not necessary. Within this order, citizens can still choose the insurance which fits best their needs.

This is not the case in the current public health insurance in Germany. It is a statutory insurance for the major part of population; only 10 per cent of the citizens can opt for full coverage in a private insurance. By a statutory insurance, the state substantially curtails the citizens' freedom to choose without compelling reasons. There are no such serious market failures in the health care sector that health insurance could not be supplied by private providers.[29]

The current public health care scheme however has to be obligatory for the major part of society because it is organized as a pay-as-you-go system which needs sufficient net-contributors to cover the older people's expenses.

3.2 Competition on Health Insurance Markets[30]

Especially in the health care sector, the merits of a competitive setting have to be taken advantage of since resources are particularly scarce. That is why an order has to be found which allows competition for efficient health care provision.

The principle of actuarial fairness is fundamental to (health) insurance: Insurers provide individuals with insurance against financial losses due to illness and demand a premium in turn which allows them to break even.

Competition can only be achieved by adhering to this principle. If insurers cannot demand risk-equivalent premiums, they have the incentive to enter in competition for good risks, that is, for individuals whose expected present value of premiums exceeds the expected present value of expenses.

Risk-equivalent premiums correspond to the average risk of a cohort when insured from birth on because risk differences are not known at this point of time (genetic tests precluded). By accumulating ageing provisions and individualising them by adapting to age and illness of insurants, the premium is smoothed over life-time and a (real) increase in premium is avoided. At a given premium, insurants with illnesses or higher risks have to be provided with higher ageing provisions than relatively healthy individuals. Hence, there is no incentive for insurers to choose only young and healthy insurants and to refuse elderly or sick people. Thus a risk-equivalent calculation does not imply higher premiums for sick or elderly people.

Switching insurers is possible by transferring individual ageing provisions.[31] Ageing provisions ensure that even sick people can change insurers without suffering disadvantages because ageing provisions serve to level the cost risk for the new insurance. The possibility to change insurers leads to a competition on the merits and in efficiency, because it creates incentives for insurers to provide all insurants with the best possible health care provision.

In the current social security scheme, competition has been most widely curtailed to the advantage of distributional goals, so that "the principle of actuarial fairness been given up in favour of the principle of solidarity[32] [...]". The breach of the principle of actuarial fairness leads to massive inefficiencies in the system. These inefficiencies are accepted because public opinion holds that health insurance should be financed in a "solidary way". In the German statutory insurance, the financial means for this purpose are to be raised according to the ability to pay of its insurants. This ability to pay is measured by wage income (income related contributions).

Income related contributions prevent efficient competition in the health insurance sector. Contributions based on wage income are only accidentally equivalent to the risk of the insurant and therefore to the expenses caused. Without equivalence between premiums/contributions and insurance benefits, insurants are regarded as low, respectively high risk individuals. Therefore, insurers have incentives to only attract insurants whose expected premiums exceed their expected expenses. This cream-skimming leads to a massive waste of resources because insurers do not strive to provide their insurants with efficient health benefits but to develop mechanisms for avoiding high risk individuals. The missing price signals thus prevent an efficient competition.

Governments try to circumvent the problem of cream-skimming and missing competition by obligation to contract for insurers and (morbidity-oriented) risk-adjustment schemes. These assign the insurers with a lump-sum and surcharges or deductions which depend on an insurant's morbidity, age and gender as well as disabilities. Apart from administrational costs, these risk-adjustment schemes create the incentive for insurers to claim that the health status of their insurants is worse than in reality in order to get higher surcharges.[33] Insurers can also circumvent obligation to contract by concentrating their marketing activities on young people or by delaying health insurance membership applications from the elderly.[34]

These facts mirror the fundamental problems of administrated "markets". As soon as the signalling function of prices is weakened or suspended by "solidary" prices, there will be evasionary reactions from suppliers and demanders. The insurers try to attract only insurants who are net payers, while the insurants will try to get as much benefits as they can out of the system. Both reactions lead to a false allocation and a waste of resources. The redistribution margin shrinks, because inefficiently allocated means in the health sector lack for other purposes.

3.3 Insurance Markets and Social Policy

The advantages of competition can also be reaped in the health care sector without abandoning generally acceptable redistribution to the needy. Redistribution is conducted outside of the market by giving financial support to people who cannot afford their insurance premiums.

Redistribution is based on the ability-to-pay, which can be most effectively accounted for in the tax-transfer-system. The latter includes all sources of income in the tax base without contribution assessment ceiling.[35]

The redistribution within the statutory health insurance in Germany is not only an impediment to competition. Due to the contributions levied on wage-income, the resulting redistribution is neither systematic nor based on the actual neediness. Proponents of wage-income related contributions are convinced that levying contributions on income reflects solidarity of the rich with the poor. This might have been the case in the past: With the introduction of a statutory health insurance in the 19th century, wage income was an appropriate indicator for the citizen’s ability-to-pay. Nowadays, the ability-to-pay is not sufficiently defined by wage-income, because other sources of wealth, such as capital income are neglected. That is why asset rich people are regarded as needy in the statutory health insurance in Germany, if they have low income from wages. Their contributions to the system will automatically be lower than those of people with high income from wages but no assets, although both can have the same total amount of income.[36] Additionally, there are contribution assessment ceilings, that is, contributions are only levied on a certain amount of income. Furthermore, individuals can opt out of the statutory system for health insurance (including long term care insurance) when earning more than a defined amount per year. This amount is fixed by the German government on a yearly basis and is set at 49,950 Euro for the year 2010.[37] Consequently, a part of the society can evade solidarity, whereas the most needy are actually excluded from the redistribution mechanism within the statutory health insurance: Their contributions are actually paid by the taxpayer.[38]

With the current design of the statutory health insurance, competition resulting from market mechanism is repressed in favour of allegedly social aspects. As shown in the previous sections, unjustified redistribution is accepted on top of the serious disadvantages that result from dirigiste market planning.[39] Additionally, the current system is highly vulnerable to demographic changes and to cost increases due to medical-technological progress. Cost increases are economically uncritical if these date from modified preferences and the respective willingness-to-pay. Problems arise when these cost increases can be traced back to an unsystematic and inadequate design of the health insurance system.

It is imperative to first exploit all potentials of rationalisation in the health care sector, not only for economical but also for ethical reasons. That is why market forces should be strengthened. It is important to stress that this does not preclude generally accepted redistribution.

4. CONCLUSION

A Social Market Economy needs compatible social security systems. In a first step, we have presented the relevant principles of an Social Market Economy to show approaches for a system-compatible health insurance. Reaping the advantages of competition in the health care sector does not imply precluding the needy from health insurance. Our critique of the statutory health insurance scheme in Germany is not based on the redistribution itself, but on its unsystematic integration in the health care system, thus undermining efficient competition.

The morbidity-oriented risk-adjustment scheme tries to combine competition and redistribution. The goal of providing every citizen with efficient health care can however not be achieved herewith. It rather creates incentives for insurers to gain profits which have not been generated by the provision of efficient health care.

A systematically designed health insurance can offer both “goods”, security and health, without wasting scarce resources. The needy who cannot afford to buy this “security” in the market, are supported by the society outside of the health insurance system.

That means that governmental actions have to be complementary to the market systems. The fundamental principles of a market economy do not only separate governmental actions from the market sphere, that is the market for health insurance, but they simultaneously legitimate publicly supplied and accurate support of the needy.

The demand for security rises in times of crisis. Above a given point, however, this security can only be publicly guaranteed at the expense of the citizens' freedom. Justice of rules and procedures cannot guarantee comprehensive economic security, but the certainty to be treated equally and to be able to act under non-arbitrary conditions.

We expect the acceptance of the Social Market Economy to rise when its fundamental principles are not only adhered to in theoretical discourses, but applied in the everyday political process.

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1| *Chancellor Merkel in: Die Welt, January 31, 2009 (online).*
2| *Press release Bertelsmann Stiftung, June 16, 2008 (online).*
3| *This is surely no exhaustive account of all Social Market Ecomomy's principles. We will only address the most important features, which serve as guiding principles for the analysis of social security systems.*
4| *Schlecht (1990), pp. 35 et seq., Roth (2002), p. 58. It should be stressed here that this notion of social welfare is not compatible with the goal of maximizing an aggregated social welfare function. Rather, the theoretical possibility of consent to a social order is taken as a benchmark. See for a thorough analysis Vanberg (2008), pp. 23-48.*
5| *E.g. Zeppernick (1987), p. 9.*
6| *Schlecht (1990), pp. 42 et seq, p. 198.*

7| *Schlecht (1990), pp. 188 et seq.*
8| *Watrin (1980), p. 491.*
9| *We will not discuss the notion of moral here. Referring to Homann, moral behavior is regarded as intrinsically motivated orientation on values such as environment protection, care for others etc. Moral behaviour could however lead to cost disadvantages in competition if these values are not generally binding for all market participants (Homann (1994), pp. 16-17).*
10| *Cf. Homann (1994).*
11| *E.g. Schlecht (1990), pp. 62 et seq., Vanberg (2008), pp. 61 et seq. Roth (2002), pp. 118 et seq.*
12| *Vanberg (2008), pp. 36 et seq.*
13| *It would lead too far to analyze thoroughly the idea of constitutional economics here. See e.g.: Vanberg (2008), pp. 24 et seq.*
14| *Ibid., p. 38.*
15| *Eucken (2004), pp. 30 et seq.*
16| *Vanberg (2008), pp. 57 et seq.*
17| *Kirchgässner (1991), pp. 49 et seq.*
18| *Watrin (1985), pp. 138 et seq.*
19| *Watrin (1980), pp. 486 et seq.*
20| *Hayek (1969), pp. 118 et seq.*
21| *Roth (2007), p. 53.*
22| *Cf. Hayek (2003).*
23| *Gäfgen (1989), pp. 14 et seq. Totally equalizing health status – even if it was possible – would imply consuming many resources which would in turn be lacking for other, more beneficial purposes.*
24| *Cf. Milbradt (2005).*
25| *Maitland (2002), p. 453.*
26| *These approaches follow the model of "Private Citizens' Insurance", which has been developed at the Institute of Economic Policy and the Otto-Wolff-Institute. A more detailed account can be found in Eekhoff et al. (2008).*
27| *Eekhoff et al. (2008), p. 75, Oberender/Zerth (2004), p. 114.*
28| *Zimmermann (2007), p. 158.*
29| *Informational asymmetries for instance and the resulting moral hazard issue can be limited by deductibles.*
30| *This section basically follows Eekhoff et al. (2008), pp. 80 et seq. and pp. 105 et seq.*
31| *Without medical-technological progress and without changes in relative prices, insurers calculate with constant premiums over the life-cycle. When young, the premium is higher than the expenses for the insurant. Thereby, ageing provisions are accumulated to finance higher expenses when insurants get older.*
32| *Solidarity as a mutual acceptance of responsibility in a society (Thuy (1999), p. 29. Translation by the authors).*
33| *Jankowski/Zimmermann (2003), p.11, Eekhoff et al. (2008), p. 43.*
34| *Eekhoff et al. (2008) p. 36.*
35| *The proponents of an all citizens' health insurance scheme also advocate the inclusion of all sources of income in the contribution base. The all citizens' health insurance is a statutory insurance for the whole population, contributions are levied on all sources of income. Apart from the difficulties which arise from the inclusion of (house) rents (negative income possible), bureaucratic costs have to be born in mind: The process of examining the ability-to-pay and means-testing would have to be made both in the health insurance and in the tax-transfer system for the whole population (see Eekhoff et al. (2008), pp. 68 et seq.).*

36| Knappe/Arnold (2002), p. 11.

37| http://www.bundesregierung.de/nn_1272/Content/DE/Artikel/2009/10/2009-10-07-neue-rechengroesse-in-der-sozialversicherung-fuer-2010.html. The opt-out-threshold is higher than the contribution assessment ceiling, which is set at 45,000 Euro yearly income from wages for the year 2010. If someone has decided to opt-out at a certain time, it is almost impossible for this person to return to the statuatory system.

38| Eekhoff et al. (2008), pp. 45 et seq.

39| Besides income redistribution, further distributional measures are implemented in the health insurance, such as non-contributory insurance of children and spouses. These measures are also conducted for alleged solidarity reasons. The unequal treatment of singles and spouses and of different models of division of labour within a family are however not solidary at all, all the more because the most needy are excluded from this “solidarity”. Please see Zimmermann (2007) for a thorough investigation of the unsystematic redistribution.