



THE SOCIAL MARKET ECONOMY WHAT DOES IT REALLY MEAN?

Siegfried F. Franke
David Gregosz

THE SOCIAL MARKET ECONOMY

WHAT DOES IT REALLY MEAN?

Siegfried F. Franke
David Gregosz

CONTENTS

FOREWORD	5
I. INTRODUCTION	7
THE LONG ROAD TO THE SOCIAL AND ECONOMIC CONCEPT OF THE SOCIAL MARKET ECONOMY	7
II. THE SOCIAL MARKET ECONOMY STANDS FOR...	19
1 PRIVATE OWNERSHIP OF THE MEANS OF PRODUCTION	19
2 RULES-BASED COMPETITION	23
3 A STABLE AND WORKABLE MONETARY SYSTEM WITH PRICE STABILITY	33
4 THE GOAL OF HIGH EMPLOYMENT LEVELS	41
5 THE GOAL OF EXTERNAL BALANCE WITH A HIGH EXPORT QUOTA	47
6 STEADY AND MODERATE ECONOMIC GROWTH	53
7 FAIR DISTRIBUTION OF INCOME	59
8 FAIR DISTRIBUTION OF WEALTH	67
9 CARING FOR THE ENVIRONMENT	73
10 EUROPEAN INTEGRATION WITHIN A PEACEFUL WORLD ORDER	79
III. A LOOK AHEAD	85
»ORDNUNGSPOLITIK« AS A CHALLENGE FOR THE WHOLE OF EUROPE	85
GLOBAL COMPETITION BETWEEN ORDER SYSTEMS	89
AUTHOR AND ILLUSTRATOR PROFILES	94
EDITORIAL INFORMATION	95
OVERVIEW: THE SOCIAL MARKET ECONOMY AT A GLANCE	96

FOREWORD

»Not the free market economy of the laissez-faire plundering of a bygone era [...], but the socially responsible market economy that once again brings the individual to the fore, that places a high value on the person and that provides a fair return for work carried out, this is the modern version of the market economy ...«

LUDWIG ERHARD, CDU PARTY CONFERENCE, RECKLINGHAUSEN, 28 AUGUST 1948

The Social Market Economy is a proven economic and social model that not only provided Germany with its economic miracle after the Second World War, but that also brought the country many years of stability and prosperity and allowed it to successfully handle the economic consequences of Germany's partition. The robustness of this model is particularly demonstrated in times of crisis. The financial and economic crisis of 2008/2009 once again proved the resilience of the German economic system. No other industrialised country has better withstood the upheavals in the global economy that were triggered by the collapse of Lehman Brothers. The German economy has also proved itself to be remarkably robust when faced with the European sovereign debt crisis.

But despite these facts, many people find it difficult to describe the basis of Germany's lasting economic success and what is really meant by the term »Social Market Economy«. This is why the Konrad-Adenauer-Stiftung is always striving to throw light on the historical roots and fundamental economic correlations that are linked to Germany's economy and its overarching model, the Social Market Economy. The Stiftung has brought together all its activities in this area under the auspices of the Social Market Economy Project Group. This publication is the result of the discussions of this project group. It provides the basis for a deeper understanding of the Social Market Economy by introducing and explaining in greater depth the key principles of the German economic system, with reference to its founding fathers. Taken all together, these are the elements that make up the model we know as the Social Market Economy. These principles also provide us with appropriate answers to the challenges that face our economy today.

We hope you find it an interesting and thought-provoking read.

Berlin, March 2013

MATTHIAS SCHÄFER
Head of Social Market Economy Project Group
at the Konrad-Adenauer-Stiftung

DAVID GREGOSZ
Coordinator for International Economic Policy

INTRODUCTION



THE LONG ROAD TO THE SOCIAL AND ECONOMIC CONCEPT OF THE SOCIAL MARKET ECONOMY

*From Mercantilism to the Enlightenment
and Classical Liberalism*

From mercantilism to the Enlightenment and classical liberalism

The SOCIAL MARKET ECONOMY is a social and economic concept that is the result of a long historical and political process. This process began with the absolutism of the 16th to 18th centuries, a time when new continents were being discovered and trade was opening up. The term *mercantilism* covers a range of economic policies that all have the common aim of strengthening the power of the absolute ruler. Mercantilism is based on fairly unsophisticated economic theories. Its policies certainly encouraged exports but at the same time they erroneously hampered imports. They also promoted state-owned manufacturing, thus to some extent foreshadowing industrial policy. In France, it brought about the collapse of agriculture (→ 2, 5).

In contrast, the *classical liberalism* that can be traced back to Adam Smith, David Ricardo, Jean Baptiste Say and Robert Malthus focused on the prosperity-enhancing effects of the division of labour that logically leads on to the encouragement of free international trade with as few restrictions as possible. However, the policies failed to pay sufficient attention to the regulatory function of the state, as delineated by Smith et al., particularly with regard to competition policy and the need for an adequate public infrastructure. This meant that the freedoms propagated by liberalism – based on the fundamental values of the Enlightenment – were exploited more thoroughly by capitalists than by workers. The accumulation of private wealth stood in stark contrast to the breakdown of the large families that were typical of the peasant and artisan classes, growing urbanisation and the harsh working conditions of an industrialising society.

The counter-movement: classical socialism

It is therefore unsurprising that counter-movements began to spring up that had their roots in worker solidarity and ended up finding their conceptual expression in the *classical socialism* of Karl Marx. In practical terms, this idea led to political tyranny, particularly in Russia and the Soviet Union. This tyranny sought to impose by force a planned economy and the development of the »New Man«. This system – which was unfortunately widespread in Eastern Europe after the Second World War – not only presented a danger to life and limb for the people who lived under it, but set their chances of prosperity back by decades.

National Socialism: a disastrous direction

In Germany, the coalescence of various factors led to *National Socialism*, which combined a right-wing dictatorship with an economic model that vacillated between a market and a planned economy to serve the needs of war. This system also trampled upon liberal principles and basic human rights.

The foundations of democratic socialism

The Stalinist tyranny and the predictable collapse of the Third Reich served to spur on some thinkers who did not wish to accept the fact that movements based on worker solidarity necessarily translate into political dictatorship. They felt it must be possible to combine socialism with democracy. This resulted in the theory of *democratic socialism*, an idea that in Germany was strongly championed by the late SPD economics minister (and for a short time finance minister), Karl Schiller. Schiller made a major contribution to reconciling German social democracy with the »market«. He is also responsible for the formula stating that the main economic goals can be achieved »within the framework of a market economy« (§ 1, clause 2, semi-clause 1, German Stability and Growth Act [Stabilitäts- und Wachstumsgesetz, StWG]).

Democratic Socialism is still *the* guiding principle of the SPD, even if under the influence of Gerhard Schröder it has at best been adroitly tilted towards a social (with a small s!) market economy.¹

The resurgence of liberalism: ordoliberalism...

Others devoted themselves to the problem of how to reintroduce fundamental liberal principles to the economy and society while avoiding earlier mistakes. They grappled with the theory and practical application of socialism and also took into account the policies of economic stabilisation recommended by John Maynard Keynes in his »General Theory of Employment, Interest and Money« (1936). The Freiburg School is particularly well-known in this respect. In today's climate of socially acceptable mockery of neo-liberalism, it cannot be overemphasised that some of the proponents of these theories went in fear for their lives while working on these social concepts, or at least were risking imprisonment. Amongst their ranks were economists such as Walter Eucken, Constantin von Dietze, Adolf Lampe and the lawyer Franz Böhm. They believed that liberalism only allows the ideals of freedom to truly blossom if it is combined with a system of government regulation, so they coined the term ordoliberalism (from the Latin *ordo* meaning order, rank). They also used it as the title of an annual journal that is still published today (ORDO – Yearbook for the regulation of the economy and society).



Walter Eucken



Franz Böhm

They believed that liberalism only allows the ideals of freedom to truly blossom if it is combined with a system of government regulation, so they coined the term ordoliberalism.

In Nuremberg, Ludwig Erhard was working largely independently on a liberally-oriented concept for the post-war era. Almost miraculously, he managed to avoid the attention of the Gestapo, particularly when his memorandum entitled »War Finances and Debt Consolidation« found its way via Carl Friedrich Goerdeler to other resistance fighters and Goerdeler himself recommended him for leading positions in the post-war era. Alfred Müller-Armack, Professor of Economics and Cultural Sociology at the University of Münster, met privately with Erhard in business circles and his work linked basic liberal precepts with Christian social doctrine.

... and its practical application as the Social Market Economy

Ludwig Erhard tackled the basic principles of ordoliberalism, but in their practical application he also took into account the particular challenges faced by the political leadership of the young Federal Republic of Germany. These included dealing with the destruction suffered by cities and production sites and the consequences of the severance of political and economic ties with the eastern part of Germany. They also had to grapple with the mammoth task of not only caring for but also integrating some 9 million refugees and displaced persons in the shortest possible time.

So Ludwig Erhard's concept of a Social Market Economy, expressed by the slogans »Prosperity for all« and »Property for all« was based on two stages.

In the »FIRST STAGE« it was a question of increasing the economy's creativity and productivity as quickly as possible by relaxing or removing regulation. The aim was to ensure that the population had access to basic necessities such as food, clothing and housing. The plan was for everybody to find a job as quickly as possible within (West) Germany's recovering and growing economy and have a share in the country's increasing prosperity. Erhard stressed that the right kind of free market economy would inevitably have a social element because it creates more productive jobs and more income than a restricted, planned economy.



Ludwig Erhard

»Prosperity for all« and »property for all« (Ludwig Erhard)

Erhard never lost sight of the »SECOND STAGE« of the Social Market Economy, a stage that he believed was absolutely essential and that he perhaps rather unfortunately named the »formed society« [»Formierte Gesellschaft«]. By this he meant that the second side of the Social Market Economy coin should be implemented, that is to say the demand for »property for all«. This was not only aimed at encouraging savings and privately-owned homes, but also at giving broad swathes of the population access to the nation's capital stock. Erhard and Müller-Armack always emphasised the importance of human dignity, which includes access to an emergency welfare safety net. However, in accordance with the principle of subsidiarity, this also includes family assistance and an income from the share in capital stock so that people are not solely reliant on their own working capacity, which can be adversely affected by factors such as sickness and age.

»The reconciliation of capital and labour« (Alfred Müller-Armack)

According to Müller-Armack, the Social Market Economy in the sense outlined above is in a position to end the conflict between capital and labour that arose with the Industrial Revolution. He expressly referred to the »reconciliation of capital and labour« and in this respect he created the »Irene formula« (named after Irene, the Greek goddess of balance and reconciliation). More broadly, we can deduce that the ongoing promotion and elucidation of the Social Market Economy, where possible within a non-restrained but institutionally safeguarded framework, has the power to gradually win over and as a result reconcile its doubters and opponents to the values of the Social Market Economy that lead to prosperity and freedom. It can also provide a platform to debate the content and scope of the *formed society's* social and political aims.

According to Müller-Armack, the Social Market Economy in the sense outlined above is in a position to end the conflict between capital and labour that arose with the Industrial Revolution.

Even if a properly understood concept of the Social Market Economy in itself already contributes to a certain degree of social equilibrium, it can also not be denied that an anonymous, pluralistic industrial society needs to be supported and its pressures relieved through social components. These include adequate social insurance, effective accident protection in the workplace, a certain degree of protection against dismissal, maternity leave and other assistance in the form of grants, housing benefits and welfare payments. On top of this, there is also the constitutional guarantee of collective bargaining and the right of employees to have a voice in their firms. All of this can only work within a democratic society under the rule of law.

The balance between freedom and security

In the sense of the »reconciliation of capital and labour« and a formative social policy, a whole series of targets on welfare and social policy can be traced back to the *formed society* – even if this particular nomenclature has been long forgotten. These targets have set the direction for all German governments since that era. However, there is always a danger of the »social« element over-expanding and over-burdening the economy's capacity. Even in the early 1960s Müller-Armack complained about the beginnings of »sociopolitical overload«.

In view of the constantly changing circumstances of an outward-looking economy, the Social Market Economy is aware that some sort of compromise has to be struck between »freedom« and »equality« or »justice« based on solidarity. It is helpful to recall the warnings of Alexis de Tocqueville (along the lines of: »in the struggle between security and freedom, freedom always loses«) and Benjamin Franklin (»He who sacrifices freedom for security deserves neither«).



Alfred Müller-Armack

However, there is always a danger of the »social« element over-expanding and over-burdening the economy's capacity.

It should also be frankly conceded that the first slight recession of the post-war era in 1966; the oil crises of 1973 and 1978/79 and the resulting economic crises; union demands that focused on higher wages rather than a share of capital stock; reunification; the ongoing process of globalisation and finally the string of financial crises since 2007 (real estate crisis, the collapse of Lehman Brothers, the bank crisis, the sovereign debt crisis, the euro crisis) have all barely left time or opportunity to consistently work on the creation of what Erhard and Müller-Armack called a *formed society*.



Wilhelm Röpke

»The reconciliation of capital and labour«: an ongoing task

The task of reconciling capital and labour has once again become a priority in light of the current crises and – in view of the ever-changing circumstances – it will remain an ongoing task. The everyday political activity that is ordained by the financial markets cannot be allowed to push this task off the agenda. It is possible and necessary to think back to the values that underpin the Social Market Economy in order to counter emerging tensions, such as those caused by youth unemployment or poverty among the elderly. As previously mentioned, it is also useful to have an institutionally safeguarded framework.

The task of reconciling capital and labour has once again become a priority in light of the current crises.

Environmental goal-setting: an ordoliberal concern

At this juncture, we would like to briefly mention (→ [9](#)), that the importance attached to setting environmental goals over recent years is not an unknown concept to the Social Market Economy. On the contrary, the ordoliberals' warning about the »ruthless exploitation of nature« forms part of the SECOND STAGE of the market economy, and more specifically in the goals set by the *formed society*. Even before Germany had an environment ministry there was a ministry of the interior, which was responsible for environmental issues and generally carried out these duties in a satisfactory way. The idea of »environmental policy« is credited to Hans-Dietrich Genscher (1969).

The concept of sustainability that became more widely used after the UN climate summit in Rio in 1992 was also of German origin. The reverse translation into German goes back to Hans Carlowitz, a mine captain at the Kursächsischen Hof in Freiberg, who used it in his book »Sylvicultura Oeconomicae« in 1713 to draw attention to the fact that no more trees should be cut down than can grow back within a certain period.

The ordoliberals' warning about the »ruthless exploitation of nature« forms part of the second stage of the market economy, and more specifically in the goals set by the formed society.

The Social Market Economy – its values and view of humankind

The historical development of what was to become the Social Market Economy illuminates those values that are rooted in the Enlightenment and liberalism in the true sense of the word. In a nutshell, it is a question of human dignity, something that in the individual involves the values of freedom, justice, subsidiarity and solidarity.

Humans should be given the freedom to develop and make their own decisions so that they are free from both individual and state power. On the basis of constitutional discourse on the reasons for and restrictions on state power, we can say that human dignity justifies freedom while at the same time limiting it. Justice consists of allowing people to develop themselves while at the same time preventing their decisions from hurting others in the long term. This is why the state is needed to set the rules and ensure they are observed, while also abiding by them itself. In constitutional terms, this represents a democratic state.

Over and above this, the Social Market Economy demands personal responsibility and assistance within the smaller social reference group. First and foremost, this means the family, but when this subsidiarity reaches its limits, it is time to call on overarching social solidarity.

If we develop these values a little further, we can formulate the core thesis that the Social Market Economy carries within it all desirable ethical traits and corresponds to a correct understanding of the term »social justice«. It is:

1. DEMOCRATIC,
2. ENLIGHTENED AND LIBERAL,
3. EFFICIENT AND ENVIRONMENTALLY-FRIENDLY,
4. SOCIAL AND
5. ETHICAL.

(Cf. on the following Franke, 2006/2010, 78–84.)

→ DEMOCRATIC: At its core, the Social Market Economy is based on a competitive economy, which allows it to react to changing needs and circumstances. The essential element of a free system is the ability to express oneself and act freely, whether as citizens (by voting); as producers (by deciding to be self-employed and opting for a particular business or sector) and as consumers (by demanding and buying products and services). Just as elections are the key characteristic of a democracy in political terms, the market constitutes the democratic side of economic activity.

→ The concept is therefore LIBERAL because it does not dream of the »New Man« and because it does not make unreasonable demands on his virtuousness. Rather, it takes people as they are, with all their strengths and weaknesses. It creates a context in which individuals can contribute to increasing the prosperity of society – whatever their motivation.

In order to elucidate a little more, it is necessary to examine the difference between »spontaneous order« and »hierarchical order« (as organisational principles). The market economy system is based on spontaneous order, in the sense that individual economic agents (as they are called by economists), which may be individuals, households, associations, federations or companies, are not subject to a particular code of behaviour. They are simply bound to abide by abstract general rules that do not set guidelines but simply pro-

In a nutshell, it is a question of human dignity, something that in the individual involves the values of freedom, justice, subsidiarity and solidarity.



Alexander Rüstow

scribe. Within this framework, they can try to achieve their goals and desires while being continually forced to react and cooperate as a result of the actions of other market participants. In accordance with the hierarchical principle, the whole system adapts to these constantly changing circumstances in a way that far outstrips the organised command economies, as has been shown by bitter experience.

It is this context that provides the basis for describing the market economy as liberal, but at the same time it is also clear that the state also has an important role to play. It has to set the rules, ensure they are observed, impose sanctions and adapt them where necessary. To speak metaphorically, it has to be a strong and credible referee while resisting the desire to join in the game or be biased towards a particular player or team (→ 2).

EFFICIENT AND ENVIRONMENTALLY-FRIENDLY: Of course a market economy does not mean that the individual economic agents are not subject to mistakes and misjudgements. Even the market cannot guarantee the theoretical best of all worlds! But aberrations and even losses are noticed more quickly than in command economies because economic agents that are unwilling or unable to adapt soon find themselves at a huge disadvantage.

The state has to be a strong and credible referee.

In contrast to a state-run economy, the paths of information, supervision and reaction are significantly shorter and speedier in a market economy that is characterised by spontaneous order. This means that the detrimental effects of wrong assessments are reduced and economists refer to the least cost combination. This describes the optimal use of resources combined with minimised waste, which also has the effect of protecting the environment.

SOCIAL – the market economy is socially-oriented even without the adjective »social« because the democratic and the *liberal* already encompass elements of the social and because being economical with resources is of course also good for society.

It is also »social« because a functioning market as previously described creates a high national income and because only a high national income allows the introduction of socially-motivated actions of secondary redistribution – as Alfred Müller-Armack repeatedly stressed – and guarantees a share in prosperity. It is also social because a functioning market is needed for the introduction of real social policies based on solidarity that are not simply »sticking plasters« for the people or that only tackle real deprivation.

Social policy is not some kind of optional add-on. In our anonymous mass society based on the division of labour it is difficult for individuals – whether they are single or living in one of today's small families – to look after themselves and their families in times of crisis (caused by factors such as unemployment, sickness and age). So subsidiarity has to be complemented by social solidarity.

This is why social welfare systems are necessary, and the constitutional state is also a social exigency. With his »Irene formula«, Alfred Müller-Armack lobbied for strong but not ideologically-driven unions and backed politically neutral unions rather than the unions of the past that had particular ideological or party-political ties. This was with a view to preventing the kind of major political divisions between unions that occurred during the Third Reich. As a result, these considerations were revisited and brought together in the Works Council Constitution Act [Betriebsverfassungsgesetz, BetrVG], a law that was put on ice during the Hitler era (1952: BetrVG; 1955: PersVG).

In addition, only a free but rules-based market economy can achieve the results needed to build a *formed society* in terms of ongoing sociopolitical goals.

Against this backdrop, the use of the adjective SOCIAL to describe the market economy is justified. It is designated as an economic system that should be worked towards in the German constitution [Grundgesetz, GG], for example in article 3, paragraph 1 GG (equality and the ban on arbitrary discrimination), article 20, paragraph 1 GG (the postulation that Germany is a democratic and social federal state with a legislature bound by constitutional order) and article 9, paragraph 3 GG (freedom of association, unions, right to collective bargaining).

ETHICAL: Taken all together, the Social Market Economy emerges as a value system that monitors itself and determines itself in reciprocal fashion. It meets high ethical standards and yet at the same time manages to have low levels of ethical involvement at the individual level. This is not meant in a derogatory way, because it goes against the principle of human dignity to be constantly preaching lofty goals that in the cold light of day could not even be met by a saint.

The Social Market Economy is also, in the best sense of the word, »multicultural«, as is shown by the following very modern quote from Adam Smith (1776 [1970, 119]):

»It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from the regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.«²

The need for »Ordnungspolitik«

Any solution to the problems facing Germany and Europe – the advance of globalisation, demographic change, climate change, scarcity of resources, migration, the reorganisation of the financial markets and the euro crisis – requires a clear regulatory basis. History shows that centralised interventionist policies tend to create even more problems in the medium-to-long term. It is more urgent than ever before to espouse a return to an Ordnungspolitik based on the principles of the Social Market Economy and to lobby for them in Europe. However, they also require a certain degree of courage and pertinacity. Unlike in the post-war period, when it was a question of setting a fundamental direction for Germany's renewal, today the challenge for Ordnungspolitik is to change institutionalised and embedded patterns of behaviour while the system is still up and running. This is a hugely difficult task because it also involves European and global issues (→ 10, A LOOK AHEAD).

It is more urgent than ever before to espouse a return to an Ordnungspolitik based on the principles of the Social Market Economy and to lobby for them in Europe. However, they also require a certain degree of courage and pertinacity.

So it is all the more important to regularly clarify the fundamentals and principles of the Social Market Economy. This also includes the fact that, right from the beginning, the Social Market Economy had European integration in its sights.

Developing the argument

The key principles and aims of the Social Market Economy are based on the constituent principles of ordoliberalism as formulated by Walter Eucken. They are set out in writings by Erhard and Müller-Armack on the Social Market Economy and some of these principles are included in the German Stability and Growth Act [Stabilitäts- und Wachstumsgesetz] of 1967. Admittedly, it was the SPD economics minister at that time, Karl Schiller, who took the lead in framing this law and finally guided it through parliament, but we should not forget that the previous CDU economics minister, Kurt Schmücker, had laid down much of the groundwork in this respect. Of course many of the key principles are enshrined in the German constitution, in laws relating to the economy, welfare and taxation and in party platforms.

The principles and aims of the Social Market Economy are briefly listed below and they will be looked at in more detail as part of our argument in Part II of this publication.

- 1 Private ownership of the means of production including economic freedom, professional freedom, both necessarily linked to liability;
- 2 Competition as a goal that ensures freedom and that includes free consumer choice;
- 3 A stable and workable monetary system with price stability;
- 4 High employment;
- 5 External balance with high export quota;
- 6 Steady and commensurate economic growth;
- 7 Fair distribution of income;
- 8 The possibility of income from capital stock (fair distribution of wealth) and
- 9 Environmental goal-setting.
- 10 The conclusion looks at the link between the Social Market Economy and European integration.

In Part III we will examine in more detail the values and principles of the Social Market Economy, brief firstly by looking at the need for *Ordnungspolitik* across Europe as a whole (→ **A LOOK AHEAD**). Secondly, the chapter broadens the focus and takes a look at the competition between regulatory systems in light of globalisation. A brief summary at the end of the publication gives an overview of the constitutive elements of the SOCIAL MARKET ECONOMY.

Recommended political actions

The recommended political actions that emerge from this include placing greater emphasis on economic, social and political correlations, along with the need for lifelong learning. Political foundations such as the Konrad-Adenauer-Stiftung that are independent but have links to particular parties can make a contribution in this respect by working tirelessly to expand the store of knowledge on the values of the Social Market Economy and how it contributes to prosperity. They can achieve this through publications, seminars, conferences and joint projects with schools, universities, businesses and further education providers. This challenge has to be met both at home and abroad in order to maintain the »brand essence« of this model and to turn the Social Market Economy into one of »Germany's exports« (to quote Angela Merkel). It is an ongoing challenge that requires constant adaptation and adjustment in terms of content and presentation so that it speaks to people of all ages and all levels of education.

The following arguments are our contribution to meeting this challenge.

NOTES

1 | It is well-known that the PDS, which emerged from the former SED, and is now known as »The Left« felt that the idea of democratic socialism was no longer adequately dealt with by the SPD, so it quickly took it over and included it in its party name (Party of Democratic Socialism).

2 | Smith (1776 [1970,119]).

SOURCES AND RELATED LITERATURE

- *Böhm, Franz* (1971): Freiheit und Ordnung in der Marktwirtschaft, in: Goldschmidt, Nils/Wohlgemuth, Michael (ed.) (2008): Grundtexte zur Freiburger Tradition der Ordnungsökonomik, Tübingen, pp. 299–312
- *Erhard, Ludwig* (1965/1966): Das gesellschaftspolitische Leitbild der Formierten Gesellschaft, in: Ludwig-Erhard-Stiftung (ed.) (1981), pp. 79–81
- *Eucken, Walter* (1952¹): Grundsätze der Wirtschaftspolitik, Tübingen (and many subsequent unedited editions)
- *Franke, Siegfried F.* (2006): Mit oder gegen die Marktwirtschaft zur »sozialen Gerechtigkeit«? In: Franke (2010), pp. 73–90
- *Franke, Siegfried F.* (2010): Der doppelt missverständliche Liberalismus. Eine Sammlung von Aufsätzen und Vorträgen, Marburg
- *Hasse, Rolf H./Schneider, Hermann/Weigelt, Klaus* (ed.): Lexikon Soziale Marktwirtschaft, 2., current and awaited edition, Paderborn, Munich, Vienna, Zurich
- *Hüther, Michael* (2008): Die politische Umsetzung der Sozialen Marktwirtschaft durch Ludwig Erhard und Alfred Müller-Armack [speech given at the Konrad-Adenauer-Stiftung, Berlin], 20 May 2008
- *Janssen, Hauke* (2009): Nationalökonomie und Nationalsozialismus, 3., revised edition, Marburg
- *Keynes, John M.* (1936): The General Theory of Employment, Interest and Money, London numerous new editions and translations)
- *Ludwig-Erhard-Stiftung* (ed.) (1981): Grundtexte zur Sozialen Marktwirtschaft, edited by Stützel, Wolfgang/Watrin, Christian/Willgerodt, Hans/Hohmann, Karl, Stuttgart, New York
- *Ludwig-Erhard-Stiftung* (1993): Adjektivlose oder Soziale Marktwirtschaft? With articles by de Jasay, Anthony/Radnitzky, Gerard/Starbatty, Joachim and Wünsche, Horst Friedrich, Bonn
- *Müller-Armack, Alfred* (1960): Die zweite Phase der Sozialen Marktwirtschaft: Ihre Ergänzung durch das Leitbild einer neuen Gesellschaftspolitik, in: Ludwig-Erhard-Stiftung (ed.) (1981), pp. 63–78
- *Müller-Armack, Alfred* (1974): Genealogie der Sozialen Marktwirtschaft, Bern, Stuttgart
- *Plickert, Philip* (2008): Wandlungen des Neoliberalismus, Stuttgart
- *v. Prollius, Michael* (2007): Der Neoliberalismus der 30er Jahre: Wurzel der Sozialen Marktwirtschaft [speech given at the Konrad-Adenauer-Stiftung, Berlin], 28 Feb 2007
- *Schiller, Karl* (1961): Der Ökonom und die Gesellschaft. Das freiheitliche und das soziale Element in der modernen Wirtschaftspolitik, Stuttgart
- *Smith, Adam* (1970): The Wealth of Nations, Andrew Skinner (ed.), Bangay, Suffolk (Engl. first edition 1776)
- *Weigelt, Klaus* (2005): Art. »Soziale Marktwirtschaft: Menschenbild«, in: Hasse/Schneider/Weigelt (ed.) (2005), pp. 388–391
- *Willgerodt, Hans* (2011): Werten und Wissen. Beiträge zur Politischen Ökonomie, Stuttgart
- *Zohlnhöfer, Werner* (1988): Sozialpolitik – Achillesferse der Sozialen Marktwirtschaft? In: Aus Politik und Zeitgeschichte, B 17-18/1988, pp. 40–54



PRIVATE OWNERSHIP OF THE MEANS OF PRODUCTION

Goods and services that are not generally accessible and that are not subject to collective use – so consumer goods, private capital goods and services – should also be produced privately. The required means of production should be in private hands.

Ownership and human nature

Aristotle understood that the desire for private ownership is deeply rooted in human nature. History has shown that this seemingly innate desire for ownership is accompanied by handling this property in a careful and responsible fashion. When the means of production are left in private hands, this leads to an increased supply of goods without necessary reinvestment and expansion being neglected. History has shown that private ownership of the means of production is always more effective than collective ownership in terms of increasing prosperity because the latter system does not allow personal responsibility to be allocated in a sufficiently precise way.

Ownership and freedom

Freedom encompasses the right to decide whether to be self-employed or employed. This is also a key element of economic and professional freedom. It is also part of the principles of fairness if ownership that results from previously restrained consumption and a willingness to take risks remains in private hands and if every individual can choose to be self-employed or employed in the sectors and occupations of their choice based on their own inclinations and abilities (article 2, paragraph 1 and article 12 GG).

Modern free and democratic constitutions have therefore enshrined the right to ownership in their canon of human rights. This not only includes consumer goods and commodities, savings and legal titles but also private ownership of the means of production. Article 14, paragraph 1 line 1 GG protects ownership as thus defined and guarantees that it can be inherited.

GERMAN COMPANIES BY REVENUE (2010)

Revenue in euros	Number	89.5	99.7	%
17,500 – 50,000	911,925	}	}	28.8
50,000 – 100,000	638,550			20.2
100,000 – 250,000	688,698			21.8
250,000 – 500,000	355,419			11.2
500,000 – 1 m.	236,759			7.5
1 m. – 2 m.	147,241			4.7
2 m. – 5 m.	103,215			3.3
5 m. – 10 m.	38,563			1.2
10 m. – 25 m.	25,184			0.8
25 m. – 50 m.	9,280			0.3
50 m. – 100 m.	5,172	0.2		
100 m. – 250 m.	3,136	0.1		
250 m. and above	2,144	0.1		

A total of 3,165,286 companies

Source: German Federal Statistical Office: VAT statistics, Institut für Mittelstandsforschung (IfM), Bonn

German VAT statistics demonstrate the existence of a broad range of medium-sized businesses in the country. In 2010, this category constituted some 3.17 million businesses bringing in total revenues of 5.2 billion euros. If we also expand the threshold to include companies making annual revenues of less than 50 million euros, we can also include 99.7 percent of small and medium-sized enterprises. Small and medium-sized enterprises (SMEs) are companies that employ fewer than 500 employees and that have an annual turnover not exceeding 50 million euros. These businesses turn over almost 2 billion euros, representing a share of 37.8 percent.

The above-mentioned basic rights of economic and professional freedom and the right to ownership and inheritance also apply to the European Union's Member States (articles 15 to 117 of the Charter of Fundamental Rights of the European Union [EUCFR]).

Role played by private ownership of the means of production

Availability and responsibility go hand-in-hand and provide opportunities to increase prosperity and benefit society as a whole. The motivation provided by private initiative, creativity, risk propensity and dispositive capabilities addresses meta-economic goals such as power, prestige and the desire for ownership, which in turn provide the motivation for further performance. If we move away from the Marxist idea that a totally new kind of human can evolve or be created, then it can be psychologically very effective to address these meta-economic aspects. Private ownership makes it possible to use motivation as a lever to organise and make use of the production factors in a national economy in a very flexible way so that society has an adequate supply of quality products and services. This also benefits citizens who are not owners – generally employees and their families. And if the private means of production are widely distributed so that they are not just in the hands of a few major conglomerates but also owned by a diverse range of medium-sized and even small enterprises, then employees also have appropriate freedom when selecting or changing their workplace.

Potential risks involved in private ownership of the means of production

Private ownership of the means of production can create risks, because it means that owners can gain a strategic advantage over the broad majority of employees and potentially exploit it excessively. Poor decisions can lead to many families getting into difficulties.

Private ownership of the means of production can open the door to heteronomy, whereby other people are permanently forced to carry out activities that they either do not wish to do, reject or feel are meaningless. In addition to this potential for exploitation, there is also the danger that owners and their families may exploit themselves.

There is also the possibility that the owner of the means of production in particular sectors will make agreements that are to the detriment of upstream suppliers or end users, which impairs the overall social effectiveness of private ownership as an institution.

Interdependency of the principles of the Social Market Economy

It is important to guard against the risks of private ownership as outlined above. This is possible if it is clear that the principles of the Social Market Economy cannot simply be selected at whim but that they are totally interdependent, a fact that was repeatedly stressed by the father of ordoliberalism, Walter Eucken. The principle of private ownership of the means of production is inextricably bound up with the requirement for personal liability and the principle of competition as a goal that guarantees freedom. The father of the Social Market Economy also made it clear that operational decisions also require a minimum amount of operational coordi-

The principle of private ownership of the means of production is inextricably bound up with the requirement for personal liability and the principle of competition as a goal that guarantees freedom.

nation and co-determination, which should be governed and regulated by means of a »works constitution«. According to Alfred Müller-Armack, a certain degree of co-determination on the part of employees – not heteronomy – was part and parcel of the Social Market Economy. The Works Constitution Act [Betriebsverfassungsgesetz] of 1952 can be traced back to him. This law provided for worker co-determination on operational and social issues with a view to mitigating conflict.

Private ownership and liability

In this context, liability is of course not used in the penal or regulatory sense, but rather is used to describe how someone who expects to make profits from the ownership and use of the means of production also has to be prepared to accept losses in the event of failure. This generally guarantees that entrepreneurial decisions are carefully weighed up and prevents extremely risky de-

cisions being taken. In other words, a key principle of the Social Market Economy is that DECISIONS AND LIABILITY go hand-in-hand. This is also a result of the competitive nature of the Social Market Economy (→ 2).

Competition as a goal that guarantees freedom prevents a dangerously excessive volume of the means of production falling into a single pair of hands by ensuring that competitors can enter the market.

Distribution of private ownership and the »dilution« of ownership rights

On the whole, the principle of private ownership of the means of production is not directly at risk. This is demonstrated by the large number of family firms in Germany that – depending on how they are classified – make up 70 to 90 percent of all companies (see diagram on page 20). Their importance for the economy is a result of their major contribution to annual GDP figures (over 50 percent). They also employ almost half of Germany's workforce. A large percentage of these family firms are also globally active.

Competition as a goal that guarantees freedom prevents a dangerously excessive volume of the means of production falling into a single pair of hands by ensuring that competitors can enter the market.

However, there are numerous regulations relating to social, environmental and energy policy that significantly restrict the disposal of private property. Any examination of the principle of private ownership of the means of production must therefore include both ownership rights and disposal rights. If the restrictions placed on disposal rights are too great, then ownership rights lose their significance for guaranteeing freedom and increasing prosperity. This is what we call the »dilution of ownership rights«.

Another danger may be caused by major corporations. There is no doubt that the manufacture of capital-intensive products requires a great deal of investment. But the associated separation of management and owners throws up particular problems of liability that have

still not been resolved. There is also a tendency for members of executive and supervisory boards to take on a great many appointments, which makes for coherent reciprocal safeguards, but at the same time tends towards over-concentration and may result in pressure being put on medium-sized suppliers. These are problems that are countered in Germany and around the world using a combination of voluntary agreements, national laws and the involvement of NGOs such as Transparency International. This has trickled down in the form of guidelines and laws in the areas of corporate social responsibility and compliance.

In view of the constant new challenges that are arising as a result of globalisation, it is not always easy to decide at which point a further concentration of the economy or further dilutions in ownership rights start to become a threat to freedom and prosperity. It should also be borne in mind that the majority of people are largely concerned about safeguarding their immediate environment and jobs and have little interest in abstract dangers.

SOURCES AND RELATED LITERATURE

- *BDI*. Bundesverband der Deutschen Industrie/Deutsche Bank, Frankfurt am Main (ed.): Die größten Familienunternehmen in Deutschland. Daten, Fakten, Potenziale. Ergebnisse der Frühjahrsbefragung 2011 [carried out by the Institut für Mittelstandsforschung], as at: April 2011
- *Doehring, Karl* (1994): Privateigentum und soziale Verpflichtung, in: Ludwig-Erhard-Stiftung (1994), pp. 319–334
- *Franke, Siegfried F.* (2010): Der doppelt missverständene Liberalismus. Eine Sammlung von Aufsätzen und Vorträgen, Marburg
- *Franke, Siegfried F.* (2010a): Die Bedeutung des Privateigentums an Produktionsmitteln, in: Franke (2010), pp. 127–150
- *Franke, Siegfried F.* (2010b): Ordnungspolitik seit 1948, in: Franke (2010), pp. 91–126
- *Hamm, Walter* (1994): Die Funktion von Privateigentum, Vertragsfreiheit und privater Haftung, in: Ludwig-Erhard-Stiftung (1994), pp. 305–317
- *Ludwig-Erhard-Stiftung* (1994): Grundtexte zur Sozialen Marktwirtschaft, vol. 3: Marktwirtschaft als Aufgabe, ed. Herrmann-Pillath, Carsten/Schlecht, Otto/Wünsche, Horst Friedrich, Stuttgart, Jena, New York
- *Müller-Armack, Alfred* (1959): Die Soziale Marktwirtschaft nach einem Jahrzehnt ihrer Erprobung, in: Müller-Armack, Alfred (1966): Wirtschaftsordnung und Wirtschaftspolitik, Freiburg i.Br., pp. 251–265
- *Reichmuth, Karl* (ed.) (2008) [in collaboration with Kappeler, Beat/Starbatty, Joachim/Wagschaal, Uwe]: Weg aus der Finanzkrise. Entscheid und Haftung wieder zusammenführen, Zurich
- *Stiftung Familienunternehmen* (ed.) [n. d. (2009)]: Die volkswirtschaftliche Bedeutung der Familienunternehmen, Munich



RULES-BASED COMPETITION,

because a »market economy« is at heart a »competitive economy«. Competition releases creative powers that contribute to greater prosperity, create jobs and ensure price stability. It is also extremely efficient. Competition guarantees freedom because it protects people from private power and from arbitrary state action if governments limit themselves to regulatory policy and only intervene in extraordinary circumstances.

Meaning and delineations of the term

The concept of competition is multi-faceted, encompassing three main areas. The first of these is totally unrestricted competition with no rules. This opens the door to unfair practices and the kind of cut-throat competition that can lead to cartels and monopolies that are detrimental to the consumer. Adam Smith was aware of this danger. In his famous quote in »The Wealth of Nations« he comments on the fact that people of the same trade rarely meet together, even for merriment and diversion, without the conversation ending in a conspiracy against the public. This is a clear admission of the need for state-regulated competition with the goal of safeguarding freedom. The second area is therefore that competition should be understood in the sense of it being a goal that safeguards freedom. This requires appropriate regulatory policies, as is also stipulated in § 1 StWG, which states that the four goals of stability and growth¹ should be pursued »within the context of a free market system«. ² However, it is often expected that competition should make a contribution towards a host of aims in the areas of economic, welfare and social policy. This expectation gives competition an instrumental function.

Competition as a goal that safeguards freedom

When viewed in this way, competition is directly linked to the social value of freedom. Within the context of the rules that are designed to prevent the growth of the type of competition that leads to ruinous or monopolistic structures, this form of competition allows economic and professional freedom to flourish, as stated in (→ **1**). This includes freedom of contract, which is however tied in with the rule that forbids contracts in which one of the parties is obliged to give up their future freedoms. Any such contract should be declared null and void because clearly one of the contracting parties is in a position to dictate the conditions (known as »contracts of adhesion«). The free exchange of opinions should also be understood as a means of safeguarding freedom.

A distinguishing feature of this form of competition that safeguards freedom is the lack of specifically stipulated state goals. The thinking on this is that there is no competition if clear directions have already been set or if it is obvious what will be the end result.

Competition as a goal that safeguards freedom does not mean denying its economic function, as this largely enables the functioning of the price system in free markets, which can be expressed as:

1. A SIGNALLING FUNCTION,
2. A MOTIVATING FUNCTION,
3. A STEERING FUNCTION AND A
4. MONITORING FUNCTION.

The key functions of competition that safeguards freedom

1. Prices, which also include salaries, wages and fees, send out signals to companies, customers and employees about whether or to what extent it is worth making a renewed or new commitment to this sector, products and services or to training in order to take a job in this sector.
2. This is how competition creates motivation to behave accordingly.
3. It also contributes to steering production factors (capital and labour) towards their most favourable use.
4. This is monitored by comparing target results with actual results.
5. = 1. The result of this comparison, whether it is satisfactory or not (in the event of losses or meagre income), provides a signal that closes the circle and the process starts all over again. The new signal provides motivation, guides the factors of production and the result of this activity has to be monitored once again.

In summary, this kind of competition that safeguards freedom can also be called »functional competition«. It:

- allows good market supply at reasonable prices,
- contributes to improved products and production methods and to the efficient use of scarce resources by encouraging technological progress, and
- acts as an appropriate incentive and sanctions mechanism,

in order to:

- A avoid errors wherever possible,
- B correct errors such as planning errors as quickly as possible,

- C effect a speedy withdrawal from the market when there is incapacity (minimisation of sub-optimal resource use), and
- D facilitate rapid adjustment when faced with external shocks (such as raw materials shortages) and changes in demand.

The state as regulator and effective referee

In an interest-led, voter-oriented representative parliamentary democracy it is not easy to set and consistently monitor the rules for this kind of competition, despite the fact that this is so important for the common good. However, it should be stated that a government's actions with regard to »competition as a goal that safeguards freedom« should be restricted to regulation, monitoring and imposing sanctions. In this respect it is important to point out that there is no economic system that al-

However, a market economy that is rules-based but largely non-interventionist minimises the loss of resources caused by poor decisions by sending out signals that rapid adjustments are needed to prevent the risk of disappearance from the market.

ways delivers the perfect, desired results. The market economy is also incapable of this, because people make mistakes and it is not possible to totally control the plethora of internal and external factors that impact the economy. However, a market economy that is rules-based but largely non-interventionist minimises the loss of resources caused by poor decisions by sending out signals that rapid adjustments are needed to prevent the risk of disappearance from the market (see previous chapter). In contrast, in a planned economy there is increasingly stubborn adherence to previous decisions on erroneous market structures that in the long term hinder prosperity. This is why the state has to resist the temptation to »join in the game«, in order to protect economic sectors, drive forward certain developments and »save« jobs.

Only extreme and unusual events such as natural catastrophes or terror attacks justify limited state intervention in the area of competition.

What if the market fails?

Apart from the above-mentioned »extraordinary events«, what should be done in the event of market failure? First of all, we should clarify the meaning of this term. We cannot expect the market to produce results that it is incapable of achieving. In the case of certain goods, the market »fails«, so it is not in a position to provide the coordination that is needed by society. The diagnosis of »market failure« is therefore not a moral or political verdict but rather an expression of a somewhat unfortunate technical term (Watrin, 1986, 6). Of course in the technical field the term failure is commonplace, for example if there is a power failure due to a lightning strike. But because the market's function is always tied in to human activity, the term »market failure« tends to carry with it subjective elements of blame or moral judgement (greed).

What constitutes a »market failure«? In brief, the market fails if:

1. THERE ARE NATURAL MONOPOLIES,
2. THERE ARE EXTERNAL FACTORS,
3. PUBLIC GOODS ARE INVOLVED, OR
4. THERE ARE INFORMATION ASYMMETRIES.

Note on 1. When unit costs continue to fall in line with increasing volumes, the sales volume has to be high enough to allow for necessary expansion costs. This is why the somewhat misleading expression »natural monopoly« has become commonly used. This may be the case with services such as electricity, water and railways or with reserves of raw materials that are concentrated in one place,

The diagnosis of »market failure« is therefore not a moral or political verdict but rather an expression of a somewhat unfortunate technical term.

something that in global terms occurs quite rarely (Wienert, 2001, 204). So it seems an obvious step to make an exception for this sector in terms of regulation and let the state help to keep potential competitors at bay (Eickhof, 2005, 340 et sqq).

Note on 2. Human actions often have an effect on uninvolved third parties. This is because people are – inescapably and to some extent of their own volition – social animals. This becomes a problem when the effects are negative and so annoying or downright harmful to third parties. In an anonymous mass society based on the division of labour, this problem cannot always be resolved through internalisation, whereby the initiator of the problem bears all the costs.

Note on 3. A private offer should not be expected for public goods that neither compete for consumption nor allow the exclusion of those who are unwilling to pay, because this unwillingness to pay – if it in fact exists – would not recoup even half of the immense cost of such goods. Prime examples of such goods are foreign defence, domestic policing, the justice system and orderly administration.³

Note on 4. The used car market is often used as a striking and memorable example of information asymmetry. It is clear that the seller of a used vehicle knows more about its defects than the potential buyer. It is a basic principle that the more information asymmetries present themselves, then the more an economy is organised around the distribution of labour, and the more goods there are that are manufactured using multi-stage processes. In general terms, this refers to what are known as credence goods. These are goods whose quality and impact only becomes clear during use after being purchased, and it is often difficult for the consumer to ascertain this impact (for example, is the flavour provided by natural or artificial ingredients? To what degree of dilution can an ingredient still be described as »pure«?).⁴

The aforementioned four aspects have two things in common. Firstly, the market's allocation capacity is or at least may be reduced. This is caused by the fact that the market receives no or insufficient information. The state is of course required in this instance (Zimmermann, 2005, 367 et sqq). Secondly, the examples of market failure show that society and the economy do not function without a certain degree of trust.

Even if this trust is a central element of free societies, it still needs legislative support. More precisely, trust and the law are intertwined. The law requires trust and references this in many of its specific prescriptions. On the other hand, trust is created when all those involved know that legal examinations may take place if necessary. This is why institutions are needed such as a consumer protection ministry or consumer testing associations (such as Stiftung Warentest in Germany). Certain sanctions may be enforced by penalties or become obvious in loss of reputation (for more details see Franke, 2011a).

The necessary state intervention in the event of market failure can be categorised as follows. Its main focus is to:

- set reasonable conditions for the acceptance of external effects on third parties,
- devise regulation to enable market transactions, and
- pass credible laws to prevent market participants exploiting information asymmetries to the detriment of others. Below are a few examples of this:

1. Sensitive souls may find themselves bothered by the actions of others in a wide variety of ways. But a populous society organised around the division of labour not only necessitates a certain degree of consideration, but also a certain degree of patience. For example, some people feel perturbed if a new building is planned in their neighbourhood, even if it is unlikely to cause disturbance in terms of noise, odours or other effects. So the legal system stipulates that new developments have to be tolerated, as long as there is compliance with building regulations (such as minimum distances, local building techniques, etc.).

2. Some of our environmental problems are caused by the fact that air, water and the ground are used to dispose of waste. Strict prohibitions and laws are in place in order to reduce the resulting harmful effects on third parties. This is unavoidable, because it is necessary to set limits for permitted emissions. However, relying solely on prohibitions and laws requires a degree of monitoring that is difficult to achieve. So it makes sense to formulate conditions and create instruments that – within the bounds of what is tolerable – do not directly restrict freedoms but that make good use of the market mechanism. These include »genuine« eco-taxes and emission certificates (→ 9).

Environmental protection is a striking example of a public good. No-one can be denied the right to enjoy a clean environment. But if the state alone has to care for the environment by means of prohibitions and laws, it would soon be financially overwhelmed because citizens would not be prepared to pay the costs involved. People who proclaimed their willingness to pay would be asked to hand over the cash, while their reluctant neighbours would still enjoy the identical levels of environmental protection. Economists call this »preference concealment«.⁵

It is therefore important to strongly argue for the aforementioned market mechanism to be activated in order to meet the goals of environmental protection and acquire the means to do this through revenues generated by the market, without a need to do it via rules and prohibitions.

3. As already mentioned, information asymmetries require institutions to support the generally subordinate market side. This may involve criminal or regulatory law, or organisations that carry out tests to provide consumers with a clear picture of the products or services on offer (such as Stiftung Warentest in Germany).

And of course we can say quite objectively and without malicious intent that government policies can also »fail«. It is part of the concept of the Social Market Economy to highlight the reasons for this and to work to overcome them.

In summary, it is clear that government action is required in order to (a) allow free but rules-based competition and (b) create where necessary the conditions under which desired behaviours are achieved, not through the power of the state but through incentives created by the market economy. Care must be taken to ensure that the government selects the right market sectors and the proper instruments and that it does not overshoot the mark.

The danger of overshooting the mark exists because government action always triggers bureaucratic self-interest and because politicians feel they have a mandate to intervene if they feel it is in line with the majority of voters' perceptions about distribution and fairness.

These perceptions of distribution and fairness are another reason for potential market failure. The objection is that the market often does not provide socially just distribution. It is certainly an issue for debate whether the current distribution of income and wealth requires adjustment (→ [7](#), [8](#)). This would have to be carried out in the way that is generally provided for in the second stage of the Social Market Economy, the *formed society*. This is based on

the (as far as possible) unadulterated result of free competition. If considerations of fairness lead one to interfere with the market's allocation capacity, then this is deeply »asocial« – as was rightly stressed by Erhard and Müller-Armack – because it usually results in a smaller amount being distributed (see also the section on »Competition and »Social Justice«).

There are many reasons why necessary government regulation and supervision are not carried out while other interventions are made too late or are inadequate or excessive. Taken all together, this is known as »government failure«. The market's faulty allocation mechanism then entails further deficiencies in income and wealth distribution that should in fact have been corrected, so the result is often poorly thought-out interventions (see section on »Risks of Government Intervention«, p. 28). Because of the potential for government failure, intervention in the market mechanism is only justified when the inefficiencies of the government do not exceed those of the private sector (Hedtkamp, 1994, 524).

And of course we can say quite objectively and without malicious intent that governments can also »fail«. It is part of the concept of the Social Market Economy to highlight the reasons for this and work to overcome them.

A side note on government failure

As with market failure, the term government failure should not be prematurely used to assign personal blame. »Government failure« implies that the public decision-makers (actors) have failed to make a decision, made the wrong decision or the decisions were made too late or to an inadequate extent. There are many potential reasons for this »failure«:

1. The decision-makers fail to recognise the problem.
2. They recognise the problem but fail to get support from their own party/parties.
3. Internal actors (for example, members of ministerial bureaucracy) give the government wrong or inadequate information.
4. External experts are not brought in, or the decision-makers are influenced by the unions or inadequately informed or they cannot see the wood for the trees, perhaps because of contradictory expert opinions.
5. The upper house is obstructive or EU regulations have to be followed.
6. The whole policy-formulation and decision-making process reacts too slowly to new scientific or academic findings.
7. Some of the actors have an ideological bias that affects decision-making.

8. Parties and governments are afraid of losing votes in the short-term and hence their influence on political life.
9. Government failure can be a result of »rationality traps«, in which individual and overall economic rationality clash because different social sub-systems have not been managed in line with uniform regulatory principles (Franke, 2000, 79 et sqq).

This list of possible reasons for government failure proves that it should be given as much attention as market failure. Radical remedies are only possible if the long-standing functional weaknesses of parliamentary/representative democracies are overcome (Franke, 2000, 215 et sqq; Zohnhöfer, 1999, 222 et sqq).

Competition and »social justice«

The idea of competition as a goal that safeguards freedom always has to be balanced against a whole series of ongoing goals in the areas of economic, welfare and social policy. »Competition« is and should be the means of achieving these goals. It can then be understood as an »instrument« that is used to reach these goals. In this sense, »functional competition« is extraordinarily widespread. Competition is only in the broadest sense »functional« at the point and to the extent that it helps to achieve the desired goals in the areas of economic, welfare and social policy. If it fails to do this, then intervention is needed.⁶

The problem is that the »desired goals« can overwhelm the performance of the market due to uncertainty, vote-winning strategies and ideological reasons. If we then turn to the actions favoured by democratic socialism such as influencing the market, market interventions and market regulation, we find that the market's performance drops off and prosperity is compromised.

The balance between two types of competition – competition with the primary goal of safeguarding freedom and competition used primarily as an instrument – is even set out in the German constitution (article 2, paragraph 1 and article 12 GG on the one hand and article 20 paragraph 1 GG on the other hand) and also in EU law. Article 3 of the EU Treaty indeed recognises the function of competition as safeguarding freedom but at the same time the abundance of other goals (promoting prosperity, scientific and technological progress, social issues) point to the instrumental character of competition. This becomes completely clear in article 173 of the Treaty on the Functioning of the European Union (included at the insistence of the French), which very explicitly addresses industrial policy.

Risks of government intervention

Government intervention is necessary when there are obvious gaps in rules and legislation. On the other hand, risks can arise from the reasons listed above for government failure, because politically-motivated goals combined with subsidies and sanctions can limit the scope of freedom. So, for example, alternatives to the basic principles or to application-based research may not appear on the horizon if a certain direction has been pre-ordained by the government (for example, large-scale support for electromobility). In addition, too many government regulations tend to paralyse the economy and people's willingness to be self-employed, leading to relocation to less-regulated countries. The government influences the country's competitiveness with its administrative rules and in the way it sets up its welfare systems and wage formation process. Both of these have a direct impact on a country's labour costs and hence on its competitiveness (see diagram on page 30).

Other potential risks include »meritorious« action by the government. Because people's preferences are distorted by time in as much as they generally place greater worth on current consumption than on future costs or disadvantages, government intervention becomes necessary – whether or not there are philosophical objections. Examples of this are compulsory vehicle insurance, pensions, health insurance and compulsory school attendance. There is always a temptation for the government to take its »help« too far and end up with a both a dense regulatory network and a monopoly on the supply of merit goods. However, as the vehicle insurance example shows, this is not necessary.⁷

Existing competition laws and recommended changes

Competition law in Germany is generally in line with the requirement for sensible rules-based competition with the aim of safeguarding freedom. In this respect, it is necessary to review the ministerial approval pursuant to § 42 of the Act Against Restraints on Competition [Gesetz gegen Wettbewerbsbeschränkungen, GWB]; which allows the German economics minister to authorise a concentration prohibited by the Bundeskartellamt if it is justified by the vague legal terms »advantages to the economy as a whole« and »overriding public interest«. The competition overseers based in Brussels can put the brakes on any extreme demonstrations of national high-handedness. However, the EU is bound by a great many aims as set out in its treaties, such as on industrial policy, and this in itself tends to restrain competition.

In →¹ private ownership of the means of production is linked to liability – in accordance with the principles of the Social Market Economy. However, it should be conceded that certain economic activities require high capital sums or indeed risk capital. High losses in capital transactions may therefore put extreme strain on equity holders, creditors and the affected workforce. So corporate law has to be gone over with a fine toothcomb in order to ascertain whether personal interdependencies on executive and supervisory boards may lead to anti-competitive tendencies. Public functions should also be prevented from having the option of becoming private companies (GmbHs) whose majority shareholding is still in public hands. And finally, particular attention should be given to the specific legal form of GmbH & Co. KG.

A side note on the financial markets

Competition on the financial markets is in need of special attention. State control or oversight should not only extend to the size of the financial institution, but also to the type of financial services it offers and its levels of risk. It is necessary to distinguish between bank oversight, insurance oversight and stock market oversight.

In Germany, bank oversight is carried out by the Deutsche Bundesbank and the Federal Financial Supervisory Authority [Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin]. This dichotomy makes sense, because it separates the independent operative oversight of the Deutsche Bundesbank, i. e. the supervision and monitoring of the credit institutes based on their records (reports, balance sheets, etc.) from sovereign measures that may have to be imposed. This is carried out by BaFin, a body that is directed by the federal finance minister. Attempts to concentrate the powers of oversight within the Bundesbank are problematic because although the bank is politically independent, it would find itself housing a department that is under political direction. It would be very difficult to explain to the public that this does not affect its duties in the area of monetary policy.

The BaFin has sole responsibility for insurance oversight, but it only oversees the stock market in terms of its securities trading at federal level. Otherwise, the respective state ministry is responsible for this area.

The financial crisis has led to the European Union increasing its oversight of the financial system. Here too, bank oversight is divided into two areas. Since December 2010, supervision and oversight has been the responsibility of the European Systemic Risk Board (ESRB), with a focus on macro-prudential oversight. Sovereign interventions of course remain the preserve of the appropriate European and national supervisory bodies (European System of Financial Supervision, ESFS).⁸ The ESFS in turn provides an umbrella for sovereign oversight, which is divided into three sections.

Its structure has remained essentially the same, with three authorities based in London for bank oversight (EBA), in Paris for insurance oversight (EIOPA) and in Frankfurt for stock market oversight (ESMA), but they have all been granted increased powers under Community law.⁹

It remains to be seen whether and to what extent they will be effective, because day-to-day oversight remains in the hands of the national bodies, while EU inspectors make the final decision in the event of conflicts. This could lead to resistance on the part of national governments – as is illustrated by the way successive British governments have fought to defend the UK's financial sector.¹⁰

The particular problem of the banks: how to mitigate »systemic risks«

There is no doubt that banks are subject to an abundance of regulations. The question is, whether and to what extent this is really constructive in terms of rules-based competition. Until now, it has been impossible to limit the »systemic risks« that have resulted from the »too big to fail« problem.

What do we understand by this?

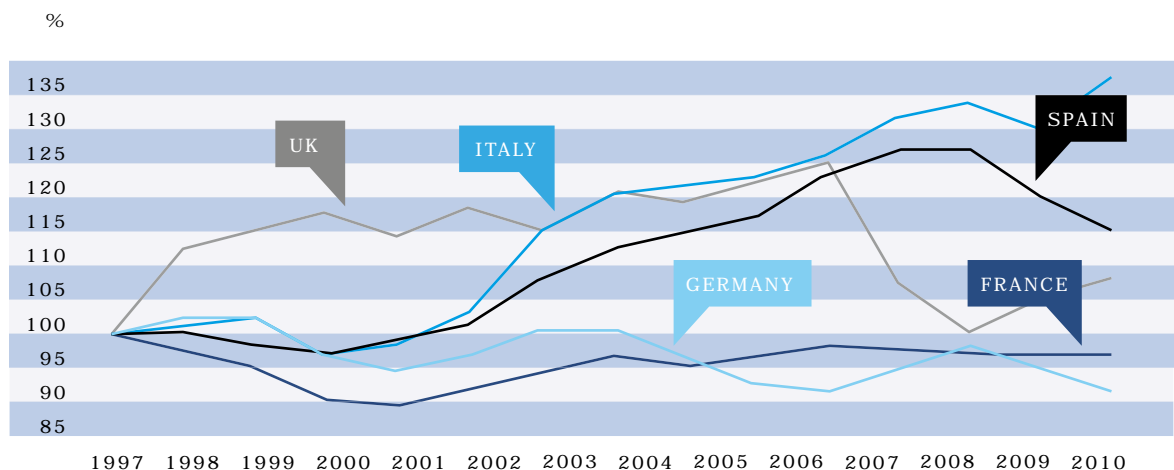
»Money is a public good.« But not every public good has to be produced by the state; it is often a good idea for public goods to be produced privately, though under supervision. At present, money can only be »raised« and »dispersed« into the nether reaches of the economy if it is done in coordination with an independent central bank with a private commercial banking system. The banks have to work together via the interbank market but they are also in competition with each other. If the market power of certain banks is not properly restrained, then they become too big and incur too much risk in their desire for higher equity returns. If they collapse they take other banks down with them because of the way the banks are all interlinked. In the worst case scenario, this brings about the collapse of the whole fi-

ancial system and cuts off the real economy based on the division of labour from the credit supply.

Because of this risk, in the past governments and their taxpayers have stepped in at times of crisis and provided capital assistance. This leads to the oft-quoted »moral hazard« in which individuals, groups or institutions have no problem taking on dubious risks when there is a chance of making large profits while losses can be paid for by the taxpayer. In this case, the moral boundary of liability is no longer effective. We should therefore welcome the fact that the Basel Committee¹¹ has agreed to an increase in the equity ratio (Basel III). Of course it is questionable whether the banks should share responsibility for macroeconomic management through a special equity buffer.

It would also be advisable to focus more closely on the question of the organisational separation of investment banking from the economy's credit supply. This separation was introduced in the USA after the stock market collapse of 1929 and the resulting Great Depression in the form of the Glass Steagall Act of 1933. After President Bill Clinton gave in to pressure from lobbyists in 1999 and repealed the Act, there has been an increase in crises caused by investment banking that have spilled over into the real economy.

COMPETITIVENESS AMONG THE COUNTRIES OF WESTERN EUROPE
(UNIT LABOUR COST TRENDS 1997 – 2010)



Source: Organisation for Economic Cooperation and Development (OECD)

The diagram shows that unit labour costs have increased less in Germany over recent years than in almost all other EU Member States. In contrast, they have increased sharply in Southern Europe, whose economies have become less competitive. The very slight increase in unit labour costs in Germany can be traced back to the restrained wages policy of management and the unions, and also to the productivity gains made by the German economy. Unit labour costs are an important indicator of a company's competitiveness. They are calculated by setting absolute labour costs (the government plays a key role in setting the level of these costs) against a company's productivity.

In a nutshell, neither Germany, nor the EU, nor supranational organisations or intergovernmental conventions (such as the World Bank, the International Monetary Fund [IMF], the G 7/8 or G20) have ever managed to really resolve this problem because the national interests of different countries are too divergent. So it is all the more important that the increased capital requirement as stipulated in Basel III is implemented. On top of this, there has been a sharp increase in the »shadow banking« sector, involving hedge funds that are often based in tax havens, and unofficial transactions. The EU is working on finding solutions, but it is no easy task.

NOTES

1 | Price stability, high employment, external balance and steady, moderate economic growth.

2 | We should give credit for this formula to (→ **INTRODUCTION**) the social democrat Karl Schiller (Minister of Economic Affairs in the first Grand Coalition (1966–1969) and later for a short period Economic and Finance Minister in the social-liberal coalition of 1971/1972).

3 | Alongside the examples mentioned here of public goods, or more correctly, specific public goods, there are many other goods that could in principle be excluded. However, this is not done on political grounds or for reasons of practicality. This usually results in depletion of these goods, at least at times. This is why they are known as common pool resources. Examples include very popular degree courses and the road network. Modern digital recording methods and strict data privacy regulations have made it possible to introduce tolls for HGVs on motorways and dual-carriageways. It is likely to be only a matter of time and political expediency before this system is expanded to cover private vehicles. For the sake of completeness, we would mention that there are also both public and private goods where consumption is not subject to competition and that may be excluded. Examples of these are roads, paths, parks and even TV programmes that are in both public and private hands.

We should also point out that although the government is responsible for regulating public goods, it is not always obliged to produce them itself (Hedtkamp, 1994, 524). For a more detailed review of the concept of public goods, see Franke, 2000, part II, p. 61 et sqq.

4 | »Potemkin« goods are a special case. These are goods in whose function we simply have to trust. Airbags are a good example of these types of goods. It is pointless to carry out test collisions in order to test their function, because a new airbag would have to be installed after the crash, and then the same problem would arise.

5 | The term »preference concealment« is somewhat unfortunate because it implies consciously lying to sections of the public. This may very rarely be the case, but in fact when there is a lack of market offers there is no chance of true preferences emerging.

6 | Competition can also be attributed with the effect of safeguarding freedom and increasing prosperity (cf. Franke, 2010a, 51 et seq; idem. 2010b, 83 et seq). Unfortunately many are not satisfied with this but cloak »functional competition« in a host of other goals that are not likely to be achieved, thus justifying intervention.

7 | For more on governments and merit goods, see Franke, 2000, 71 et sqq; Erlei, 1992.

8 | The recently popularised concept of macro and microprudential oversight and regulation means that macroeconomic aspects are the focus of oversight procedures in order to ensure appropriate monetary policies are in place that contribute to achieving macroeconomic goals while avoiding the creation of bubbles and credit squeezes. If necessary, this can lead to microeconomic interventions in individual credit institutions (microprudential regulation), brought about by European and national bodies that are charged with the appropriate sovereign powers.

9 | EBA = European Banking Authority; EIOAPA = European Insurance and Occupational Pensions Authority; ESMA = European Securities and Markets Authority.

10 | The bank oversight structure as outlined above has once again been called into question by EU Commission plans as announced in August 2012. The Commission wants the ECB to take responsibility for the oversight of banks that are too big to fail. The details still remain unknown, so it is unclear whether it is only operational oversight that will be transferred to the ECB from the ESRB (which in any case has close ties to the ECB) or whether directives for sovereign functions will also be affected. If this is the case, it is likely to be a source of contention in some Member States.

11 | In full: Basel Committee on Banking Supervision. The Committee currently comprises representatives of the central banks and supervisory bodies from some 30 countries. It is based in Basel at the Bank for International Settlements (BIS), but it is independent from it.

SOURCES AND RELATED LITERATURE

- *Eickhof, Norbert* (2005): Art. »Ordnungspolitische Ausnahmehereiche und Ausnahmeregelungen«, in: Hasse/Schneider/Weigelt (ed.) (2005), pp. 340–343
- *Erlei, Mathias* (1992): Meritorische Güter, Münster, Hamburg
- *Franke, Siegfried F.* (2000): (Ir)rationaler Politik? Grundzüge und politische Anwendungen der Ökonomischen Theorie der Politik, 2., revised and expanded edition, Marburg
- *Franke, Siegfried F.* (2010): Der doppelt missverständene Liberalismus. Eine Sammlung von Aufsätzen und Vorträgen, Marburg
- *Franke* (2010a), Die Soziale Marktwirtschaft in der globalen Bewährung, in: Franke (2010), pp. 41–61
- *Franke, Siegfried F.* (2010b): Mit oder gegen die Marktwirtschaft zur »sozialen Gerechtigkeit«? In: Franke (2010), pp. 73–90
- *Franke, Siegfried F.* (2011a): Vertrauenserosion. Eine Gefahr für Politik, Gesellschaft und Wirtschaft, Marburg
- *Franke, Siegfried F.* (2011b): Wirksame Neuregelungen zur Lösung der Finanz- und Eurokrise? [Written, significantly expanded version of the speech given at the conference »Wettbewerbsfähige Soziale Marktwirtschaft – Zukunftsmodell oder Utopie?« 3/4 Feb 2011, Evangelische Akademie Bad Boll], online versions provided by the Evangelische Akademie Bad Boll
- *Gerken, Lüder* (2003): Die Freiheit des Menschen in Liberalismus, Ordoliberalismus und Wohlfahrtsökonomik, in: Schick, Gerhard (ed.) (2003): Wirtschaftsordnung und Fundamentalismus [Stiftung Marktwirtschaft], Berlin, pp. 45–55
- *Goldschmidt, Nils/Wohlgemuth, Michael* (ed.) (2008): Grundtexte zur Freiburger Tradition der Ordnungsökonomik, Tübingen

- *Hasse, Rolf H./Schneider, Hermann/Weigelt, Klaus* (ed.) (2005): Lexikon Soziale Marktwirtschaft, 2., current and awaited edition, Paderborn, Munich, Vienna, Zurich
- *Hedtkamp, Günter* (1994): Staatswirtschaft und öffentliche Haushalte, in: Ludwig-Erhard-Stiftung (2005): Grundtexte zur Sozialen Marktwirtschaft. Vol. 3: Marktwirtschaft als Aufgabe, ed. Pillath-Herrmann, Carsten/Schlecht, Otto/Wünsche, Horst Friedrich, Stuttgart, Jena, New York, pp. 519–533
- *Watrin, Christian* (1982): Der neue Leviathan – über Gefahren einer Selbsterstörung der freien Gesellschaft, in: Ludwig-Erhard-Stiftung (1982): Symposion VIII. Soziale Marktwirtschaft im vierten Jahrzehnt ihrer Bewährung, Stuttgart, New York, pp. 139–153 (discussion, pp. 157–171)
- *Watrin, Christian* (1986): »Marktversagen« versus »Staatsversagen«. Zur Rolle von Markt und Staat in einer freien Gesellschaft [Schweizerischer Handels- und Industrie-Verein, series no. 42], Zurich
- *Wiener, Helmut* (2001). Grundzüge der Volkswirtschaftslehre. Vol. 1: Einführung und Mikroökonomie, Stuttgart, Berlin, Cologne
- *Zimmermann, Klaus W.* (2005): Art. »Ressourcenschutz«, in: Hasse/Schneider/Weigelt (ed.) (2005), pp. 367–369
- *Zohlnhöfer, Werner* (1999): Die wirtschaftspolitische Willens- und Entscheidungsbildung in der Demokratie, Marburg

THE SOCIAL MARKET ECONOMY STANDS FOR ...



3

A STABLE AND WORKABLE MONETARY SYSTEM WITH PRICE STABILITY,

because the aforementioned principles of private ownership of the means of production and rules-based competition can only have a positive impact on society and the economy if there is a reliable, stable monetary system with price stability.

The consequences of a non-functioning monetary system

Lenin is credited with saying that the surest way to destroy a nation and its bourgeois society is to debauch its currency. One of the characteristic features of those countries that fell under communist power after the Second World War was their removal of the signalling function of market prices through the introduction of transfer prices set by a planned economy. The fact that they set false incentives and above all neglected the need for reinvestment can still be observed in the generally poor infrastructures of those countries that broke free from dictatorship and planned economies in 1990 and joined the EU in 2004 and 2007.

Monetary reform – a good decision by the Western Allies

For Walter Eucken, the adverse consequences of a weak currency that is constantly subject to state intervention were so dangerous that he placed monetary stability at the top of his list of basic principles for a free society. The Western Allies also realised that the reconstruction of (West) Germany would require monetary reform in order to withstand the expansionism of the Soviet Union. So in 1947 the Bizone leaders gave Ludwig Erhard the task of preparing monetary reform, a task that Erhard tackled with great commitment and dedication. He completed his work in June 1948, after France also became part of the occupied zone (the Unified Economic Area known as the Trizone).

The new currency (Deutsche Mark) was created with a view to encouraging stability and the signalling, steering and controlling functions were able to take effect, though the economy had to be released from other restraints before it could become fully effective. This is why Erhard was bold enough to say – much to the initial annoyance of General Lucius D Clay – that all price controls and government economic controls should be lifted.

The new currency was to be kept as stable as possible as this was the only way to build the confidence needed to allow the incentives and steering mechanisms described in → 2 have a lasting impact. This provided a basis for Germany's successful reconstruction.

What is money – and how is its value kept stable?

A commonly accepted means of payment (»money«) significantly facilitates the exchange of goods and services as it is no longer necessary to look for a partner who is offering exactly what you need and who at the same time is looking for exactly what you own or can produce and are prepared to give away (known as »double coincidence«). The use of money means that more exchanges can be carried out, and in a simpler way. Originally, money was based on barter goods (such as mussels, pearls, rare metals, etc.). It then became a currency that was tied to particular materials before taking a paper form that could be freely manipulated, and today it has taken on a digital form. Nowadays, bank notes and coins for use in small daily transactions play a very minor role. Instead, money exists in the form of bits within and between the computers of economic entities.

»Freely manipulated« – Does this lead to abuse?

»Freely manipulated« in this context does not constitute a charter for the arbitrary inflation of money within national economies. Money only retains its value if there are no appreciable differences in the relation between the amount of money that is available for exchange and the amount of goods and services produced. With purely paper money, it is easy to increase the money supply by turning on the printing machine. And now, in our digital age, it is even easier, as money can be created at the push of a button and moved around the digital network in the blink of an eye. So the term »freely manipulated« means that, in these circumstances, particular care is needed to

Money only retains its value if there are no appreciable differences in the relation between the amount of money that is available for exchange and the amount of goods and services produced.

adapt the amount of money to the supply of goods, something that of course not only requires adjustment but also setting targeted incentives for growth.

In other words, the money supply has to be managed in such a way that the price level remains roughly stable, that potential growth can be achieved (while avoiding excessive demands) and that economic slumps do not result in permanent contraction of the capital stock of business and the economy.

Finding solutions to the associated problems is a Herculean task that modern societies have handed over to the central banks – and for good reason, as will be explained a little later.

What is the price level? And how do we measure it?

In an open and dynamic economy with free competition (→ 2) there can be no fixed prices and hence no price stability. The prices of goods and services are constantly in flux because of changing consumer habits and shifting costs. The resulting signalling effect contributes to production factors being steered towards the cheapest applications. The ever-changing product and factor prices give an indication of relative scarcities. In this context, this is known as relative price variability. If, for example, the price of margarine goes up while the price of butter remains the same, margarine has become relatively more expensive than butter and butter has become relatively cheaper than margarine. The same applies to the factor markets with regard to the relation of wages to capital costs.

How can we measure changes to the price level if the prices themselves are always changing? This is done by means of the »shopping basket«. Because it is impossible to follow the changing prices of hundreds of thousands or even millions of different goods and services, a representative sample of goods is selected and they are given specific consumption rates. Goods/services and the allocated rates have to remain stable over a set period of time. The cost of this shopping basket is then calculated on a monthly and an annual basis. A comparison with the corresponding previous period shows how the cost has changed, and this can be expressed as a percentage.

This measurement produces the following conclusion: price stability only exists if price fluctuations in the various goods, weighted with their amounts, are approximately in balance. Of course all goods do not remain at the same price, but the total for the overall shopping basket remains approximately the same.

There are various ways of bundling goods. The most well known is the harmonised consumer price index (GCPI), because this index is often published and is used to track changes in the cost of living. This index contains some 750 representative goods from twelve categories of daily life. In addition, changes in building costs, capital goods and terms of trade (ToT) can be recorded.

Of course the shopping basket cannot always remain the same. New or significantly improved goods appear and are in demand by private households and businesses alike, while some of the previous goods disappear. So from time to time, usually around every 5 years, it is necessary to change the shopping basket so that it is a true reflection of reality. Statistical processes allow the old index to be linked to the new one. However, it is necessary to understand that this can only show a general trend, as new goods and services are of course characterised by the fact that they did not exist in the past.

The explanations can be illustrated by a simple example relating to the consumer price index (living costs).

Let us take the example of a family that only consumes two products – bread and milk. Initially the household consumes four loaves of bread and two bottles of milk per day. A loaf costs 2 euros and a bottle of milk 1 euro. So the family's daily living expenses are 10 euros.

If the price of bread doubles to 4 euros a loaf – while the price of milk remains the same – and the family reacts by cutting down and only eating two loaves a day, then their living expenses remain steady at 10 euros.

If bread becomes 50 percent cheaper and the family fills up on eight loaves a day, they will still spend no more than 10 euros.

It is clearly wrong to conclude that the rate of inflation as an expression of price level changes is zero percent. As outlined above, the price level changes can then only be calculated if not only the selected goods but also the amount consumed of each good remains stable. In the above example there is an inflation rate of 80 percent when the price of bread doubles. When the price is halved, this leads to an inflation rate of minus 40 percent. When inflation drops below zero, it is known as *deflation*. As we will demonstrate, deflation also sends misleading signals to the economy and is therefore just as important to prevent as inflation.

The impression that is linked to the term *felt inflation* is also misleading. If in our example the price of milk doubles, this would lead to an inflation rate of 20 percent. But because milk is considered more important for children, the 100 percent price increase is given particular attention, while its weighting in the overall shopping basket is suppressed.

The link between national product and money supply

National product (also called national income) describes the monetary value of goods and services that are produced in a national economy (for example, Germany) in a particular period (usually one year). The relation between money supply and real national product at a particular point in time is the price level.

If the national product grows, this results in the following problem: if the money supply remains steady, then the price level has to fall. Increased prosperity only then becomes noticeable in the fact that households and companies get more for their money than they did in the past.

But this simple viewpoint is countered by psychological and economic factors. Businesses have the impression that they are not achieving the expected return on investment. In addition, existing liabilities do not go down but remain at the same level. As a result, willingness and ability to invest will also wane, and so the real national product quickly falls again. Factor prices also include wages, which also have to be adjusted downwards, resulting in resistance from trade unions and workers. It is therefore not advisable to maintain a steady price level.

In theory it is quite clear and simple: if the price level is to remain steady, then the money supply has to grow in accordance with the volume of goods. Of course this throws up some practical problems. The public institution that is responsible for the money supply, known as the central bank, of course cannot wait for the volume of goods to increase and then quickly put money into circulation. Instead, it has to constantly and carefully monitor the market and decide on the basis of the data that it gathers how much potential for

growth the economy has (this is one of the main responsibilities of the central bank's chief economist). The money supply has to be increased accordingly, and the central bank has to announce the anticipated economic growth figures that it is using to steer its money supply policy. To put it in more concrete terms, the central bank signals that it will tailor and sew the money coat in such a way that the real economy can fit into it. Over time it is of course necessary to make adjustments, which are carried out on an ongoing basis through fine alterations to monetary policy.

The situation becomes tricky when the national product contracts. This may have psychological causes, may be the result of misjudgements by businesses or may be due to political decisions or foreign events. Superficially, the issue seems quite clear: the money supply has to fall for the sake of stabilisation. If it were to remain steady, then the drop in the real mountain of goods would run counter to a stable money supply, which would lead to price increases and hence inflation.

Price stability that is achieved in this way during an economic downturn would be paid for by a long-term fall in prosperity. In this way, the central bank is showing that it does not have confidence in the economy's powers of innovation. This would dampen the mood, demand would remain low and companies would neither utilise their existing production capacities nor have the confidence to innovate and streamline.

In this situation, the central bank finds itself on a tight-rope and needs to act with great delicacy. Even if there is an economic downturn, it at least has to make moderate increases in the money supply in order to build confidence. In this way it encourages demand and helps to utilise capacities. It should not be assumed that companies will respond to increased demand by raising their prices. Individual businesses will beware of allowing their capacity to lie fallow and rot away because they know this will allow their competitors to step in.

However, once the economy is back on its feet, the central bank once again has to restrict the money supply in order to avoid the economy overheating and driving up prices, while at the same time not choking the economy's upturn, innovation and growth.

In conclusion, it should be pointed out that the central bank also has to take into account two other issues in its money supply policies. It has to be aware of the »velocity of money«. When the velocity of money is high, it is necessary to have less money in circulation than when it is low. In addition, we should bear in mind that the need for money not only serves the purposes of trade but also of speculation.

Why the central banks should be independent

In their battle to win votes, politicians tend to promise more on the expenditure front than they can really sustain in terms of income. The government and institutions that are directly linked to the government and parliament are therefore – as we have learned from bitter experience – rather unsuited to the Herculean task of handling monetary policy. For their own protection, democracies need autonomous institutions that are included in the constitution but independent of the executive branch. These particularly include an independent judicial system and an independent central bank. It is necessary to have empirical proof that monetary value is fundamentally linked to the central bank's degree of independence.

For their own protection, democracies need autonomous institutions that are included in the constitution but independent of the executive branch. These particularly include an independent judicial system and an independent central bank

Even constitutionally-guaranteed political independence can be made difficult by governments, the parties to labour agreements and the commercial banks. Excessive national debt, excessively high wage agreements, over-generous lending policies and working with too little capital all create a dilemma for the central banks because these factors all consume a large part of the planned increase in money supply. If the central bank holds firm to the money supply target that it believes to be correct, it risks causing unemployment in the short-to-medium-term and with it the aforementioned risk that capital stock that is not fully utilised is not regularly maintained, let alone modernised, so that unemployment becomes structurally ingrained and ever more difficult to combat. This also affects independent central banks, because their members have of course been through a social and political process of socialisation. This is why in the long term the central banks tend to increase the money supply to the detriment of price stability. They are keen to tackle short-term consequences directly and prevent the situation worsening.

Money as a public good

Even if the central bank carefully assesses the money requirements of the economy as a whole, it still lacks the knowledge and capacity to distribute it into the nether reaches of the economy, to companies and private households. It should not finance the government's borrowing requirements because although it is an autonomous institution, it still belongs to the state and its organs. There is a need for a separate banking system that is both collaborative and competitive.

The combination of providing a basis for (monetary) credit creation and its distribution into every area of the private sector should be understood as a public good that should be treated as a joint responsibility by the central bank and the private commercial banking system. Loans granted to the many private actors, but also to the government, the repayments, the daily transactions etc. all mean that the banks can never balance their accounts at close of business. Surplus liquidity should be invested, and refinancing to balance out deficits is a daily occurrence between banks and also between some banks and the central bank.

This relationship is known as interbank trading. If the banks fail to trust each other because they have no confidence in the debt instruments that are normally used as security, this impairs the ability of the commercial banking system to keep the credit flowing. There is also the risk that some banks will totally collapse and drag other banks and companies down with them. This can have devastating consequences, particularly when the vulnerable bank is »too big to fail« and nations and their economies are closely intertwined, as was shown by the collapse of Lehman Brothers in September 2008.

Then the central banks are forced to be the lenders of last resort. They provide the banks with refinancing funds at unusually low interest rates and flood the market with »cheap money«.

This harbours the moral hazard issue. The banks know that the government cannot allow the worst-case scenario to happen in which the economy's money supply collapses, so they enter into high-risk financial transactions. If they are successful, they make huge returns on equity. If they fail, the government, or more precisely the taxpayer, will step in. We should not imagine that bankers begin their day by asking who they are going to rip off today. Rather it is a subconscious or subcutaneous knowledge that if things get really bad, the state will step in.

As shown in → 2, this problem can only be resolved if capital regulations are made much stronger and if the credit transactions that are necessary to fund the economy are strictly separated from investment banking and the trade in »financial products«.

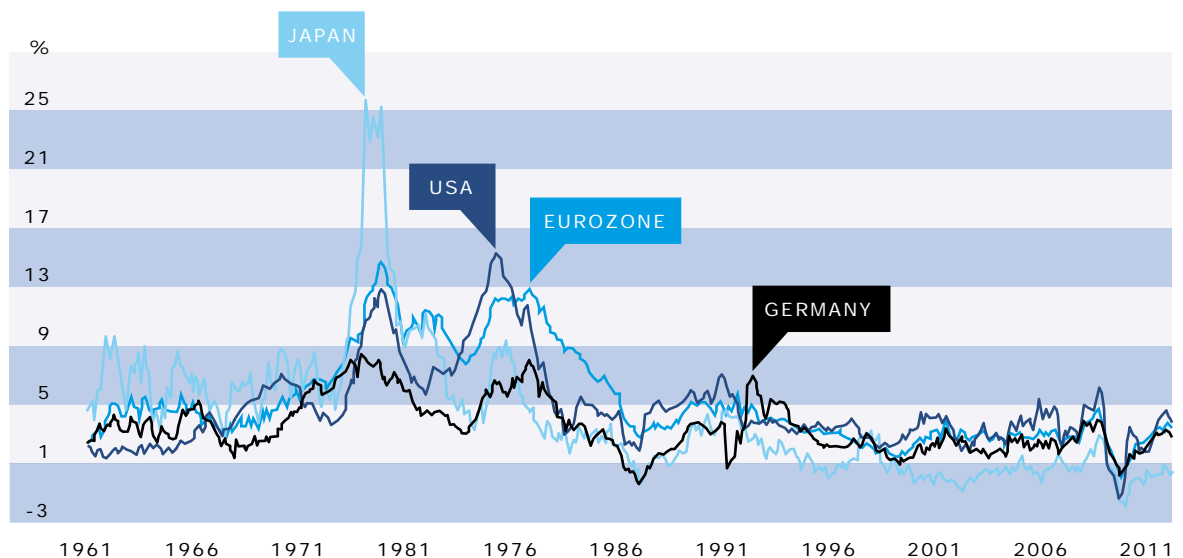
The eurozone and the European System of Central Banks (ESCB)

As we know, the EU Treaty means that all EU Member States are obliged to work towards the introduction of a single currency. Convergence criteria have been agreed in order to ensure a minimum level of economic and financial equality. Once members have met these criteria, they are then eligible to join the monetary union (also known as the »eurozone«, after the name of the currency). Denmark and the UK have opted out of this obligation.

The eurozone was set up in 1999, initially with 11 countries. Other states have joined since then, and by 2012 there were 17 members.

Very special organisational rules are required in order to meet the goal of unifying as many EU Member States as possible within the monetary union and create a specific monetary policy for the eurozone. The European System of Central Banks (ESCB) and the European Central Bank (ECB) were established in 1998 (modelled on the Deutsche Bundesbank) in order to achieve this aim. The ESCB includes all the central banks of EU countries and its main focus is maintaining price stability, (article 127, paragraph 1 TFEU).

INFLATION RATES IN SELECTED REGIONS (1961 – 2011)



Source: Eurostat, OECD

Germany's rate of inflation has remained in the low single-digits for decades thanks to a monetary policy that focuses on stability. After the introduction of the European single currency, the monetary policies of the Deutsche Bundesbank were by and large continued by the European Central Bank. As a result, inflation rates in the eurozone have also remained steady at around two percent.

The ESCB operates in parallel to the ECB. Only the ESCB is an EU body (see article 13, paragraph 1 EU Treaty, article 282 TFEU). The EU's decision-making bodies, that is to say, the Executive Board and the Governing Council, head up the ECSB and are responsible for monetary policy. The Executive Board comprises the President and Vice-President of the ECB plus four other members. The President decides which of them should take on the post of Chief Economist. The ECB Governing Council is made up of the Executive Board and the presidents of all the central banks in the eurozone countries.

In order to safeguard the autonomy of the central bank, the members of the Executive Board serve an 8-year term and may not be reappointed. This is designed to prevent its members from being tempted to follow »government-friendly« monetary policies in order to improve their chances of being reappointed.

Targets for price stability

The ECB has set out its targets for price stability as follows: Annual price level increases should be »below, but close to, 2 percent«, measured against the HICP. It reached this target long ago (see diagram on p.38) and is thus continuing in the footsteps of the Deutsche Bundesbank. There are two reasons why the inflation rate cannot be zero. Firstly, there is inevitably imprecision in the way it is measured, and secondly some price rises are not caused by inflation but by quality improvements.

Integration in international monetary agreements

As mentioned above, economic growth in the EU naturally also depends on the terms of trade and the structure of the global financial system. So it goes without saying that some countries and even the EU itself as a supranational entity are working together on key regulations for the financial system and entering into appropriate agreements. These include the decisions made by the Basel Committee on Banking Supervision, the work of the IMF and the attempt by the European Exchange Rate Mechanism II (ERM II) to limit the range of exchange rates and where possible bring them closer together. As with its predecessor, the European Monetary System, the aim of ERM II is to help non-eurozone countries move towards monetary union. These countries' exchange rates against the euro are given a range that should if possible not be exceeded and that over time should become narrower so that they will eventually be in a position to join the union.

However, at the moment only Denmark (despite opting out), Latvia and Lithuania are members of ERM II. It still makes no sense for the other countries to join because it would mean the range would have to be excessively widened.

The problem of »bubbles«

The attention of the public, politicians and the ECB is generally concentrated on the consumer price index. But of course this is only half of the picture. Anyone who has bought property or plans to buy property will know that price movements in this area often have little connection to the consumer price index. The same is true if we look at the prices of key raw materials such as oil, ore, rare earth metals and raw cocoa, but also basic foodstuffs such as rice, wheat and so on. It has not been unusual to see price hikes of up to 200 percent over relatively short periods of time. So it is necessary to include a detailed index of asset prices and raw materials prices in order to calculate price stability.

It is not our intention to examine the many reasons for price increases in different asset classes, however we would point out that the world's main central banks are responsible for the policy of »cheap money«. The availability of large amounts of money often causes difficulties for banks. This is because they cannot place this money into the real economy on their own; they cannot increase their capital and number of qualified staff to the required level in a short space of time; and because there is still a lack of demand, which means businesses are hesitant to take out new loans.

So the banks are looking for other profitable investment opportunities. They are therefore getting involved in the high-end property market and in raw materials and basic foodstuffs, either directly or through lending to other institutional investors (hedge funds). At intervals, the demand generated in this way becomes exaggerated. Prices and actual values begin to diverge and a price bubble forms.

The bubble bursts when the feeling grows that a more realistic valuation is on the horizon. Those who are quick to act sell or perhaps recover their invested capital or suffer only slight losses. Asset prices drop and the banks demand repayment of loans or reliable securities. This causes difficulties for other actors and also forces them to sell. The sad end result is that the air seeps out of the bubble and leads to the destruction of capital. This amounts to an attack on the real economy. This is also a justification for the reduction of the banks' systemic risk, so that remedial measures on the part of the central banks do not become excessive.

SOURCES AND RELATED LITERATURE

- *Becker, Werner (2012):* Der Euro – Währung für Europa. Wie ist die Bilanz der Gemeinschaftswährung zu bewerten? Konrad-Adenauer-Stiftung, Berlin
- *Franke, Siegfried F. (2010):* Ordnungspolitik seit 1948, in: Franke, Siegfried F. (2010): Der doppelt missverständene Liberalismus. Eine Sammlung von Aufsätzen und Vorträgen, Marburg, pp. 91–126
- *Franke, Siegfried F. (2011):* Vertrauenserosion. Eine Gefahr für Politik, Gesellschaft und Wirtschaft, Marburg
- *Franke, Siegfried F. (2012):* Grundlegende Aufgaben der Zentralbanken, in: The Federal Agency for Civic Education (bpb), dossier »Finanzmärkte«
- *Schäfer, Wolf (2005):* Art. »Währungsordnung und Wechselkursystem«, in: Hasse, Rolf H. / Schneider, Hermann / Weigelt, Klaus (ed.) (2005): Lexikon Soziale Marktwirtschaft, 2., current and awaited edition, Paderborn, Munich, Vienna, Zurich, p. 481 et seq
- *Willgerodt, Hans (2011):* Werten und Wissen. Beiträge zur Politischen Ökonomie (in particular Part II, articles »Das Problem des politischen Geldes« and »Gedekte und ungedeckte Rechte«), pp. 323–355

THE SOCIAL MARKET ECONOMY STANDS FOR ...



4

THE GOAL OF HIGH EMPLOYMENT LEVELS.

It is an element of human dignity and the values of freedom and individual security that individuals should be able to support their families through their work and at the same time make a positive contribution to the prosperity of all. Long-lasting unemployment has a detrimental effect on the personality because it attacks people's sense of self-worth. High levels of unemployment are also a burden on the welfare system.

The legal mandate

In the German Stability and Growth Act, politicians are obliged to work towards a goal of »high employment« (article 3, paragraph 1 StWG). In article 3, paragraph 3 of the EU Treaty, the EU even sets a target of »full employment«, but adapts this in article 147 TFEU – for good reason – to the target of a »high level of employment«.

The market economy and the Social Market Economy require the potential to react to changing conditions of supply and demand. Guarantees of full employment would erode the competitive system (→ 2) and in an age of globalisation would reduce the necessary capacity for adaptation and innovation. The state has neither the means nor the opportunity to fund guarantees of full employment. However, empty promises undermine the trust that is needed in state institutions. Nevertheless, the potential to create forced full employment by decreeing a »duty to work« (as in article 24, paragraph 2 of the GDR constitution of 1974 and similarly in the former Soviet Union's constitution), goes against all the basic principles of democracy.

The stipulation of a »high level of employment« includes the requirement that the EU Commission and national governments use their overall social and economic policies to help the workforce and companies to adopt the necessary adjustments as quickly as possible so that transition times, i.e. periods of unemployment, are kept as short as possible. This also clearly addresses the aim of economic growth (→ 6).

The employment rate: the main indicator of the success of national employment policies

Indicators are of course necessary in order to assess the success of national employment policies. Such indicators are reliant on a defined basis for assessment, in this case the concept of employable people, and also on the question of who is considered to be »unemployed«.

The values system of modern, enlightened societies forbids the use of child labour (article 32 of the Charter of Fundamental Rights), and states that people should also not work themselves into the grave. People are also generally aware that their wellbeing later in life is linked to giving their children a good education. As a result, children, schoolchildren and students are not considered to

be employable people and, excluding factors such as illness or early incapacity to work, people are expected to retire after a particular age. Here too, it is clear that the numbers of employable people depend on legal principles that as far as possible have to be decided by consensus in parliament.

Generally speaking, »unemployed« refers to those employable people who have no employment, whether self-employed or in the employment of another. The question is how to count their numbers in any kind of reliable fashion. In very large countries such as the USA and Russia, or in countries that have less sophisticated administrative systems, their numbers are estimated by means of surveys. This is primarily aided by the concept of the International Labour Organisation (ILO).

In Germany, the number of unemployed is calculated by the Federal Employment Agency and the Federal Statistical Office. As far as the Employment Agency is concerned, people are considered to be unemployed if they are:

1. capable of working, i.e. they are not ill and belong to the potentially economically active population
2. willing to work and
3. if they have registered as seeking work with the Federal Employment Agency. As it is largely impossible to directly measure »willingness to work«, people who register as »seeking work« are also considered to be »willing to work«. So unemployment is measured using administrative data. The Federal Statistical Office uses the unemployment rate in accordance with the ILO concept for the purposes of international comparability. This generally leads to a lower rate than when unemployment is measured using administrative data.¹

The main indicator that high employment has been achieved is the unemployment rate, which is calculated in two different ways in Germany. The unemployment figures as calculated above are used as part of the total figure for the dependent civil workforce and for the civil workforce. In the second case, the figure includes self-employed people and any family members that help them, while the counter remains the same, so the second figure is one percent lower than the first. In both cases, »civil« means the figure excludes people who are employed by the military.²

Critics have constantly voiced the objection that unemployment figures are distorted. As it is impossible to directly measure »willingness to work«, it should be taken into account that people may register as unemployed in order to claim unemployment benefits but have no intention of taking a regular job. In the event of job offers or job interviews they try to convey the impression that they are not cut out for this particular kind of work. As a result, the official unemployment rate is too high. Others claim that the official rate is too low because it does not include the majority of those people who are indeed looking for work but who do not register as unemployed because they do not need to claim unemployment benefit. These might include mothers who have taken a ten-year break to bring up their children but who now want to return to work, or self-employed people who have had to give up their businesses.

There is anecdotal evidence to support both of these arguments, but there is little statistical proof. However, it should be conceded that the criteria of »reasonableness« in relation to taking a job have been raised over time, which has helped to counteract the risk of abuse.

In this respect, we will take a brief look at the question of measurement using administrative data and measurement in accordance with the ILO concept. It is understandable if the more precise concept of administrative measurement is used for the purposes of national employment policy. For the purposes of international comparison and in order to give the EU Commission an idea of the situation in the individual Member States, it is of course sufficient to use a concept that can be used fairly equally in every country (see diagram on p. 44).

Key secondary indicators of unemployment

As previously mentioned, it is important to know how the potential of employable people can be defined alongside the official unemployment rate. In addition, the number or rate of short-time workers and the ratio of advertised vacancies are of interest when assessing the problem of unemployment.

Short-time working is a very useful tool in German employment policy. In a nutshell, it allows companies to retain a portion of their workforce in times of crisis by shortening their working hours by up to 50 percent. Workers do not lose all their wages, and a large part of the difference is made up by the Federal Employment Agency.

This instrument has been shown to be very beneficial. Once the crisis is over, companies are not left standing wringing their hands because they urgently have to find skilled staff, and workers do not lose too much of their income, so overall demand is stabilised and the necessary skills are not lost.

Other key indicators for assessing the employment issue are the number of people taking early retirement, the success rate of job creation schemes and retraining schemes, the female employment rate and time spent studying.³

Another indicator is the often yawning gap between the number of advertised job vacancies and the number of people out of work. This is also due to the fact that the advertisement of job vacancies is often poorly managed because companies do not use placement services, particularly when looking for highly-skilled staff. In general, the severity of the unemployment problem can be seen from the »gap«, because this signals difficulties in the matching process.

The matching process

The labour market has the task of matching labour supply and demand. This has become more difficult over recent years, partly because of the pressures caused by globalisation. Increasing competition places great demands on companies and workforce alike. Businesses are constantly being urged to innovate, and workers are expected to be extremely flexible, in terms of both their physical location and mental attitude.

It is clearly time to find smart ways of linking together the following policy areas: research funding, competition, regional relocation, education and welfare. How to plan practical job creation schemes in conjunction with businesses, create jobs that are gender-equitable, offer suitable jobs to graduates without allowing academic education to turn into nothing more than narrow vocational training – these are all problems that have to be resolved as part of the aforementioned interlinking, in order to achieve permanent levels of high employment. The inherent difficulties can be seen in the problem of the retirement age.

The problem of finding the right retirement age

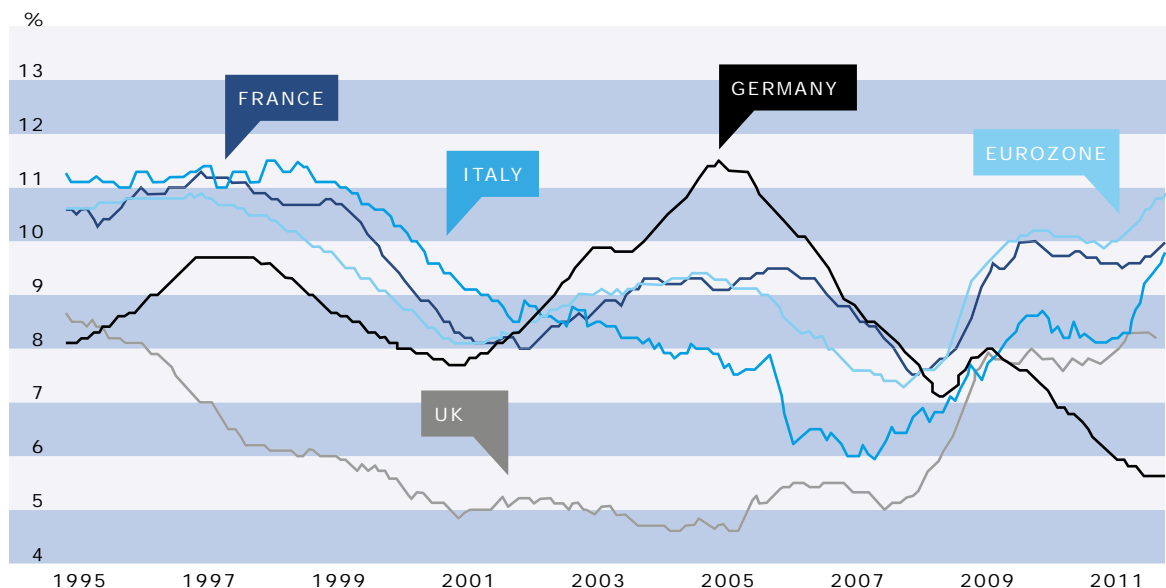
Early retirement is a tool of labour market policy that was particularly popular during the 1980s and in the early days of reunification as a means of expediting much-needed restructuring and providing young people with work opportunities⁴. However, in the light of demographic change, it no longer plays any meaningful role. Indeed, the opposite is true. If statutory social security contributions are not to be overextended in view of increasing life expectancy, for reasons of international competitiveness and the solidarity of the working population, then it is necessary to increase the retirement age and indeed this has already been legally set in motion. This is not only a problem for social scientists but also an important element of the matching process. It goes against the principles of freedom to impose a retirement age that remains unchanged since the days of Bismarck upon people who are able and willing to work. The link between increased life expectancy and demographic shrinkage also makes it advisable to raise the retirement age. Two diametric tendencies place a huge burden on matching process policy in this area. The first of these is the difficulty of changing »social achievements« such

as the retirement age and salary levels. The second is the still inadequate availability of jobs that are suitable for the potentially declining powers of older workers. Both of these have become unhealthily intertwined and have resulted in major problems for both of Germany's main parties, the SPD and the CDU/CSU, though more for one than the other. Other countries in Europe are facing the same problems. Violent protests broke out when France's former president, Nicolas Sarkozy, approved the raising of the retirement age from 60 to 62 in the autumn of 2010. During his election campaign, the country's new president, François Hollande (who was elected in May) promised to reverse and not implement this reform.

Responsibility for labour and employment policy

As these illustrations show, achieving and securing the goal of high employment is a major task for those who bear the responsibility for or who are involved in labour and employment policy, as so many areas have to be interlinked.

HARMONISED UNEMPLOYMENT RATES



Source: OECD

The unemployment rate is defined by the ratio in percent of unemployed to employed people. The diagram shows the criteria set by the International Labour Organisation (ILO) for the harmonised unemployment rate. The figures have been seasonally adjusted. Whereas the unemployment rate in Germany has dropped over recent years, it still remains high in much of the rest of Europe.

For historic reasons, agreements that are made without state intervention on wages and salaries, including regulations on pay for holidays, breaks and training, are accorded great importance. The right to collective bargaining is enshrined in the European Charter of Fundamental Rights (article 12, paragraph 1 EUCFR). In the German constitution, this right is guaranteed in article 9, paragraph 3. The responsibility for negotiating employment contracts is placed in the hands of those who are most familiar with the problems of particular industries and businesses. This is why the founding fathers of the Social Market Economy, Ludwig Erhard and Alfred Müller-Armack, were not only supporters of collective bargaining but indeed regarded it as an essential element of the Social Market Economy.

Nevertheless, we can still make a critical examination of the right to strike that is derived from collective bargaining (article 28 EUCFR). This has a historical justification because from the beginnings of the Industrial Revolution until well into the 20th century, capitalists were generally more able than workers to exercise their rights to freedom and to alter a legal relationship. It is difficult for individuals to defend themselves in the event of disputes and the collective withdrawal of labour becomes their only option. This is designed to cause losses to employers and force them to back down.

This becomes problematical when employers are also represented at state level. In this case, they do not dispose of their own income and do not themselves suffer any losses. Wage concessions and strikes then affect the taxpayer and uninvolved third parties. The same is true of value chains that are closely intertwined. A strike by just a few specialists can affect third parties and wreak economic havoc.

So strikes should not only be viewed as a last resort that is tied in with strict conditions. In this increasingly connected 21st century, surely it is time to think about finding new mechanisms for resolving conflicts. This idea suggests itself because the management-labour partnership can be threatened if, as in our previous example, a few specialists can win through blackmail while large, strong organisations on both sides can make agreements that are to the detriment of third parties. These might be medium-sized, unionised suppliers who then have to bear the cost of wage concessions.

It is clear that John K Gailbraith's theory of »countervailing power« also contained some erroneous ideas.⁵ He accepted the need for a strong capital side, because this is the only means of achieving the necessary investment in the design and manufacture of quality products. The power bestowed by this must of course be balanced out on the labour side by similarly strong union power that can represent the interests of the

otherwise powerless workforce. The unions must also have the legal right to make credible threats; the right to strike must be coupled with a credible ability and willingness to strike.

However, history has shown that the concept of countervailing power leads to cartel-like structures in the area of collective bargaining, where both sides seem to have little permanent desire to make each other's lives difficult. Instead – as has been empirically proven – there is a tendency to make agreements that are to the detriment of third parties. Cost increases caused in this way are often passed down to small and medium-sized suppliers and the central bank finds itself faced with the problem of having to carry out a degree of quantitative easing that is not beneficial in the medium-to-long term (→ [2](#)).

Therefore it falls to labour market and employment policy legislators (in Germany the government and parliament, and at European level the EU Commission, Council and Parliament) to configure the above-mentioned areas in a meaningful way and also to set necessary limits on the power of the social partners.

NOTES

1 | Cf. *Regina Konle-Seidl: Erfassung von Arbeitslosigkeit im internationalen Vergleich. Notwendige Anpassung oder unzulässige Tricks?* IAB summary report (Institut für Arbeitsmarkt- und Berufsforschung/Institute for Employment Research), no. 4/2009

2 | The exclusion of the military goes back to the Cold War era when it was necessary to keep the number of soldiers secret. As part of its reunification, Germany publicly stated the permitted maximum level of its armed forces, so this figure is no longer secret. But in the past any intelligence service worth its salt would certainly have known the exact numbers.

3 | There are two possible reasons for the fact that there are fewer working women in Germany than in many other European countries. The first of these may be down to conscious decisions made within households. Everyone has the right to self-determination, so these decisions should be respected and the state should not make use of subtle (or not so subtle) incentives or coercion mechanisms to influence people's freedom to make decisions. However, it can be a sign of »hidden« unemployment, because of an inadequate supply of jobs that make it possible to combine family and career.

Excessively long study times are not only, and certainly not predominantly, a result of deficiencies on the part of universities (although this is often insinuated in conjunction with calls for university reform), but they are also influenced by worries about whether it will be possible to find a job once the exams are over. If in doubt, many people choose to put off their graduation or study for a higher qualification rather than end up as an out-of-work academic.

4 | There is no hiding the fact that some companies have had a tendency to focus on recruiting young staff. A neglected side-effect of this has been the collapse in the number of engineering students. After all, how many 52 or 55-year-old fathers who have just been shown the door are going to encourage their university-age children to study engineering? Just a few years later, this has led to a real shortage of engineers.

5 | Theory developed in his book, »American Capitalism. The Concept of Countervailing Power«, 1952

SOURCES AND RELATED LITERATURE

- *Belke, Ansgar* (2005): Art. »Beschäftigungspolitik«, in: Hasse/Schneider/Weigelt (ed.) (2005), pp. 130–132
- *Belke, Ansgar/Baumgärtner, Frank* (2005): Art. »Beschäftigung«, in: Hasse/Schneider/Weigelt (ed.) (2005), pp. 126–130
- *Burda, Michael/Wyplosz, Charles* (2009): Makroökonomie. Eine europäische Perspektive, 3., completely revised edition, Munich (particularly Chapter 5)
- *Eekhoff, Johann* (2008): Beschäftigung und soziale Sicherung, 4., substantially revised edition, Mohr-Siebeck, Tübingen
- *Franz, Wolfgang*: Arbeitsmarktökonomik (2009): 7th completely revised edition, Dordrecht, Heidelberg, London, New York
- *Galbraith, John K.* (1952): »American Capitalism. The Concept of Countervailing Power«
- *Hasse, Rolf H./Schneider, Hermann/Weigelt, Klaus* (ed.) (2005): Lexikon Soziale Marktwirtschaft, 2., current and awaited edition, Paderborn, Munich, Vienna, Zurich
- *Kirsch, Guy/Mackscheidt, Klaus* (2006): Arbeiten bis 90, in: Frankfurter Allgemeine Zeitung, 27 May 2006, p. 13
- *Konle-Seidl, Regina* (2009): Erfassung von Arbeitslosigkeit im internationalen Vergleich. Notwendige Anpassung oder unzulässige Tricks? IAB summary report (Institut für Arbeitsmarkt- und Berufsforschung/Institute for Employment Research), no. 4/2009
- *Sesselmeier, Werner/Funk, Lothar/Waas, Bernd* (2010): Arbeitsmarkttheorien. Eine ökonomisch-juristische Einführung, 3., completely revised edition, Heidelberg

THE SOCIAL MARKET ECONOMY STANDS FOR ...



5

THE GOAL OF EXTERNAL BALANCE WITH A HIGH EXPORT QUOTA,

because free international trade can contribute to international understanding; because it provides the freedom to look out beyond our own national borders; because it provides new stimuli and is able to increase the prosperity of the nations involved, in this way helping to safeguard peace.

International trade – a path to peace

Of course, the creators of the European unification process after the Second World War based their ideas on common values. However, they did not hide the fact that they were also trying to make use of the economic, cultural and political cross-linking of the Member States of the European communities (from the European Coal and Steel Community to the EEC, the EC and finally the EU) to push the opportunity costs of military conflict so high that negotiated solutions would be found before it reached this stage.

What does the goal of external balance really mean?

Everything a nation consumes, gives away, distributes or redistributes, so the economic »pie« – the national income or national product (Y) – first has to be »baked« or produced.

A nation can be austere by keeping the pie small and making it with local ingredients. In economic terms, this represents a »closed economy«. If we turn it into an equation, the letter C represents the volume of consumer goods and services for private households, I represents the volume of capital goods and services for businesses and G represents the volume of public services. It is also useful to illustrate this: the national income (Y) as the volume of vehicles, TVs, loaves of bread, machine tools or buildings that are manufactured and built. But the impossibility of comparing apples and oranges means that these letters hide the total value of all consumer goods, capital goods and public services expressed in a monetary unit (e.g. US dollars or euros). So our definition takes the form of the following equation:

$$Y = C + I + G$$

There can be no objections if the majority of the population are happy with their country's own products and want to be self-sufficient as a nation. However, they have to realise that their nation will have low levels of prosperity if it has few of its own raw material resources.

But many citizens are not enthusiastic about pure self-sufficiency. To put it in everyday terms, they are happy to drive French or Japanese cars and start their day with a glass of freshly-squeezed orange juice or a slice of pineapple or kiwi fruit. Many people have travelled abroad and are keen to repeat the experience.

Clearly people benefit from these kinds of foreign imports. So the »pie« is also filled with imported goods (M). Of course other countries cannot just give us these goods and services – we have to offer something in return. These are export goods (X), goods that are produced domestically and that are in demand elsewhere. Here too, it is only possible to compare the wide range of exports and imports in a monetary way, expressed in US dollars, euros or other currencies. So in equation (2), exports are given a plus sign and imports a minus sign. Actual exports are sent abroad, while the exporting country receives foreign exchange, so foreign currencies¹ in return (hence the plus sign), whereas actual imports enter the country while foreign exchange flows out (hence the minus sign).

$$Y = C + I + G + (X - M)$$

Free trade creates a greater variety of products and hence higher quality of life, as stated by Paul Krugman,² who was obviously – consciously or unconsciously – leaning on Adam Smith when he proposed that the prosperity-enhancing principle of the division of labour should also be used on a global scale, which is why the call for »free external trade« was a key element of Classical Liberalism (→ **INTRODUCTION**). This also corresponds to the principle of cost minimisation in the production of the desired goods and services. This should not be understood in the rather deprecatory sense of simply maximising profits. »Cost minimisation« also means minimising use of resources without compromising quality. This is a goal that is directly tied in with the goal of protecting the environment.

Without delving further into these issues, we should mention that the concept that is today known as »globalisation« also includes the previously outlined idea of »free international trade« in the sense of (predominantly) finished products but also goes way beyond this. The political will to work with international partners and the new possibilities created by the latest information and communication technology have led to transaction costs³ sinking to such a degree that cross-border value chains can also be profitable. In other words, semi-finished products, often including modules⁴ are manufactured in various countries by various companies and then brought together for assembly in a particular location. Design drawings, software developments, telephone hotlines, reservations – all these and more can now be executed in far-off countries and

used by other countries in the blink of an eye. Global corporate networks mean that problems can be worked on 24 hours a day. New hybrid types of businesses have also emerged. For example, businesses may compete with each other in the market with their end products, but also work together in the pre-production stages in order to save on development costs.

Ludwig Erhard: External balance with high export quotas

The exchange of exports and imports can balance out at a very low level, which of course does little to increase the prosperity of the nations involved. In geographical terms, Germany is a small country with few raw material reserves but a population that is now around 82 million. In order to achieve and maintain an acceptable level of prosperity, it is necessary to import substantial amounts of raw materials such as oil, gas, ore, rubber and timber, along with luxury items such as coffee, tea, foreign wines and exotic fruits. All this can only be paid for if we in turn can offer a range of quality products. In this respect, we would point to the »Made in Germany« quality stamp that has been valued all over the world for decades.

The Stability and Growth Act sets the goal of »external balance«, but of course we should add the phrase »with high export quotas«, as Ludwig Erhard formulated it many years ago. Only an appropriate volume of export goods can bring in the foreign exchange that is needed to buy the imports outlined above.

Strictly speaking, the goal should be: balance of the consolidated current account and transfer payments

Citizens and companies within a nation may have a diverse range of economic relationships that go beyond the external trade that is described above. For example, they may buy properties abroad, build factories or sell foreign securities. They may also make private money transfers across borders. Countries and their governments are also part of this activity. All the monetary flows that are triggered by these actions are part of the balance of payments, which is broken down according to the type of action into various sub-sections.

One of these sub-sections is the current account and transfer balance sheet, which includes four sub-accounts:

Current account and transfer balance sheet

1. BALANCE OF TRADE – visible trade balance; monetary summary of exports and imports of goods
2. INVISIBLE BALANCE – a monetary summary of cross-border shipments, financial services, patents, licences and tourist services (in Germany this is the largest single item)
3. FACTOR INCOME – a monetary summary of wages and salaries that flow into or out of a country; income as a result of foreign debt securities or foreign asset ownership
4. TRANSFER BALANCE SHEET – a summary of transfers made for no return: transfers by migrant workers, emergency aid, reparations, payments to international organisations, development aid

»Exportweltmeister« (world export champions) and »Vizeweltmeister« (world export runners-up) are commonly used expressions in Germany and, when examined more closely, they refer to the balance of trade.

It is possible to make a more concrete definition of the goal of »external balance« when viewed in this context. Of course it is illusory to believe that each of these sub-accounts balance at the end of each accounting period. The aim is rather to ensure that the bottom line of these accounts balances at the end. So the consolidated current account and transfer balance sheet should no longer show a bottom line.

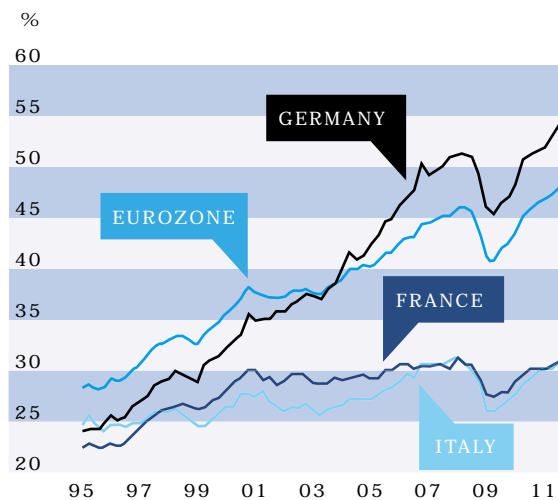
Each year, different circumstances constantly result in readjustments in size. On average, the last decades in Germany have produced a negative invisible balance. The main reason for this is the Germans' love of travelling. The balance of the transfer balance sheet is also clearly negative. The balance of factor income fluctuates from time to time but generally stays around zero. This suggests that the overall current account and transfer balance sheet can only be balanced if the balance of trade is in the black. »Exportweltmeister« (world export champions) and »Vizeweltmeister« (world export runners-up) are commonly used expressions in Germany and, when examined more closely, they refer to the balance of trade.

The size of the balance of trade surplus that is required to balance the current account and transfer balance sheet depends on the size of the national income and the bottom line of the sub-accounts. For many years, the rule of thumb has been that a balance of trade surplus has to be between 0.5 and 1 percent of GDP in order to achieve a balance.

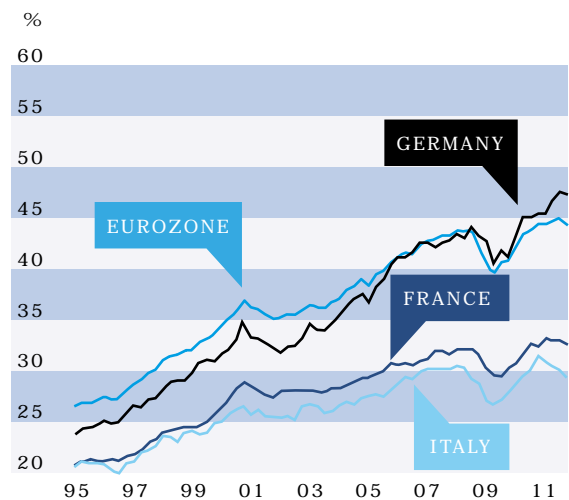
Balance via the capital account

We should of course concede that for many years the surplus in the balance of trade has been so large that it is unable to balance out the negative results of the other sub-accounts. Then the consolidated current account and transfer balance sheet is in the black. In this case, a balance is achieved through a capital export, which can be carried out in a variety of ways. In simple terms, one part of the surplus is used for direct investment: setting up production facilities abroad or acquiring shares in foreign companies. If there are no promising direct investment opportunities, then it can be used to buy foreign debt instruments. Of course foreigners also make direct investments in Germany and buy German debt instruments. The resulting monetary flows are included in the capital account as a sub-section of the balance of payments. In general, the capital account is in the red if the current account and transfer balance sheet is in the black.

EXPORT QUOTAS (1995 – 2011)



IMPORT QUOTAS (1995 – 2011)



Source: Eurostat. Exports and imports of goods and services in relation to GDP at 1995 prices

The term export quota means the ratio of a country's exports to its GDP. It gives information about the volume of trade within the economy. The export quota is used to measure an economy's degree of openness. In Germany, export volume as a ratio of GDP is between 40 and 50 percent.

The import quota represents the ratio of imports to GDP. Increasing import quotas mean countries are increasingly reliant on the foreign supply of goods. Increasing globalisation of trade leads to greater division of labour, and hence not only to an increase in exports, but also in imports.

The problem of Germany's surplus

The consolidated current account and transfer balance sheet were only in the red for a short period after German reunification. Before this, it had been mainly positive, and a short time later it was once again in the black and capital exports increased.

When looking for the reasons for this, we have to frankly admit that it not only depends on the performance of German businesses but also on the undervalued »German euro«, which has fuelled additional export demand. The expression »German euro« is perhaps a little irritating. It means that the exchange rate mechanism between the members of the eurozone has ceased to exist since the introduction of the euro. But of course this does not stop the economies of the various countries growing at different rates. If those countries that have become weaker fail to balance out sinking unit labour costs, and those that have become stronger fail to balance out increasing wages in particular, then the products of the weaker countries become relatively more expensive and those of the stronger countries relatively cheaper.

This is precisely the situation that has existed in the eurozone for some time now. As a result there has been some strong criticism, for example from Economic Sciences Nobel Prize winner Paul Krugman,⁵ but also from Peter Bofinger, member of the German Council of Economic Experts and other voices in the eurozone that are concerned about this skewed situation. An oft-heard proposal is that wages should be increased in order to strengthen domestic purchasing power. The »sixpack«⁶ even intended penalties to be incurred if the surplus or deficit exceeded four percent.⁷ Apparently these came down to the transfer union that was hotly disputed in Germany, in which the countries with surpluses should pay compensation to countries with deficits, similar to the financial equalisation scheme in operation between Germany's federal states.

These criticisms were well-founded. If we think the situation through to its logical conclusion, it would mean that the countries with surpluses would own the majority of production facilities and sites over and above the capital exports. Of course this is only the case if the surpluses can be invested in real terms. If this is constrained for whatever reason, then the only option is to buy debt instruments. Of course the debt of countries with weak economies can be fraught with risks, as has been shown in the examples of Argentina and Greece. Transfers also flow in the event of state bankruptcy (Argentina) or compulsory haircuts (Greece), but they are unregulated and have unforeseen consequences for distribution.

Unilateral assignments of guilt to countries with surpluses are wholly inappropriate. In the case of Germany, a large proportion of its exports go to those markets where they face strong global competition. Technical innovations and modest wage increases are therefore the result of strong competition and not aimed at outdoing the eurozone's southern members. It has certainly not been easy for the unions to agree to such a modest level of wage increases, so they should be praised all the more for their understanding of the global context.

Countries with stronger economies should not be blamed for the fact that other countries have done the exact opposite by using public debt for consumption rather than investment, with the resultant higher wages. Whether this was a result of a certain Mediterranean mentality or an attempt by governments to win votes is not a question that we will be examining in this report.

A new concept for reducing external imbalances

The reduction of external imbalances is of course one of the principles of the Social Market Economy. Permanent imbalances between the economic union's partners are detrimental to ongoing plans for political integration. Transfers can only be used to a very limited extent. They do not help to relieve the pressure if they become the norm and swallow up ever larger sums.

Reducing imbalances requires a very comprehensive concept with a view to the medium term.⁸ It should not only be geared towards wage increases in stronger economies but must also incorporate national economic structures. To put it in more concrete terms, if the Germans have more money in their pockets, should they buy an additional German car or should they buy German cars instead of foreign-made cars? What happens if car manufacturers have to shut down 10 to 15 percent of their capacity because neither the Germans – despite their wage increases – nor their foreign customers want to buy these cars which have now become more expensive? Can this underused capacity be used to produce more bread or sausage – just in case there is a sudden surge in demand for these items?

NOTES

1 | Calling foreign exchange »foreign currency« is initially irritating in terms of the flows of money that are set in motion by exports and imports in the eurozone. However, the fact remains that currency has to be earned, if possible through exports, in order to pay for the imported products. Euros that flow out into neighbouring European countries also have to flow back; in our interconnected world this may be an inflow from a eurozone country. The external balance does not always have to be between two countries, it can be balanced via a clearing house that involves three, four or more countries.

2 | For source see *Franke* (2010), p. 161, fn. 1.

3 | The collective term »transaction costs« describes all costs in an economy that are incurred by the initiation, contracting, execution and termination of a concrete transaction or business relationship. They increase the actual price of the goods or services and may be borne by either the buyer or the seller. If the transaction costs are too high, then part of the mutually beneficial exchange does not take place or shifts to the shadow economy. Both options result in a reduction in prosperity. Examples of transaction costs are transportation and insurance costs, but also publicly incurred costs such as customs duties, import licences, retrofitting regulations, etc. Political will (in the EU and the WTO) and global digital networks have led to these costs falling considerably, as previously mentioned.

4 | Modules refers to similar components or preliminary products that are produced cheaply and in large quantities and then used in a range of finished products. Examples from car manufacturing include: chassis, engines and seats.

5 | Paul Krugman proposes that the eurozone should accept 3 to 4 percent inflation in order to kick-start growth and reduce imbalances (for example in his interview with the weekly magazine *Die Zeit* (www.zeit.de/wirtschaft/2010-06/krugman-interview)). Of course this is a recommendation that sits awkwardly with the principles of the Social Market Economy, and experience has shown that target inflation rates are impossible to maintain. This is why Eucken and Erhard placed more emphasis on price stability (→ [3](#)).

6 | A set of regulations passed by the European Parliament in September 2011 based on six reports and opinions, hence the name »Sixpack«. They stipulate the tightening of the Stability and Growth Pact, stricter budgetary controls and movement towards the coordination of economic policies.

7 | After strong objections on the part of German Finance Minister Wolfgang Schäuble, the Commissioner responsible interpreted the relevant regulation in such a way that in this case only warnings and recommended corrections would be given.

8 | In the above-quoted interview, with his strong opinion on inflation (see fn. 5) Paul Krugman estimates that the time needed to develop a joint fiscal policy and a European health and pensions system would be some 100 years. Even with the EU's drawn-out and complicated decision-making processes, this is a little too long.

SOURCES AND RELATED LITERATURE

- *Adebahr, Hubertus* (1990): *Währungstheorie und Währungspolitik, Einführung in die monetäre Außenwirtschaftslehre*, vol. 1: *Außenwirtschaft*, 2nd edition, Berlin
- *Cieleback, Marcus* (2005): Art. »Außenwirtschaftliches Gleichgewicht«, in: *Hasse/Schneider/Weigelt* (ed.) (2005), pp. 125/126
- *Franke, Siegfried F.* (2010): *Ratlose Regierungen?! Sozial- und Wirtschaftspolitik unter dem Druck der Weltmärkte*, in: *Franke, Siegfried F.* (2010): *Der doppelt missverstandene Liberalismus. Eine Sammlung von Aufsätzen und Vorträgen*, Marburg, pp. 159–186
- *Hasse, Rolf H./Schneider, Hermann/Weigelt, Klaus* (ed.) (2005): *Lexikon Soziale Marktwirtschaft, 2., current and awaited edition*, Paderborn, Munich, Vienna, Zurich
- *Neimke, Markus* (2005): Art. »Außenwirtschaft«, in: *Hasse/Schneider/Weigelt* (ed.) (2005), pp. 122 – 125

THE SOCIAL MARKET ECONOMY STANDS FOR ...



6

STEADY AND MODERATE ECONOMIC GROWTH,

because it provides the basis for the overall well-being of a nation's citizens, enables people to live together in prosperity, makes it easier to introduce necessary domestic reforms, contributes towards protecting the environment and encourages peaceful co-existence. In other words, growth is a major prerequisite for economic and political freedom.

The concept: an initial approach and critical examination

Economic growth means that more goods and services are being produced and made available from one period to the next. Resources (in the broadest sense of the word) are used and consumed in the production and supply of these goods and services, so it is also necessary to ensure that capital stock such as production facilities and equipment are appropriately maintained and expanded. In other words, economic growth requires the existing capital stock to be cared for and expanded through reinvestment and expansion.

Critics of economic growth draw on a range of social, political and environmental arguments. These arguments would be valid if economic growth were understood simply as meaning »business as usual« and »more and more of everything«. However, such an understanding of the term cannot be imputed to either the ordoliberals or to representatives of the Social Market Economy. In 1965, Ludwig Erhard warned about the need for »moderation«.¹ The fact that economic growth should be understood in a differentiated way and in relation to »well-being« was already made clear in the Stability and Growth Act of 1967, before the first report by the oft-cited »Club of Rome« (1972).

A detailed look at the term as used in the Stability and Growth Act (StWG)

In § 1 of the German Stability and Growth Act (StWG) it is stipulated that economic growth should be steady and moderate. The term »steady« is easy to explain. It means that economic growth over the years should stay as even as possible; sudden surges in growth should not alternate with drastic slumps because, although this might produce an average increase in growth when measured over the years, it also brings with it some significant disadvantages. Skyrocketing growth may lead to inflation and overemployment, whereas drastic slumps may cause deflation and unemployment.

The adjective »steady« is also easy to justify because nothing is stipulated about the rate of annual growth. So we should now examine the second adjective that is used to describe the measurement of economic growth. This is of course an undefined legal term that has to be repeatedly interpreted interpreted in economic, social and political discourse.


There is unanimity about the three main ways of interpreting the term. Economic growth should be:

- SOCIALLY RESPONSIBLE,
- ENVIRONMENTALLY RESPONSIBLE AND
- BALANCED.

Economic growth is socially responsible when the process of growth and the associated changes to the economic structure does not overburden people's physical and mental mobility. Of course the workforce is required to have a certain degree of mobility. However, even in this age of globalisation, value creation is still generally carried out regionally. Most people do not want to be nomads but prefer to have social ties to their non-work surroundings. Physical and psychological ties therefore go hand-in-hand.

In this respect it is also necessary to address the need for lifelong learning, an area that is undoubtedly of great importance. However, the idea of lifelong learning does not mean that people are constantly attending courses and training sessions without being able to put what they learn into practice for any reasonable length of time.

And finally, it is important to ensure that economic growth does not lead to the less able being excluded from work and society.

»Environmentally responsible« means that it is necessary to observe the qualitative aspects of economic growth. From the point of view of the Social Market Economy, quantitative and qualitative growth are not contradictions in terms. On the contrary, the ordoliberals were concerned with environmental protection, and this, along with the principle of competition, requires the frugal use of resources in production (→ .

»Balanced« means the creation of an economic structure that is as varied as possible. External shocks that generally only affect a few products can be more easily absorbed.² Of course economic growth also means that certain industries will boom while others slump or disappear totally from the market, along with their products. Such kinds of structural changes always have an impact on the labour market, which is why »balanced« means that economic growth should take with it as many industries and regions as possible. Where structural change takes place, the economic process should be set up in such a way that people can find jobs in their region in flourishing or new industries.

And finally, the adjective »balanced« also refers to the »level factor«. This means that even the desired »steady« growth is accompanied by lower growth rates over a longer period of time. In theory, constantly high growth rates lead very quickly to exponential functions that can no longer be implemented in practical terms. In other words, growth rates of 8 to 10 percent, as is the case in China, are already very high but possible. With its high levels of economic output, Germany can be happy if it attains economic growth of 2 percent.³ The diagram on page 56 shows German economic growth over the last 60 years. The continuous growth in GDP has contributed to a significant increase in prosperity.

The link between prosperity and well-being

Economic growth is an important route to a nation's prosperity. Prosperity is normally indicated as per-capita GDP. In simple terms, GDP is the total of all final goods and services produced within a country, expressed in a monetary unit. Of course it only includes those goods and services that are marketed and given a price. There has been a great deal of criticism of this indicator because it does not include non-market activities such as housework or child-rearing and does not take account of the environmental damage that often results from the production of these goods and services. It is also argued that this indicator does not reflect people's sense of wellbeing and happiness. The Easterlin Paradox is often referred to in this respect. This states that people's levels of happiness have largely remained the same, although (statistical) per-capita incomes have grown four or even six-fold (see also Franke, 2010a).⁴ The Stiglitz Report took up this criticism and recommended that the prosperity of nations should be measured in a more comprehensive way. In December 2010, this report led to the German Bundestag setting up an investigative committee that – according to its chair, Daniela Kolbe – would calculate the value of growth in the economy and society, create an all-encompassing indicator to measure prosperity and progress and investigate the potential and limitations of uncoupling growth, resource consumption and technical progress.

It seems that it is time to reinvent the wheel. Prosperity, in the sense of high pro-capita GDP, is certainly a fundamental element of well-being, but it has never been believed that this indicator is the be-all-and-end-all. Individual and collective prosperity is measured by regular income and the availability of large volumes of quality goods and services that are produced in a way that is socially and environmentally responsible. In addition, in terms of the individual, future prosperity depends on commensurate ownership of assets and savings. In collective terms, it depends on good quality capital stock that must be maintained and expanded. GDP is the yardstick for this, but it should not be considered an absolute amount. More precise information on factor costs is obtained from the net domestic product (also known as national income) that includes the necessary reinvestment and corrects government influence on value added (via indirect taxation, subsidies and employers' social security contributions).

It should also be noted that well-being not only depends on the quantitative component but also to a large extent on the economic, social, environmental and political circumstances of a country and its surroundings. Here we are reminded of Ludwig Erhard, who tried to express this and inspire people with his idea of the *formed society* (→ **INTRODUCTION**).

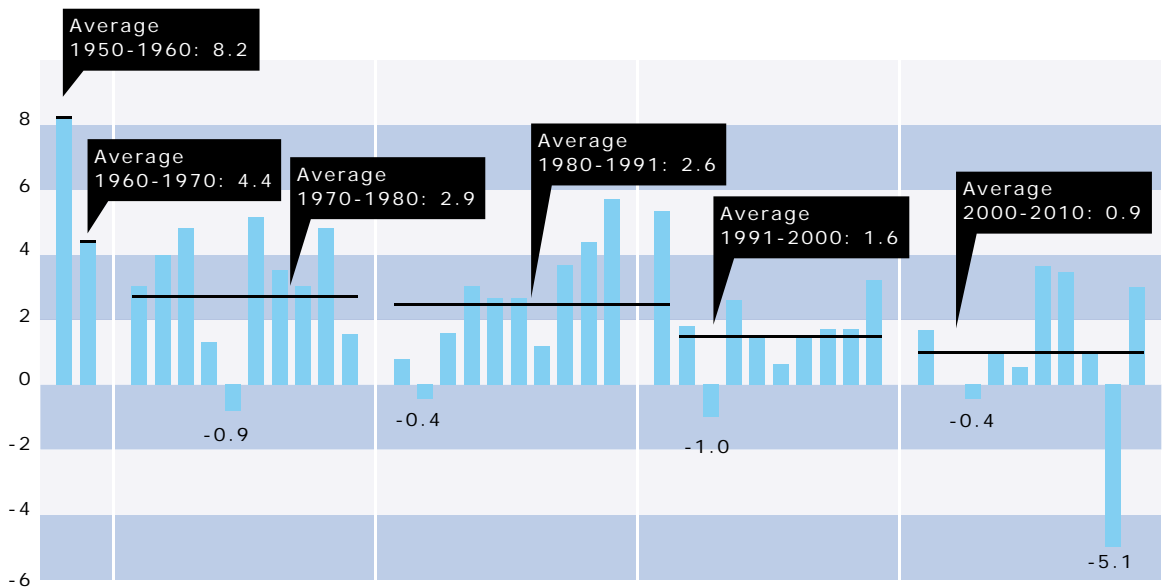
The individual aspects of this situation are measured with the aid of social indicators. Without claiming to be exhaustive, the following areas will be examined and described in more detail:

1. Conditions of employment (individual and collective): do employees enjoy collective bargaining and the right to strike? How long is the working week and how many weeks are worked per year? Do employees receive paid holidays and if so, how many days or weeks? Do employees receive sick pay? What kind of industrial safety measures are in place?
2. What is structure of the country's economy? Is it primarily a monostructure that is dominated by one or just a few products? Or is it multi-layered, with a wide range of products and services and no significant regional neglect?
3. Is there adequate social security and how is it organised? Is there a social security system (including unemployment benefits)? Do people have access to welfare and is other emergency assistance available (housing benefits, legal aid)?
4. With regard to the healthcare system, along with the question of funding are there any other indicators that provide information on numbers of doctors, hospital beds, infant mortality, life expectancy and inoculation rates?

5. What is the state of the country's education and training system? This includes questions about the school system, compulsory school attendance, literacy rates, number of high school graduates, number of university graduates and the vocational training system (e.g. combined academic and vocational training). It is also necessary to examine the opportunities for further education and whether the government provides funding.
6. Considerations of fairness require the provision of data about inequalities in the distribution of income and wealth in addition to information about access to the healthcare and education systems [see points (4) and (5)]. This includes the question about the state of the country's taxation system.
7. From an ecological viewpoint, indicators of water, air quality and ground quality are of significant, along with information on biodiversity (particularly diversity of species) and noise pollution.
8. What is the situation regarding political co-determination in the country? Is the constitution based on democratic principles? Are the people included in its realisation? Is the constitution legitimised by the people on an ongoing basis? What is the state of the country's electoral law? Is there a party system, free elections and protection of minorities? What role is played by the principle of subsidiarity (such as in local self-government?), an independent judiciary and press freedom?

The Federal Statistical Office and Eurostat, the European Union's Statistical Office, have carried out studies and provided a host of regular information on all these points for some years now. So the criticism can hardly be raised that the »growth target« is only directed at prosperity. The GDP or national income indicators have to be weighted using the social indicators derived from the above-mentioned areas.

GROSS DOMESTIC PRODUCT – YEAR-ON-YEAR CHANGES IN PERCENT (1950 – 2010)



Source: Hamburg Institute of International Economics (HWWI)

The diagram shows annual growth rates of the German economy and their 10-year averages over a period of more than 60 years. Economic growth is understood to mean the increase in GDP, so the total value of all goods and services produced in an economy, from one period to the next.

This weighting may differ depending on cultural area, nation and current levels of prosperity. It should be emphasised that – unlike in GDP – all the known and deducible social indicators do not cluster in one dimension. So there is also a problem of communication. On the news, the GDP growth rate is simply given as a percentage. If the presenter were also to read out 20 social indicators it would soon become incomprehensible to many viewers, who would probably quickly change channels. Of course this does not mean that the data gathered should simply be processed and filed away. As the example of environmental policy shows, it is studied by the department responsible and taken into account during the political decision-making process.

The United Nations Development Programme (UNDP) has now for many years produced a »Human Development Index« (HDI), which combines pro-capita income and the three areas of health, education and living standards into one formula. The rankings that are published are not necessarily easy to understand. For years, Iceland topped the rankings, often in first place, until it became clear that the country's standard of living was largely based on dubious credit transactions.⁵

In this respect, it is necessary to mention several interconnected issues. Firstly, it is clear that in the struggle between social and political forces there is a need for compromise when it comes to the weighting between GDP and the desired characteristics of the social indicators. Secondly, we also have to be aware that it is not possible to compare apples and oranges in one indicator. The attempt to develop a comprehensive indicator of prosperity and progress ignores this impossibility or wants to permanently include ideas in the indicator that are based on ideology.

And finally, as mentioned above, we should clearly point out that qualitative factors are involved in the production of GDP, and that precisely the development of these factors requires a certain degree of quantitative growth. Examples of these include the movement towards alternative energy, more childcare places, more and better education, better health care and care for the elderly, which all require new buildings, better equipment and trained specialists who of course also have to share in the products that they do not themselves produce. So from all this we can conclude that quantitative growth and qualitative aspects of well-being go hand-in-hand.

NOTES

1 | How the times are changing: at the time, Erhard was mocked by many academics because of his calls for moderation. Today, many are calling for limits on growth for environmental reasons and for the sake of fairness towards third world countries.

2 | To cite a drastic example: many years ago 80 percent of the Nigerian national budget came from oil revenues. So the country suffered great difficulties when oil prices slumped.

3 | The high growth rates of certain emerging nations are sometimes seen as a challenge. However, we should not allow ourselves to be misled by this, as foreign trade and globalisation only contribute to increased prosperity for all if there are no permanent imbalances (→ 5). Emerging nations still have a great deal of catching up to do in this respect. And pronounced differences in growth rates mean no fast equalisation of per-capita incomes. If the initial situation of the countries is very different it may even lead to an even greater spread.

4 | The author believes that the Easterlin Paradox is a hollow theory. Every society experiences a certain degree of dissatisfaction because – regardless of absolute income levels – there are always economic agents who earn less than the average income. They do not compare their situation with the much more spartan lives of their parents or grandparents but with the incomes of those who are above them.

5 | The 2011 ranking also shows some interesting results: Greece takes position 29, just one place behind the UK. In 7th place, Ireland is ranked ahead of Germany (9th), and at 88, Iran is ahead of the candidates for EU entry, Turkey (92).

SOURCES AND RELATED LITERATURE

- *Fehl, Ulrich* (1994): Voraussetzung und Motor von Wirtschaftswachstum, in: Ludwig-Erhard-Stiftung (1994): Grundtexte zur Sozialen Marktwirtschaft, Bd. 3: Marktwirtschaft als Aufgabe, ed. Herrmann-Pillath, Carsten/Schlecht, Otto/Wünsche, Horst Friedrich, Stuttgart, Jena, New York, pp. 347–360
- *Franke, Siegfried F.* (2010a): Vermehrt oder vermindert der Sozialstaat individuelles Glück? [Speech given at the autumn convention of the Arbeitskreis Politische Ökonomie, 22 Okt 2010, Helmut-Schmidt-Universität Hamburg] (www.siegfried-franke.de)
- *Franke, Siegfried F.* (2010b): Wirtschaftswachstum – was denn sonst? Drei Thesen zur Begründung eines angemessenen quantitativen Wirtschaftswachstums, in: Franke, Siegfried F. (2010): Der doppelt missverständene Liberalismus. Eine Sammlung von Aufsätzen und Vorträgen, Marburg, pp. 237–253
- *Gabisch, Günter* (2005): Art. »Wachstum«, in: Hasse, Rolf H./Schneider, Hermann/Weigelt, Klaus (ed.) (2005): Lexikon Soziale Marktwirtschaft, 2., current and awaited edition, Paderborn, Munich, Vienna, Zurich, pp. 479–481 et seq

THE SOCIAL MARKET ECONOMY STANDS FOR ...



7

FAIR DISTRIBUTION OF INCOME,

because a distribution of income that is generally considered to be »fair« is one of the key elements of the general social value of justice and because the material foundation is a prerequisite for exercising the value of freedom. The »fair« distribution of income contributes to individual security and prosperity. It reduces social tensions and contributes to fundamental acceptance of the market economy.

The concepts of income and wealth distribution

Income distribution relates to the share of households in the annual national income. It is perceived as »fair« if it allows appropriate »prosperity for all«, to quote Ludwig Erhard. The second part of Erhard's formula, »property for all«, relates to having a share in the economic capital stock, i. e. wealth distribution. Income may either flow from active participation in the annual production process, be based on ownership of capital stock such as share ownership, or may be legitimate transfer income such as unemployment benefits, housing benefits or grants.

The yardsticks of fairness: absolute and relative fairness

The sociopolitical value of fairness always includes comparisons in which something has to be »equal« in order for it to be considered »fair«. First we need to examine the terms »absolute« and »relative« equality.

1. Absolute equality means that everyone is equal in the eyes of the law.
2. Relative equality wants to treat »equal things equally« and »unequal things unequally depending on the particular circumstances«, or »appropriately«. The question arises of what should be considered as equal, what is unequal and to what extent differentiated treatment is allowed based on inequalities.¹

If we relate this concept to equal opportunities, it seems simple and plausible that they should be viewed in terms of absolute equality. So, for example, in Germany there are no restrictions on who may enrol in schools or universities. However, the arguments about the »right« kind of schools have still not run their course because there are a wide range of different ideas about how equal opportunities should be interpreted. A purely formal interpretation is insufficient because domestic circumstances often lead to children having different social skills when they start school at the age of six, and this can have an impact on their future success. This can be countered with the argument that gifted children or children who are early developers suffer if they are not given more challenging tasks at the right time.²

Benchmarks for remuneration

With regard to remuneration, the following benchmarks are important:

- Fairness linked to performance and
- Fairness linked to need.

Fairness linked to performance is based on the principle that everyone should be paid in accordance with their performance. But the question is – who or what measures this performance? In a market economy, the principle means that everyone receives their share based on the market's supply and demand.

With a slight alteration, we can also deduce that remuneration depends on market outcomes.³ These market outcomes may of course be distorted by unequal power structures. For the sake of greater precision, it is necessary to add that it should be a rules-based market economy in which competition prevents the emergence of harmful influences that dominate the market (→ 2). In contrast to this, the concept of fairness linked to need postulates that everyone should be remunerated in accordance with their need.

Clearly – if they are implemented in an unadulterated fashion – the basic principles of fairness linked to performance and fairness linked to need do not correspond with the basic principles of the Social Market Economy. This is the result we take a closer and more critical look at the ideas of fairness linked to performance and fairness linked to need.

Fairness linked to performance: can performance really be assessed only in accordance with market criteria? How do we include public provisions that are not subject to market assessments when calculating performance-related income? Is it necessary and justifiable to reduce performance-related income if the state has intervened in the market's structure? How do we deal with weaker performers in this system?

Fairness linked to need: who determines need and what are the criteria? According to Marxist precepts, everyone generally has the same needs. If we transpose this to a monetised economy with the division of labour, then everyone should receive the same income, irrespective of whether or not they are employed and their type of employment. What repercussions can we expect absolute equal income distribution to have on social and economic systems? Is there any point in striving for private ownership of the means of production and for assuming responsibility?

Would private companies pay their married employees significantly more than their single or childless colleagues, in line with their needs?

This catalogue of questions shows that both unbridled distribution of income in accordance with market criteria alone and absolute equal income distribution are not realistic options. The first could lead to extreme income inequality and the fragmentation of society with lasting consequences for internal security. The second option would result in a lack of motivation to perform, the flight of capital, a brain-drain, an increase in moonlighting and a reduction in the national income that is available for distribution. It is also not »fair«, and prosperity as the basis of the country's well-being would crumble. Finally, it should be noted that the fair participation of retirees in growing prosperity also results from a combination of fairness linked to income and fairness linked to need.

Income distribution policy in the Social Market Economy

Therefore there is a clear need to find a compromise between fairness based on performance and fairness based on need that is appropriate for all. This is the focus of income distribution policy in the Social Market Economy, and its main characteristics are outlined below. Firstly, income distribution should be tied to market outcomes in accordance with fairness linked to performance (known as primary distribution). With the aid of a sophisticated taxation and transfer system, fairness linked to need is then taken into account and primary distribution is adjusted accordingly (known as secondary distribution). This is illustrated by the simplified formula:

Gross income (according to targeted income on the market; fairness linked to performance) = primary distribution

⊖ Income/income tax – horizontal fairness: takes into account family situation, number of children, exceptional burdens, etc.; then progressive introduction of vertical fairness, which is meant to over-proportionately burden the increase in taxable income up to a top tax rate.

⊕ Transfers – child benefit, grants, housing benefit, additional job centre services, unemployment benefit, welfare payments.

⊖ Employer social security contributions – in line with the solidarity principle: same percentage of wages (up to a maximum)

⊖ Net income or disposable income

⊖ Secondary distribution

Alongside other aspects (e.g. the promotion of culture), the principle of fairness linked to need justifies certain preferential treatment, such as reduced entry to public parks, theatres, museums, swimming pools etc. for senior citizens and students.

Because society and the economy are in a constant state of flux, the political lines of compromise have to be constantly shifted and politically fought over. This must not result in people feeling they are being forced to »cough up« or that there is no point having a regular job because they can live on benefits.

Indicators of success: functional and personal income distribution, wage and profit shares, Gini coefficients

First of all, we need to look at the distribution of annual value added among production factors (labour, land, capital and dispositive factor). If we take the total of wages and salaries (w) and set it against national income (Y), then after multiplying by 100 we are left with the wage share in percent [w/Y 100]. Normally the income from all other factors (G for the dispositive factor = corporate profits; r for land = debt securities, leases; i for capital = interest, dividends) is added together, divided by Y and multiplied by 100: $\{[(G+r+i)/Y]100\}$. Although this includes several factors, the result is shown as profit share. Obviously Y is the sum of all value added, so that the result is always: wage share plus profit share = 100 percent.

In a comparison over the 20 years from 1991 to 2011,⁴ the ratio of wage share to profit share ranged between 71 to 29 and 65 to 35. However, the fact that wage share has fallen does not mean that employees are at a disadvantage compared to companies. Firstly, it should be noted that the profit share includes small businesses with small profits that are less than the incomes of

some employees. Secondly, it should be applied to total household income, as an employee may hold shares and property (possibly inherited) and have a variety of sources of income. In this case, part of the employee's income is included in the wage share and part in the profit share.

The Gini coefficient can be used to express the results of the above-mentioned compromise between fairness linked to performance and fairness linked to need. It measures the relative inequality between absolute equal distribution and absolute unequal distribution. The Gini coefficient always lies between zero and one. The smaller it is, the more equal the distribution; the closer it gets to the figure one, the more unequal the distribution.⁵

In its 2009/2010 annual report, the German Council of Economic Experts stated: »In Germany, the Gini coefficient of income before tax and transfers is 0.51, higher than the average of all OECD countries. This would suggest an unequal distribution of income. However, it is clear that income inequality in Germany is unremarkable after the redistributive effects of the tax and transfer system are taken into account. Then the Gini coefficient corresponds to the OECD average of 0.31.«

The Gini coefficient for income after tax and transfers is lower in countries such as Denmark and Sweden, while it is higher in Portugal and the USA (see diagram).

When compared to the situation in the mid-1980s, there has been an increase in inequality in Germany and many other OECD countries. This increase applies to incomes, tax and transfers.⁶

Reasons for the increase in income inequality in OECD countries (cf. OECD, 2011; Arndt, 2012).

- The integration of the goods and financial markets has not had any proven effect on inequality.
- In contrast, capital flows and technological advances have increased inequality. Outflowing investment capital has only heightened disparities within higher incomes, whereas technological advances have had an effect on income distribution as a whole.
- The expansion of education has countered this development.

GINI COEFFICIENTS OF INCOME DISTRIBUTION FOR SELECTED OECD COUNTRIES



Source: German Council of Economic Experts, Annual Report 2009/10, p. 320

The diagram shows the Gini coefficients of income distribution for selected countries. In Germany, the Gini coefficient of income before tax and transfers is 0.51, higher than the average of all OECD countries (left). However, it is clear that income inequality in Germany is unremarkable after the redistributive effects of the tax and transfer system are taken into account (right).

- Increased labour market flexibility in the OECD has led to higher employment, but also to the polarisation of wages. The inequality-reducing and inequality-increasing effects of these two processes cancel each other out.
- The number of hours worked has generally increased in the higher wage groups and reduced in the lower wage groups.
- The trend towards smaller households and the increase in men's market income have slightly increased inequality. However, the increased participation of women in the workforce has mitigated this inequality.

In all the above data, individual households are falling back to the average. At the same time, it should be conceded that the tangled mass of millions of individual pieces of data is not particularly informative. More useful conclusions can be drawn from looking at households grouped according to specific sociological, regional and economic criteria. Such categories are normally based on type and level of education (academic studies, vocational qualifications), age (workforce entrants, middle-aged people, retirees), region (city, rural areas) and sector (financial, industrial, commercial, etc.). The results of these studies provide us with probability statements.

*It is a case of finding a compromise
between fairness linked to performance
and fairness linked to need.*

It is no surprise that graduate employees are at less risk of unemployment than non-graduates or those who have no qualifications of any kind. Retiree households generally have less income than working households. Students and the unemployed have low incomes.

The insights gained from these statistics are not evidence of a growing income gap, but may provide a signal to individuals that will motivate them to improve their skills, change their profession or job or even move to another area. But above all, this data is important for the creation of sophisticated economic, social and education policies because it shows where action needs to be taken.

The influence of taxation

INCOME TAX

As previously mentioned, *income tax* plays a critical role in the transition from primary distribution to secondary distribution. Income tax is a direct form of taxation. It is applied when the income is generated and cannot be passed on. In Germany, in simple terms it is collected in three ways: as income tax, as a tax on wages in the narrower sense, and finally as a flat rate tax (on income from investments). The first two are generally applied progressively, so once the minimum living wage is exceeded, a disproportionate tax contribution is demanded until the top rate of tax is reached for the income gain.⁷

At first glance, the progression in income tax contributes to narrowing the gap between different levels of primary income. But this only applies to a limited extent, because the tax rate is relatively quickly adjusted to income gains and to the inflation rate. However, for fiscal reasons, the adjustment generally requires some time, resulting in »bracket creep« and »cold progression«. »Bracket creep« refers to a reduction in net income in relation to tax in the lower and middle tax brackets when in real terms all income levels increase at the same rate. The lower and middle income groups have to pay a disproportionate amount of this increased income in tax, whereas people in the higher tax bracket are spared additional payments. This becomes even more annoying when »cold progression« kicks in. This is where taxpayers are shifted into higher tax brackets because of inflation rather than because their real incomes have grown.

For fiscal reasons, there is unlikely to be any quick fix in »normal times«. For governments, relatively high levels of sovereign debt result in the pleasant side-effect that its liabilities become gradually devalued due to fixed tax scales and inflation.

The oft-heard and oft-implemented suggestion that the top rate of tax should be increased to a greater or lesser extent is problematic for many reasons. Admittedly, there is no economically justifiable fixed limit for the top rate of tax. However, a rate of 50 percent seems to constitute a psychological barrier for the acceptance of taxation. If this is exceeded, it results in reactions such as legal tax avoidance, tax evasion and moonlighting. It also leads to offshoring and a reduced willingness to invest. A reduction in GDP then also affects the lower and middle income brackets.

In addition, increasing the top rate of tax can also have a detrimental effect on the lower and middle income brackets. A simple example of this is if the top rate of tax is increased but the level of taxable income that attracts the basic rate and the top rate of tax remains the same. This necessarily results in a steeper progression. It is unlikely that the basic rate of tax and taxable income within this bracket will remain the same while the top rate of tax is increased along with the taxable income at which this rate takes effect, because the amount the treasury would lose from the majority of taxpayers who are in the lower and middle brackets would not compensate for the relatively small numbers of top-rate taxpayers.

In general terms, the correlation outlined above can be described as follows. Depending on whether and to what extent changes are made to the top rate of tax and the taxable income that falls within this bracket, and on whether the basic tax rate and the tax-free allowance remain at the same level or are changed, then the progression may include a large proportion of the lower and middle income brackets. This produces the oft-quoted »middle bracket bulge« effect [German: *Mittelstandsbau*]. The »top earners« and »millionaires« are used as an excuse, and billions of euros flow into the state coffers from the middle income bracket.

In simple terms, high and top incomes are created either by outstanding marketable ideas or by cartel-like insulation. Patent law, effective competition and education policies that provide opportunities for advancement are all more liable to influence the distribution of income than debates fuelled by envy, increases to the top rates of tax or discussions about inheritance tax.

INDIRECT TAXATION

Income tax in the broadest sense is not the only way the state gains access to the income of its citizens. As previously mentioned, it is applied when income is generated, so it is called a direct tax. According to the terminology of Günter Schmolders and Karl-Heinrich Hansmeyer, it is also an »observable tax«, meaning that the amount is immediately obvious when people look at their monthly pay slips or income tax prepayment statements. However, the high levels of government expenditure in a

However, at 0.31 in the OECD comparison, it is clear that income inequality in Germany is unremarkable after the redistributive effects of the tax and transfer system are taken into account.

modern, largely anonymous industrial society based on the division of labour requires a level of income that cannot be met by income tax alone, even when public works and public spending are carefully planned. The progression has to take on a scale that would not be immediately obvious to the wider public. This is why almost all tax systems include a combination of direct and indirect taxation. Irrespective of the reasons behind different legal categorisations, indirect taxes are only applied when income is actually used, i.e. spent. It is not possible to collect indirect taxes from consumers, so they are imposed on companies which then knowingly pass them on to consumers through increased prices. For reasons of practicality, these taxes also have unchanging proportional tax rates.

General value added tax is the most well known of these indirect taxes. There is also a whole series of other indirect taxes that apply to purchases of particular products (petrol, coffee, tea, alcohol, cigarettes, etc.) and that are levied on certain services (building extensions, conversions and repairs) and on insurance premiums. People are seldom aware of the real level of the associated tax burden because it is included in prices.

This is why Schmölders/Hansmeyer referred to them as »unobservable taxes«. But caution is advised: indirect taxes soon become »observable« if changes to tax rates are made too abruptly or if they are clearly shown on bills, as is usual among tradespeople. Tax rates that are too high tempt people to commit tax avoidance (by postponing or neglecting repairs) or even tax evasion (perhaps through unbilled work).

For empirical and methodological reasons it is difficult to fully understand the effects of indirect taxes. In addition, the extent and type of spending habits have to be known and categorised in terms of income level and sociological group. But it seems likely that indirect taxes have a tendency to be regressive, so the burden becomes less in percentage terms as incomes rise. The reason is clear: lower income levels (such as students, basic benefits claimants and low earners) are forced to spend a higher percentage of their income on basic necessities than people in the middle and upper income brackets. In economic terms, they have a high marginal propensity to consume and a low marginal propensity to save. Therefore they are also proportionately more affected by indirect taxes.

The EU has set out minimum and maximum tax rates for a limited number of luxury goods (alcohol and tobacco), petrol and general VAT. This was with a view to achieving greater harmonisation but also take into account the different systems that have grown up over the years. However, it is noticeable that countries such as Germany that have traditionally imposed lower levels of VAT are now justifying increases in the rate by saying that it is still below the maximum of 25 percent. But there is no mention of the fact that social security contributions are almost unheard of in countries such as Denmark, where almost the whole social security system is funded through general taxation.

Relatively high levels of indirect taxation, particularly VAT, bring with them other disadvantages in addition to the tax avoidance and tax evasion that were mentioned earlier. If taxes are not passed on for reasons of competitiveness, this results in lower profits and reduced potential for investment. And price increases caused by high indirect taxation lead to real consumption being pared down, particularly in the lower income brackets, with the resultant risk of poverty.

The problem of measuring and reporting on poverty

The aim of distribution policy within the Social Market Economy is to allow everyone to share in society's increased prosperity and thus achieve the targets it has set itself. As we have repeatedly stressed, it is not just about »prosperity« but about the contribution that it makes towards higher social and sociopolitical goals. And of course these include preventing poverty in society as far as possible.

But first we need to define the meaning of poverty. In absolute terms, it refers to a level of income that still guarantees survival. In 1990 the World Bank stated that the poverty line stood at around 400 US dollars, or just over one dollar a day. This is still the case for some of the poorest emerging nations, for example large swathes of the Indian population live on around 1.25 US dollars a day. This problem will not be resolved through monetary action alone. Development aid programmes have to be set up with a view to the long term and tackle a wide range of problems in parallel. Along with concrete economic aid, these include improving the education and healthcare systems, fighting corruption, containing tribal feuds and stemming population growth.

Simple survival is not the only aspect of poverty. People are considered to be poor if, due to lack of income, they have a short life expectancy, are unable to afford health care, are illiterate, have very few material possessions and as a result of all this are generally excluded from society.

Absolute poverty either does not exist or is rapidly vanishing in advanced welfare states. So in these countries we need to consider how to measure relative poverty. This is normally linked to the gap between people's income and the average income. This is based on a household's relative income. If several people live in a household, it is assumed that their needs are less than people who live alone and have to provide for themselves. Age and the employment situation are also taken into account. In the EU and Germany, a household is considered to be poor if it earns less than 50 percent, or sometimes 60 percent, of the average income. The problem with this is that even high rates of growth that benefit all households equally are not able to wipe out poverty all over the world. Along with issues of data privacy and methodology, there is also a certain limitation on the poverty reports published at intervals by the EU and the German government.

But this is not to dispute the fact that the danger of relative poverty exists. One of its causes is »structural unemployment« which can arise when governments, management and unions do not react adequately to the pressures of globalisation (→ 4). This is just one more proof that – as Walter Eucken said – the individual principles are all tightly bound together. One of the principles of distribution policy in a Social Market Economy should be understood as a combination of education, social and economic policy.

NOTES

1 | Differentiation refers to situations where there are objective reasons for meting out different treatment. Privileges or discrimination refer to situations where advantages are given without any objective reason or where disadvantages have to be tolerated without any objective reason.

2 | The problem could be resolved – without ideology and accusations – if more attention were paid to expanding *second-chance learning*.

3 | As there is generally no market for public services, it is difficult to determine costs, prices and profits. For example, anyone who has studied law and gone on to work in the tax office rather than the private sector will have some idea of what they could earn in private practice. However, some of the difference is balanced about by the benefit of job security.

4 | Cf. data from the Deutsche Bundesbank, seasonally adjusted economic figures.

5 | The Gini coefficient is named after Italian statistician Corrado Gini (1884–1965). This coefficient is derived from the Lorenz curve (named after the American mathematician Max Otto Lorenz (1876–1959). If the cumulative number of households in a country (from 0 to 100 percent) is plotted on the abscissa of a coordinate system and the ordinate shows cumulative income (from 0 to 100 percent) the result is a straight line with a positive ascent of 45 degrees, because the dimension is the same in both cases. This straight line, or in mathematical terms, curve shows the notional situation of absolute equal distribution within a society. If we now use the data to calculate the actual distribution within a society we will see that the lowest 10 or 20 percent of households receive significantly less income than their magnitude in terms of percentage, while the top 10 percent receive significantly more. When this is plotted in the coordinate system with absolute equal distribution as the yardstick, the result is a curve of actual income distribution that deviates more or less significantly from the absolute equal distribution. Generally speaking, we can tell from the size of the »bulge« in the curve, i.e. from the maximum deviation of actual income distribution from absolute equal distribution, how equal or unequal is the income situation in society.

The rough estimate is expressed more precisely by means of the Gini coefficient. It constitutes the integral between the curve of absolute equal distribution and actual distribution and sets it against the total integral below the equal distribution curve. As previously mentioned, the smaller the value, the more equal is the actual income situation in a country, and vice-versa: the larger the value, the larger the income discrepancies.

6 | German Council of Economic Experts, Annual Report 2009/10, p. 320

7 | For 2011 and 2012 the following rate applied pursuant to § 32 a of the German Income Tax Act (EStG): Tax-free allowance (minimum living wage): 8,004 euros; basic rate of tax: 14 percent; end of the progression zone: 52,882 euros; top rate of tax from 52,883 euros: 42 percent; additional 3 percent above a taxable income of 250,737 (thus making the top rate of tax 45 percent). The above-mentioned incomes always relate to taxable incomes (taking into account allowances for children, extraordinary costs, etc.) and for the basic allowance. The married couples allowance applies to the joint assessment of tax. In this case, contributions are doubled. Taxes may be increased in accordance with article 106, paragraph 1 no. 6 GG by an additional income tax payment. This is currently the »solidarity tax«, whose revenues belong solely to the German federal government, whereas revenues from income tax flow to both the federal government and the regional governments.

SOURCES AND RELATED LITERATURE

- Anger, Christina (2009): Wege zu mehr Wachstum und Verteilungseffizienz [Institut der Deutschen Wirtschaft, Agenda 20D], Cologne
- Arndt, Christian (2012): Zwischen Stabilität und Fragilität: Was wissen wir über die Mittelschicht in Deutschland? 09/2012, Konrad-Adenauer-Stiftung www.kas.de/wf/doc/kas_33016-544-1-30.pdf
- Franke, Siegfried F. (1983): Theorie und Praxis der indirekten Progression. Eine theoretische und empirische Analyse der indirekten Progression in der Einkommensbesteuerung aus steuersystematischer und ordnungspolitischer Sicht, Baden-Baden
- Franke, Siegfried F. (2009): Der Staat: Betrogen oder Weichensteller? Ein paar unkonventionelle Gedanken zur Steuerhinterziehung, in: Kirchdörfer, Rainer/Lorz, Rainer/Wiedemann, Andreas/Kogel, Rainer/Frohnmayr, Thomas (ed.): Familienunternehmen in Recht, Wirtschaft, Politik und Gesellschaft. Festschrift für Brun-Hagen Hennerkes zum 70. Geburtstag, Munich 2009, pp. 497–514
- Kersting, Wolfgang (2000): Theorien der sozialen Gerechtigkeit, Stuttgart
- Ludwig-Erhard-Stiftung (1981): Grundtexte zur Sozialen Marktwirtschaft, ed. Stützel, Wolfgang/Watrin, Christian/Willgerodt, Hans/Hohmann, Karl, Stuttgart, New York (here particularly Part II, Chapter II: Die Verteilung, pp. 323–416)
- Plab, Julia (2010): Vom Konzept der Ungleichheit zur Armutsmessung [Bachelor thesis, University of Munich] http://epub.ub.uni-muenchen.de/11907/1/BA_Plass.pdf
- OECD (2008): Growing Unequal? Income Distribution and Poverty in OECD Countries, Paris
- OECD (2011): Divided We Stand: Why Inequality Keeps Rising <http://dx.doi.org/10.1787/9789264119536-en>
- German Council of Economic Experts: Analysis: Einkommensverteilung in Deutschland, in: Annual Report 2011/2012, items 557–578

THE SOCIAL MARKET ECONOMY STANDS FOR ...



FAIR DISTRIBUTION OF WEALTH,

because a share in the economy's capital stock raises awareness of economic correlations, heightens the sense of responsibility and because it is a matter of human dignity for people not to have to be solely dependent on aid from society or the state if they find themselves unable to work. Assets include a share in the economy's productive assets, along with property for own use, the purchase of national debt instruments or shares and legally guaranteed later payments (such as pensions). These kinds of assets all form part of security for people's old age.

Meaning of the term

The goal of fair distribution of wealth relates to the second part of Ludwig Erhard's formula, »property for all«. First of all, as mentioned in the chapter heading, it is a matter of giving households that do not own businesses the opportunity to have a share in the economy's capital stock. In addition, the purchase of private homes for own use should be encouraged for reasons of social security. It is also beneficial if people are encouraged to make provision for their retirement. When this is done by purchasing shares or other company holdings, this corresponds to a share in productive capital. However, people often take out life insurance policies, buy fixed-interest securities or acquire safe government bonds. They also have savings accounts or simply hold cash.¹

Who does the economic capital stock really belong to in a market economy?

Firstly, economic capital stock can be broken down into private and public capital stock. The private part consists of factory sites, factory buildings, machinery and all other durable means of production that are in private hands. The public part constitutes the public infrastructure in the broadest sense. This includes the road, rail and canal network, airports, local public transport, but also the railway operator and much more.²

Against this backdrop, it is easy to answer the question about ownership of economic capital stock. It can be split into three rough sections: Capital stock belongs to:

1. Private business owners
2. Private shareholders or partners
3. All citizens.

1 and 2 obviously relate to the private portion of capital stock, while 3 refers to the public portion.

Problems that arise when broad sections of the population have a share in capital stock

Clearly the majority of the population cannot be self-employed, so increased participation in the economic capital stock is only achievable by encouraging people to buy shares or other holdings in private companies. This is easier said than done, as acquiring shareholdings always involves a certain degree of risk. If the company involved makes losses or even goes bankrupt, then shareholders generally lose most of their investment. Even when seemingly safe public companies enter the stock market, nothing is guaranteed, as was shown by the VW low-priced share offer in 1961 and the Telekom share offer in 1996. Many people lost significant amounts of money, including a large number of employees who were hoping to secure their retirements.

Therefore private participation in the capital stock by the general public at moderate levels of risk is something that requires careful consideration. Without going into more detail, the solution can only be in creating funds with portfolios consisting of shares in carefully selected companies. The general public can then invest in these funds and the risk is significantly mitigated.

Of course the state would still have a duty to supervise the stock exchange in this case to prevent insider trading that would be detrimental to shareholders, but for reasons of competition it would not be allowed to give any advice on buying and selling (→ 2). So it would be left to individual investors to decide whether and how much they wanted to invest in the fund. This requires a basic amount of economic knowledge. Schools, the chambers of commerce and industry, independent advisors, foundations and unions should all be in a position to provide training in this area, perhaps with state subsidies. And finally it should be noted that the mentality of the majority of the German population is (still) not open to holding shares over a longer period and then benefiting from them later in life.³ There is still some work to be done to convince them in this respect.

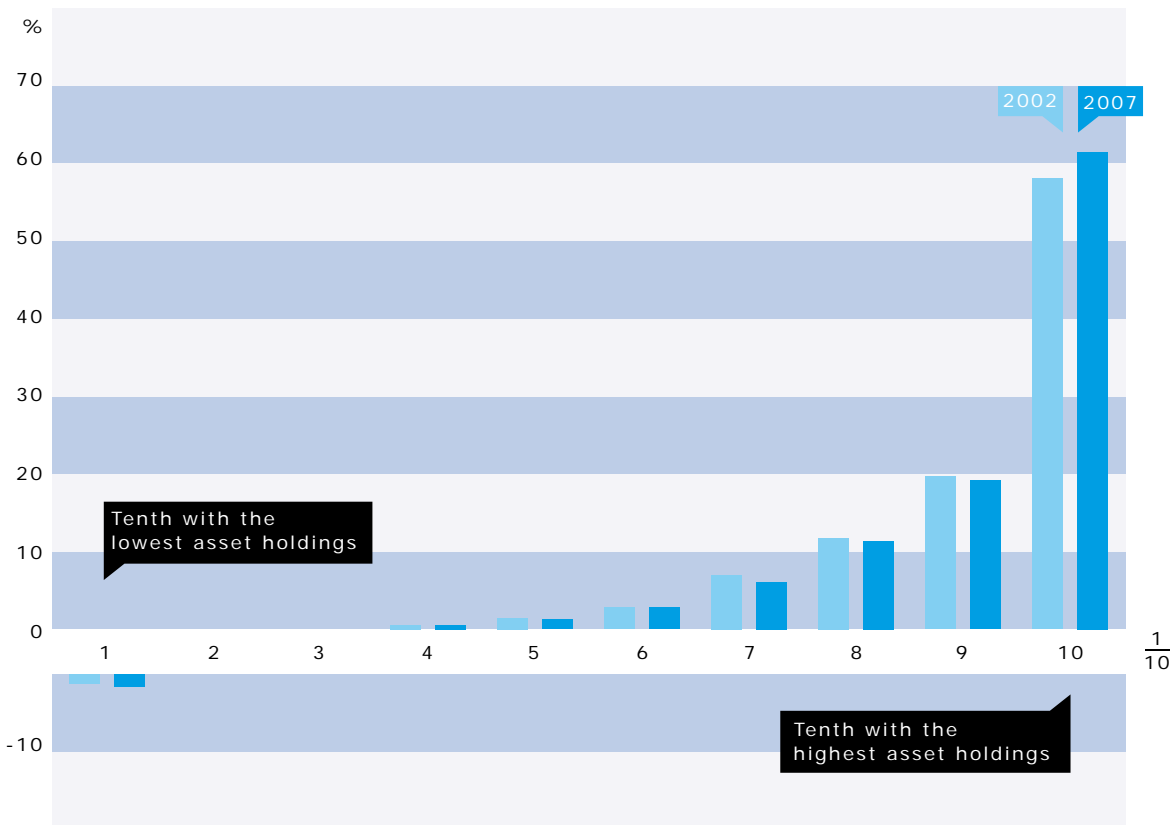
We can muse over why it has not been possible to change these attitudes over the last forty or fifty years. Clearly the desire for yearly income gains (and income distribution) – which is also encouraged by the unions – is more pronounced than the desire to have a long-term share in capital stock.

The Gini coefficient of wealth distribution – a sign of general inequality?

Against this background it is hardly surprising that the Lorenz curve of wealth distribution shows pronounced inequality and is much larger than the distribution statistics for income (→ 7). According to the German Institute for Economic Research (DIW)⁴, the total gross assets of private households in Germany in 2007 amounted to 8 billion euros. Of this, land and property ownership made up the lion's share, at 5.3 billion euros. This figure grew by over 1.1 billion euros compared to 2002. The liabilities of private households – mainly consumer credits and mortgages – amounted to 1.4 billion euros in 2007.

After deducting these liabilities, the net assets of private households amount to 6.6 billion euros. These net assets are unequally distributed: if people are categorised into ten equal-sized groups (deciles) according to their net assets, in 2007 the richest tenth owned over 61.1 percent of total assets. The top 5 percent owned 46 percent and the top 1 percent owned 23 percent of total wealth (see diagram).

DISTRIBUTION OF TOTAL NET ASSETS OF PRIVATE HOUSEHOLDS IN GERMANY, 2002 AND 2007



Source: German Institute for Economic Research (DIW), Berlin

The diagram shows the concentration of total net assets in the amount of 6.6 billion euros in the respective deciles. In 2007 the richest tenth of society owned 61 percent of total net worth (right bar). This concentration had increased since 2002 (left bar). It is clear that there is a pronounced inequality in wealth distribution, which is more significant than the inequality in income distribution.

On the other hand, 27.0 percent of the adult population own no assets or are in debt. Compared to 2002, the concentration of net worth in the upper decile increased in 2007, while it dropped in every other decile. In 2007 the average net worth of every person over 17 years of age was 88,000 euros.

However, the wealth distribution median, so the figure that separates the richer half from the poorer half, stood at just 15,300 euros. In other words, half of all adults had assets of less than 15,300 euros and the other half had assets of more than 15,300 euros. This unequal distribution of wealth is also demonstrated by a relatively high Gini coefficient. For 2007 this stood at 0.799, making it closer to the maximum value of 1 than the figure for 2002 (0.777).

Germany does not come out too badly in comparison with other countries, occupying a middle position in the wealth inequality rankings. Very few countries have a Gini coefficient for wealth distribution of less than 0.5. The main asset that forms part of total net worth in Germany is owner-occupied property. In 2007 it made up 59.3 percent of total net worth, followed by other property holdings with a share of 22.1 percent. Monetary assets made up 13.8 percent of the total net worth figure for 2007, and private insurance policies made up 13 percent.⁵

Wealth tax as an effective tool of wealth distribution policy?

Finally, we will examine the repeated demands wealth taxes of varying robustness. A few remarks:

- Firstly, it is useful to consider what is meant by wealth tax in different countries. In Anglo-Saxon countries, the »property tax« tends to refer to taxes on land and property and often even includes waste disposal. So in Germany a property tax exists in terms of land tax, waste disposal fees and water charges.

- It is necessary to examine whether and to what extent there is a relationship between income tax and wealth tax. At the end of the day, all taxes are paid on current income or assets. For its part, the German Federal Constitutional Court and its famous »part division clause« [*Halbteilungssatz*] did not entirely rule out wealth tax (as a category it is still contained in article 106, paragraph 2 GG), but it simply indicated that the total burden of income tax and wealth tax should not be allowed to significantly exceed the 50 percent figure.⁶ The fact that wealth tax has to be levied on current income, if there is not to be a diminution of capital, has at times been accounted for in a limited way by linking wealth tax to the basic principles of income tax assessment.
- If wealth tax is also levied on business assets, this leads to further problems. In so far as this burden cannot be passed on in prices because of the pressures of global competition, it reduces profits and hence investment capacity. If they are indeed passed on, this affects customers who are largely in the low to middle income brackets and who generally also have little in the way of assets.
- The wide range of what can be classified as assets also leads to difficulties in terms of definition and assessment. Book values and realisable values rarely tally, and the value is only realised when they are actually sold. The value that is then realised depends on supply and demand at that particular time.
- The wealth tax or »millionaire's tax«⁷ that is demanded for reasons of »social justice« generally does not increase the share of capital stock held by »non-owners«. It simply increases tax revenue, but this cannot be earmarked for specific purposes because of the principle of general budget appropriation. The parliaments are free to decide how it should be used (in the case of wealth tax these are the respective state parliaments, pursuant to article 106, paragraph 2 no. 1 GG). Generally it is used for consumption, and at best it is used to fund part of the public infrastructure. The same is true of revenues from wealth taxes. According to reports, the revenues should be used for »environmental projects« and educational undertakings (praiseworthy in itself), and many other projects. However, there is no talk of changes to wealth distribution, and it is also not well known that wealth distribution in Germany was much more equal when wealth taxes were levied.

- Recently there has been talk of interest-bearing compulsory loans or even compulsory levies on high levels of wealth. The idea is that people in the top bracket should contribute in this way to resolving the national debt problem. Without going into the legal ramifications and economic difficulties as mentioned above, it is unclear how the national debt is to be reduced by piling on yet more debt through these interest-bearing compulsory loans.

In constitutional terms, another highly questionable idea is the suggestion (that may be discussed later) that the compulsory loan or a part thereof could be converted into a permanent charge or set against a future wealth tax.

*In comparison with other countries,
Germany occupies a middle position in
the wealth inequality rankings.*

For compulsory levies, it is necessary to define the percentage level of the one-off payment and the level of wealth that will trigger this state intervention. If it is set at a relatively low level – a sum of 250,000 euros was discussed in summer 2012 – then it will affect large swathes of the population who have saved for their retirement and their children’s education. But if the level is set high, this will have an above-average effect on business assets. The result will be a negative effect on investment capacity, competitiveness and the jobs that go along with this.

NOTES

1 | For an up-to-date review see Der Spiegel, No. 23, 04 Jun 2012, pp. 78–81 (Wohin mit all dem Geld?), particularly p. 79 [based on data from the Deutsche Bundesbank].

2 | Some areas of the public infrastructure, such as Deutsche Bahn AG, have since then been privatised. However, they should here be allocated to the public sector because the state is still often the majority or even sole owner of these companies.

3 | The source quoted in footnote 1 shows that private households have only invested 395 billion euros of its monetary assets in investment certificates and 222 billion euros in shares, while 1,928 billion euros is kept in cash and 1,393 billion euros is kept in deposits and insurance policies. The total volume of monetary assets amounts to some 4,715 billion euros. In comparison, GDP for 2012 was in the region of 2,570 euros. Cf. also »Geldvermögensbildung und Finanzierung im Jahr 2011«. Sektorale Ergebnisse der gesamtwirtschaftlichen Finanzierungsrechnung. Press notice released by the Deutsche Bundesbank, Frankfurt am Main, 24 May 2012 (Deutsche Bundesbank, extracts from press articles no. 23, 30 May 2012, p. 32).

4 | Grabka, Markus (2009): Gestiegene Vermögensungleichheit in Deutschland. Weekly report of the DIW Berlin, no. 4/2009 www.diw.de/documents/publikationen/73/93785/09-4-1.pdf

5 | German Council of Economic Experts, Annual Report 2009/2010, p. 322 et seq, www.sachverstaendigenratwirtschaft.de/fileadmin/dateiablage/download/ziffer/z482_z522j09.pdf

6 | The verdict of the German Federal Constitutional Court demonstrates the desperate search for a legal standard for the psychological barrier of 50 percent that exists in taxation, and particularly income tax, as mentioned in (→ 7). To quote from article 14, paragraph 2 GG: »Property entails obligations. Its use shall also serve the public good«. Here the word »also« does not just mean a coincidence of actions and effects, but it limits taxation to around 50 percent (in the sense of »in equal proportions«) (German Federal Constitutional Law [Bundesverfassungsgesetz, BVerfGE], 93, 121).

7 | See for example Hans-Christian Ströbele: Millionärssteuer oder Wiedereinführung der Vermögensteuer, 7. Nov 2003 (www.stroebele-online.de/themen/debatte/21220, printed: 6 Jun 2012). This has since been called for by the Left party, the Greens and a number of citizens.

SOURCES AND RELATED LITERATURE

- *Bach, Stefan* (2012): Vermögensabgaben – ein Beitrag zur Sanierung der Staatsfinanzen in Europa, in: DIW weekly report, no. 28/2012 [Eurokrise, Staatsverschuldung und privater Reichtum], pp. 3–11

- *Boettcher, Erik/Börner, Dieter/Helmstädter, Ernst/Schmitz, Carl-Hinderich/Trippen, Ludwig/Zelz, Lothar* (1985): Zur Auswahl einer vermögenspolitischen Strategie, in: Ludwig-Erhard-Stiftung (1988): Grundtexte zur Sozialen Marktwirtschaft, vol. 2: Das Soziale in der Sozialen Marktwirtschaft, ed. Hohmann, Karl/Schönwitz, Dietrich/Weber, Hans-Jürgen/Wünsche, Horst Friedrich, Stuttgart, New York, pp. 539–542

- *Gathmann, Florian/Wittrock, Philipp* (2012): Reichensteuer und Co. Angriff der Umverteiler, in: Spiegel Online Politik, 3 Aug 2012 (www.spiegel.de/politik/-a-848060.html); printed: 20 Aug 2012

- *Grabka, Markus* (2009): Gestiegene Vermögensungleichheit in Deutschland. Weekly report of the DIW Berlin, no. 4/2009 www.diw.de/documents/publikationen/73/93785/09-4-1.pdf

- *Knappe, Eckhard* (2005): Art. »Vermögenspolitik«, in: Hasse, Rolf H./Schneider, Hermann/Weigelt, Klaus (ed.) (2005): Lexikon Soziale Marktwirtschaft, 2., current and awaited edition, Paderborn, Munich, Vienna, Zurich, pp. 472–474

- *Konrad-Adenauer-Stiftung* (2011): Vermögenspolitik [Eckhard Knappe] (www.kas.de/wf/de/71.10291, as at: 17 Nov 2011; printed: 18 Aug 2012)

- *German Council of Economic Experts*, Annual Report 2009/2010, p. 322 et seq, www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiablage/download/ziffer/z482_z522j09.pdf

THE SOCIAL MARKET ECONOMY STANDS FOR ...



CARING FOR THE ENVIRONMENT,

because, taken as a whole ecological and biological system, the environment not only makes the lives of today's population more pleasant and healthy but because it is important to keep it intact in order to pass it on to future generations. It is a matter of human dignity that we should handle our stewardship of the whole of creation in a responsible way. Therefore the social market economy recognises the national goal set out in article 20 a GG that calls for the state to protect the natural foundations of life and animals as part of its responsibility to future generations.¹

Historical and liberal roots of environmentalism

As mentioned in the introduction to the individual arguments, protection of the environment – whether for reasons of self-interest, respect for creation or a sense of responsibility to our children and children’s children – is an ongoing concern of the Social Market Economy and it is an issue that has historical and liberal roots. Even in ancient times, poisoning the well – the deliberate or neglectful contamination of ground water and drinking water – was a serious crime. Ancient burial rituals were also based on the need to keep ground water and the earth clean because of their importance to life. In the Middle Ages, people were very aware of the importance of trees for producing oxygen and providing fruits, so damaging or felling trees without permission attracted the severest penalties. Although the ordoliberalists were not familiar with the terms environment, environmental protection and environmental policy, they were very familiar with the issue, as is shown by their warnings against the »ruthless exploitation of nature«. And finally, the term »sustainability« [German: »nachhaltiges Wirtschaften«] was first coined by the German mine captain Carl von Carlowitz (1645–1714).

Environmental protection within the concept of the Social Market Economy

As mentioned in the introduction, environmentalism has always been included in the concept of the Social Market Economy. In brief, the term »social« includes the elements of an intact environment in the broadest sense. Regardless of this, Müller-Armack (1969, 225) went straight to the point when he said that many parts of the public infrastructure, including the area of environmental protection, had not kept pace with the overall growth of personal prosperity. It should also be emphasised that even a century earlier – so before there were any green parties or organisations – he highlighted the need for clean air and water, regulated town and country planning, pedestrian zones, traffic routes that did not cut straight through urban districts and residential areas and the establishment of national parks as being the central aims of the *formed society* (Müller-Armack, 1959, 128; 1960, 138 et seq, 145).²

It is clear that the Social Market Economy provides a basis and also a direction for environmental policy. It is not simply rushing to retrospectively graft ecological issues onto its key principles.

The main principles of environmental policy: restorative and preventive environmental policy

Severe environmental damage has clearly been inflicted in the past, partly out of ignorance (for example the use of chlorofluorocarbons [CFCs] as propellants in all kinds of aerosols); partly as a result of overestimating nature’s ability to regenerate; partly out of lack of respect for nature and also out of the quest for short-term profits.

Of course it is now necessary to as far as possible deal with the damage that has been inflicted over time and – because of the lasting effect of some pollutants – with the damage that is still being inflicted. Steps include reforestation, restoration and soil decontamination. These elements all form part of restorative environmental policy.

This is of course a very important area, but even more vital is the need to prevent new environmental damage being inflicted. This is the domain of preventive environmental policy, which is primarily based on the precautionary principle. A central concern of preventive environmental policy is encouraging the development of technologies that will prevent harmful substances being produced during production processes. If existing contaminants are simply contained using better filter systems (known as »end of pipe« technology), we would not be going any further than restorative environmental policy, as the problem of how to dispose of the filters filled with contaminants would still remain.

The precautionary principle, which lies at the heart of preventive environmental policy, addresses one of the key legal principles of environmental policy that will be briefly outlined below.

Legal principles of environmental policy and special rules of sustainability

The key principles of German environmental policy include the polluter pays principle, the common burden principle and, as mentioned above, the precautionary principle.

The polluter pays principle is the main legal principle. This is understandable, in that it is an important part of environmental law. Anyone who uses the environment to the extent permitted by law (air, water, earth, per-

haps as a means of disposal) or extracts its resources, is expected to pay for this use. Any illegal use or damage incurs a penalty (fines or imprisonment).

It is often difficult to ascertain who caused damage in the past, or the culprit cannot be prosecuted because such action was allowed at the time. In these cases, the common burden principle applies. This involves the costs of dealing with this damage being paid for from the public purse, and – somewhat contentiously – from general taxation.

The precautionary principle aims to prevent damage in the future. Therefore any potentially harmful consequences of new technologies have to be carefully assessed. As a rule of thumb, even technologies with a low risk of damage should be rejected or significant constraints should be imposed if potential damage would be extraordinarily serious and affect large areas of the country and its people. Examples of this are the MCA for nuclear plants or mass epidemics that may be caused by new drugs or feeding technologies. The problem is that the precautionary principle is used as justification for doing nothing and stonewalling, which allows Luddism to thrive under the mantle of environmentalism.

Subsidiary principles include the user pays principle and the cooperation principle. The user pays principle has to be approached particularly cautiously because it actually turns the polluter pays principle on its head. In this case, the polluter is not held liable, but the user pays the polluter when they cease their damaging actions or is required to share the costs of mitigating the damage if the damage is unavoidable and it is not possible to hold the polluter liable (e.g. noise insulation panels on motorways).

The cooperation principle utilises the detailed knowledge of those who are affected. In a highly complex world, with all the will in world governments cannot have the detailed knowledge that is the domain of experienced engineers who have worked in their field for many years. In addition, it is easier to gain the cooperation of industry in implementing environmental measures if it has previously been consulted and is given a certain amount of say when laws are being drafted. This is usually achieved by involving the professional associations.

Environmental damage does not stop at national borders, so it makes sense for environmental policy to be directed towards Europe as a whole. Of course the above-mentioned key and subsidiary principles play an important role at EU level, and we should also mention an additional three specific European principles. In accordance with the subsidiarity principle, the EU provides general guidelines on environmental policy, but implementation is left to the individual Member States,

with the EU only stepping in to assist when required. This is linked to the origin principle that generally forbids shipping waste to other countries and strictly forbids shipping hazardous waste to developing nations.

The integration principle and the cross-cutting principle mean that any planned laws in the area of economic policy must be examined for their potential effect on the environment.

Environmental policy that is aligned to the legal principles outlined above should increase sustainable development. So we now need to look at the special rules on sustainability that need to assume concrete legal form.

1. The substitution rule means that finite resources must as far as possible be replaced by non-finite resources (such as oil).
2. The extraction rule means that nature's capacity to regenerate must be respected when using renewable resources (such as timber and fish).
3. The assimilation rule means that the nature's capacity to absorb pollutants into the air, water or earth must be respected (such as emission limits, preliminary sewage treatment).
4. The preservation rule means that intangibles must be preserved. These include biotopes, rare plants and animals and even landscapes that may not be spoilt by erecting constructions. This is a particularly tricky rule because it relies on politicians making decisions about the value of these things.

Enforcing market mechanisms in terms of the environment

Environmental policy is a key example of how market mechanisms work within the framework of state regulations that are made based on liberal and social principles. There must of course be prohibitions that entail penalties in the case of materials or technologies that are detrimental to health. Limits have to be set and monitored. However, even with environmental goals, market mechanisms should be given priority over excessively complex and strict regulations and prohibitions.³ These include emissions certificates and green taxes, which will be examined in the next section. Subsidies (particularly stimulus subsidies) need to be used with great caution. They can result in companies failing to seek out alternatives, as is typical of a competitive system, because they are focused solely on the solution that politicians believe is worth subsidising. It is also necessary to warn against the misuse of environmental protection as an argument for protectionist policies (Rexrodt, 2000, 266).

A word on »green taxes«

Experts have long been discussing how to use taxes to achieve environmental goals. These green taxes gained greater attention when the SPD/Green coalition levied them in certain areas. In principle, green taxes should be welcomed, as their aim is to internalise damage to the environment. This is achieved either by reducing demand for certain primary or end products, by influencing the use of a certain product or by targeting a particular manufacturing process. They are accordingly divided into product taxes, emission taxes and process taxes. But these taxes also entail side-effects alongside their intended main effect. For example, if taxes on petrol have the effect of reducing demand for oil and this non-renewable resource is conserved, at the same time this has positive effects on air quality, because every litre of petrol or heating oil that is not burned reduces emissions. But on the other hand, it is doubtful whether very high taxes on vehicles that do not comply with the latest emission standards always have a positive effect. For example, if the vehicle ends up in a developing country, then pollution is not reduced, particularly if it is replaced with a new vehicle that used significant resources in its production. The global environmental balance sheet then has to account for the harmful emissions caused by the old vehicle, the resources used to produce the new vehicle and the harmful emissions produced by the new vehicle.

So in brief, it is clear that green taxes can be a useful market-oriented tool of environmental policy. But they have to be carefully tested for potential side-effects and knock-on effects. If they are only used under the mantle of environmental protection in order to produce income that can be used to fund other systems (such as subsidising pensions), then different allocation systems will be mixed up and the credibility of environmental policy will be undermined.

Environmental policy in a globalised world

It is a truism to say that environmental problems do not stop at national borders. Such problems include species extinction, climate change, marine pollution and associated issues of global distribution.

This is why the Social Market Economy is also committed to global environmental policies. It is therefore necessary to be both diplomatic and dogged when presenting environmental policies at global environmental summits, and it is important to accept responsibility. Consequently, even back in the 1980s, the CDU/CSU-FDP ruling coalition brought up the issue of environmental protection at G 7 summits. And production of the aforementioned harmful CFCs was halted in Germany in early 1994, and German pressure resulted in the EU also banning their production after 1995.⁴

Global environmental policy also means giving concrete assistance to developing and emerging countries. Here we should mention the use of »debt-for-nature-swaps«,⁵ and the fact that the International Tribunal for the Law of the Sea is based in Hamburg.

Environmental policy in a globalised world and the importance of the green economy for the Social Market Economy

The United Nations Conference on Environment and Development (UNCED), held in Rio de Janeiro in 1992, was a milestone in the fight against these environmental problems.

In Germany, the results of this Rio summit were implemented very conscientiously by drawing up strategies for sustainability, setting challenging climate protection targets and by passing a resolution to accelerate the shift towards alternative energy (20 June 2011). At the same time, Germany is one of the world's leading industrial nations. This convergence of seemingly divergent goals can be particularly ascribed to the ordoliberal concept of the Social Market Economy that has created an appropriate framework in Germany with proven success. From this, we can draw some important conclusions for the debate on sustainable development and in particular the current debate on the green economy.

Public awareness of the idea of sustainability was already growing by the time the Club of Rome published its study entitled »Limits to Growth« in 1972. In the same year, the United Nations came together for the first time to discuss the environment and set up the United Nations Environment Programme, based in Nairobi, Kenya. The Brundtland Commission then drew up the first detailed reports and concepts for sustainable development. The political high point was the Rio Earth Summit in 1992, where a global programme on sustainable development was agreed that called for global initiatives on issues such as the Framework Convention on Climate, and also local initiatives as set out in Agenda 21.

Twenty years on, there are now a wide range of multilateral, governmental, non-governmental, civil society and private sector institutions that are tackling the idea of sustainability in a wide variety of different ways. The positive side of this is that a wide range of opinions are represented, but even today we can see that it brings with it the danger of the concept becoming over-inflated. The introduction of a new concept, the »green economy«, with more specific features and therefore less room for interpretation, is therefore a logical next step. But at the same time it is a move away from the abstract discussion of sustainability towards a practical call for sustainability in the economy. However, a closer look shows that public debate about the meaning of the »green economy« is in full spate and the outcome is still unknown.

The United Nations Environment Programme was one of the first to try to define the meaning of the term »green economy«. It defines it as an economy »that results in improved human well-being and social equity, while significantly reducing environmental risks and ecological scarcities. In its simplest expression, a green economy can be thought of as one which is low carbon, resource efficient and socially inclusive«. ⁶ As part of an initial study, UNEP also proposed that changing to this kind of economy should be achieved through an investment of two percent of global GDP in ten core sectors, including agriculture and energy supply. In this, it sees no contradiction between economic growth and sustainable environmental protection, so increased GDP can go hand-in-hand with reduced consumption of natural resources. UNEP sees the major prerequisites for implementation as being the recognition of the value of natural resources, the dismantling of subsidies, the replacement of »brown economy« jobs with new approaches to work, preferential treatment for public investment, a mix of regulatory instruments and global environmental governance.

In the Social Market Economy, the principle of sustainability is not explicitly mentioned, but it is one of its fundamental components based on some of the core principles that have their roots in its ordoliberal background and values. The traditional heart of the Social Market Economy lies in the ordoliberal principles of Walter Eucken, the integration of social issues on the basis of Christian values by Alfred Müller-Armack and their political implementation by Ludwig Erhard. There were also a series of international and domestic developments that presented a constant challenge to the Social Market Economy and finally led to its development. In view of the roots of global sustainable development in terms of environmental policy, the main point of contact seems to be the orientation set by Klaus Töpfer in 1988 with his idea of an »ecological and Social Market Economy«.

When studied even more closely, the precautionary principle demonstrates the closest ties to sustainability. It basically involves the ideas of generational justice, which in turn corresponds to sustainability. In the narrower context of environmental policy, the polluter pays principle (which Eucken termed the liability principle) is also very important, because it allocates environmental damage to the polluter and thus creates a voluntary incentive to avoid such damage. In their subsidiary implementation, both principles allow and guarantee scope for personal responsibility and individual initiative, which in turn forms the basis of sustainable development.

Another important component of the Social Market Economy is the need for it to have an equalising effect with regard to a range of social goals such as economic, social and environmental goals. When the Social Market Economy was developing, it was clear that the political realisation of the market economy as a tool also had to take into account social needs if it was to gain widespread acceptance in society. The equalisation of different social goals within and with the aid of a regulatory framework is a fixed element of the Social Market Economy.

This also applies to society's ecological preferences, which are becoming ever more important. Solidarity ensures that the market economy has to constantly legitimise itself through its orientation towards the common good. For a Social Market Economy, this means that the principle of sustainability is there from the start and that the economy provides a particularly suitable framework for sustainable development.

From the viewpoint of the Social Market Economy, the term »green economy« may firstly be seen as a tardy insight into the fact that the market economy is an appropriate instrument for sustainable development. However, it remains doubtful whether, after many decades of debate on sustainability, actual development in terms of content is wanted or whether an attempt will simply be made to gain appreciation in the media for the idea of sustainability dressed up as the economy. It may also be that by focusing on an economy that uses few resources, broader social issues such as welfare benefits or jobs will be afforded lower priority. If sustainable development is to succeed, the focus should instead be on creating a binding constitutional framework for ownership and competition that in turn leads to a stable economic system. The latter should then be measured on its long-term results. In environmental, social and fiscal terms, sustainability is one of the most important criteria for success and an expression of generational justice. A legal system that is based on responsibility and liability serves to strengthen sustainability.

NOTES

1 | In this respect the CDU early on made a number of policy statements pointing out that the »social« part of the market economy also included major environmental components that had to be developed. Cf. for example Chapter III in the CDU's party platform for Germany: »Freedom in Responsibility«, 5th party conference, 21–23 Feb 1994, Hamburg, which expressly mentions the »ecological and Social Market Economy«. See also CDU report 22/1995, »Our Responsibility to Creation« (as at: 10 Jul 1995) and Ost (2000), pp. 569, 76.

2 | Müller-Armack (1948, 110 et seq) showed an intense interest in market/social-oriented building and land use planning, even before the Federal Republic of Germany was established.

3 | See also German Environment Minister Peter Altmaier in an interview with Der Spiegel (Der Spiegel, no. 23, 04 Jun 2012, p. 38).

4 | Cf. chapter entitled »Sonne ohne Reue« in: CDU: Schöpfung bewahren (CDU-Bundesgeschäftsstelle, HA Öffentlichkeitsarbeit, [ed.] 50/026 order no. 2130, Bonn, no year.)

5 | »Debt-for-nature swaps« are agreements in which developing countries are released from a portion of their debt if they stop behaviour that damages the environment (e. g. cutting down the rainforest).

6 | www.unep.org/greeneconomy/AboutGEI/WhatisGEI/tabid/29784/Default.aspx

SOURCES AND RELATED LITERATURE

- CDU (1994): Party platform of the CDU Germany: »Freedom in Responsibility«, 5th party conference, 21–23 Feb 1994, Hamburg
- CDU (1995): CDU report 22/1995, »Our Responsibility to Creation« (as at: 10 Jul 1995)
- Franke, Siegfried F. (1990): Ökonomische und politische Beurteilung von Öko-Steuern, in: Steuer und Wirtschaft, 67. (20th) edition, no. 3 (1990), pp. 217–228
- Franke, Siegfried F. (1994): Umweltabgaben und Finanzverfassung, in: Steuer und Wirtschaft, 71. (24th) edition, no. 1 (1994), pp. 26–38
- Franke, Siegfried F. (2009): Kraftfahrzeug-Besteuerung in der Europäischen Union – Ein Beitrag zum Umweltschutz? In: Belke, Ansgar / Kotz, Hans-Helmut / Paul, Stephan / Schmidt, Christoph M. (ed.): Wirtschaftspolitik im Zeichen europäischer Integration. Publication in honour of the 65th birthday of Wim Kösters, RWI-Schriften, vol. 93, Berlin 2009, pp. 39–68
- Ludwig-Erhard-Stiftung (ed.) (1983): Umweltpolitik vor neuen Herausforderungen, Bonn
- Ludwig-Erhard-Stiftung (ed.) (2000): Ludwig Erhard 1897–1997. Soziale Marktwirtschaft als historische Weichenstellung. Publication in honour of the 100th birthday of Ludwig Erhard, Düsseldorf
- Müller-Armack, Alfred (1948): Wirtschaftslenkung und Marktwirtschaft, 2nd edition, Hamburg
- Müller-Armack, Alfred (1959): Die Soziale Marktwirtschaft nach einem Jahrzehnt ihrer Erprobung, in: Müller-Armack (1974), pp. 119–128
- Müller-Armack, Alfred (1960): Die zweite Phase der Sozialen Marktwirtschaft. Ihre Ergänzung durch das Leitbild einer neuen Gesellschaftspolitik, in: Müller-Armack (1974), pp. 129–145
- Müller-Armack, Alfred (1969): Der Moralist und der Ökonom. Zur Frage der Humanisierung der Wirtschaft, in: Müller-Armack (1974), pp. 219–233
- Müller-Armack, Alfred (1974): Genealogie der Sozialen Marktwirtschaft. Frühschriften und weiterführende Konzepte (ed. Egon Tuchfeldt and Ernst Dürr), Bern, Stuttgart
- Ost, Friedhelm (2000): Freiheit und soziale Verantwortung: Soziale Marktwirtschaft als Leitbild der CDU, in: Ludwig-Erhard Stiftung (ed.) (2000), pp. 561–579
- Prosi, Gerhard (1994): Umweltpolitik im Rahmen der Marktwirtschaft, in: Ludwig-Erhard-Stiftung (ed.) (1994): Grundtexte zur Sozialen Marktwirtschaft, vol. 3: Marktwirtschaft als Aufgabe, Stuttgart, Jena, New York, pp. 439–461
- Rexrodt, Günter (2000): Soziale Marktwirtschaft und Globalisierung, in: Ludwig-Erhard-Stiftung (ed.) (2000), pp. 259–276

THE SOCIAL MARKET ECONOMY STANDS FOR ...



EUROPEAN INTEGRATION WITHIN A PEACEFUL WORLD ORDER,

because international trade in goods and services (→ 5) increases the population's prosperity in the countries involved; because lifting trade barriers also helps people to learn more about and respect the culture, customs and mentality of other peoples; and because this understanding of differences and commonalities can lead to peaceful conflict resolution.

The Council of Europe: at the heart of new European ways of thinking

When the Council of Europe came into force on 5 May 1949, this laid the groundwork for reflection about common European values with a view to finally leaving behind the conflicts that came to a terrible head during the First and Second World Wars. In September 1929, French Foreign Minister Aristide Briand made a speech to the League of Nations in Geneva in which he suggested a European union. By this he of course did not mean a supranational entity like today's EU, but rather close cooperation between European countries within the League of Nations. Unfortunately, after the assassination of Germany's Foreign Minister Gustav Stresemann in October 1929 and the death of Briand in March 1932, this idea was allowed to drop.

European integration based on the Treaty of Rome

The goal of European cooperation took on a concrete form with the founding of the European Coal and Steel Community, ECSC, in 1952¹ and the Treaty of Rome on the creation of the EEC and the EAEC in 1958. As agreed in the Treaty of Rome, the close economic ties have gradually also created a basis for stronger political ties. As we know, the EEC has since then become the EC and finally the EU, in line with the desire for political unity. The areas covered by the ECSC also passed to the EU with the expiry of the treaty in July 2002.

The constitutional conditions for European cooperation and the strong coalescence of European countries were laid down by three politicians, who are often known as the »European triumvirate«: Alcide De Gasperi (Italy), Robert Schuman (France) and Konrad Adenauer (Germany). From the original six countries (Italy, France, Germany and the Benelux states), the community (EU) has now grown to 27 Member States, a number that will increase to 28 when Croatia joins in 2013. It fosters international political and economic cooperation through the European Neighbourhood Policy, the Union for the Mediterranean, countless Association Agreements and – along with the memberships of its individual states – membership of international organisations such as the World Trade Organisation (WTO).

Also for Europe: private ownership, competition, price stability, open borders, personal responsibility and welfare assistance

Of course a host of other committed Europeans were standing behind the three great European statesmen, De Gasperi, Schuman and Adenauer. In Germany, Ludwig Erhard deserves special mention. From the start, his foreign trade policies were consistently oriented towards European and transatlantic cooperation. Very early on, he made a passionate plea for the necessary integration of Europe, but at the same time he wanted to avert the danger that Europe would become isolated and bureaucratically levelled out because of protectionist measures.² Instead, he was interested in allowing competition into the integration process in order to increase the prosperity of Europeans and at the same time consolidate the core values of the Social Market Economy.

Erhard made a passionate plea for the necessary integration of Europe, but at the same time he wanted to avert the danger that Europe would become isolated and bureaucratically levelled out because of protectionist measures.

Article 5 of the Treaty establishing the European Coal and Steel Community included the issue in accordance with the subsidiarity principle, stating that there should be no direct action relating to production unless absolutely necessary. The principle is characteristic of federally structured states, but also of supranational communities such as the EEC, EC and EU. Consequently, the subsidiarity principle is explicitly mentioned in the Single European Act in primary European law. However, it should be frankly admitted that some countries are unenthusiastic about the subsidiarity principle for historical reasons and because of their centralistic structures. The same is true of the EU Commission. Former Commission President Jacques Delors is credited with working very hard to promote the subsidiarity principle. However, in terms of practical EU policies, things often turn out the opposite of what is intended. Even the esteemed Jacques Delors jokingly asked whether there was anyone who could actually tell him what the principle meant and how it could be put into practice.

If we sift through the series of European treaties from the Coal and Steel Community to the EEC to the EU (Maastricht, Amsterdam and Nice), along with additional treaties such as the Stability and Growth Pact, it is clear that a large proportion of Social Market Economy principles have gradually been included and had an effect, but also that the European Union has gradually changed from being a classic international organisation to being an »unfinished federal state«, (Bergmann, 2012, 619). However, it has scrupulously avoided the German understanding of the Social Market Economy as an »export item« that the European Union is obliged to transpose on a one-to-one basis. It has been repeatedly stressed that the Social Market Economy represents a dynamic model of an open society that has the scope to mould itself to meet the specific circumstances, challenges, socio-cultural traditions and attitudes of the individual countries (Schlecht, 1994, 789).

The four central freedoms that were already contained in the Treaty of Rome when the ECC was established were the basic forerunners of this path. The key element that is repeatedly highlighted in the treaties is an »area without internal frontiers« with free competition (cf. for example article 2, point 1 of the Treaty of Amsterdam). The necessary regulation means that the internal market is constantly under construction, even if the oft-cited »Cassis de Dijon« verdict led the way to the free movement of goods on the internal market.³ This is not meant as a criticism! It would underestimate the innovative capacity of a dynamic economy if new products, production processes and distribution channels were not constantly being opened up. This may – intentionally or unintentionally – open new potential for discrimination, something that the EU has to constantly guard against by monitoring and adapting the regulations on an ongoing basis.

In contrast, the free movement of services is lagging behind somewhat, but clear progress has been made in the telecommunications market, the electricity market and to some extent in the financial services market (Franke, 2012, 84 et seq).

The Schengen area has expanded the free movement of persons, which originally was primarily linked to the free movement of workers and freedom of establishment, to include almost every kind of movement of persons, whatever the motivation (Franke, 2012, 85 et seq).

Progress and dangers of the Treaty of Lisbon

The principles and their underlying values based on the Social Market Economy can be clearly seen in the Treaty of Lisbon (including the Treaty on European Union in the version of 17 December 2007 and the Treaty on the Functioning of the European Union (TFEU) in the version of 17 December 2007). First of all, it should be noted that the European Union – and the EC/EEC before it – stands for the fundamental principles of human dignity and a free democracy under the rule of law (article 2 of the Treaty on European Union). And article 6 of the Treaty on European Union expressly recognises the values set out in the European Convention on Human Rights and refers to the EU Charter on Fundamental Rights.⁴ Along with intellectual property rights, it specifically safeguards the right of ownership and the freedom of economic activity that is inextricably tied in with free but rules-based competition. This is concretised in European Union competition law, which is primarily based on Title VII of the TFEU and corresponds to a call for a Social Market Economy with rules-based competition (→ [2](#)).

The explicit use of the term »Social Market Economy« in the text of the Lisbon Treaty (2009, article 3, paragraph 2) should, however, not lead us into euphoria. The goal of competition is somewhat watered down. The interdependency between a competition-oriented economy and the positive consequences of price stability and high levels of employment and growth is no longer clear. Instead, it says that the Union will work for »the sustainable development of Europe based on balanced economic growth« (article 3, paragraph 3, line 2 of the Treaty on European Union). This wording opens three gateways for interventionist activity. Firstly, the verb »work for« may be interpreted to mean the formulation and monitoring of regulations aimed at competition, but also could be understood as a call for decisionistic intervention. Secondly, the word »sustainable« is open to many interpretations, and thirdly the word »balanced« opens the door to discussions about the right tools to use.

The fact that government action not only involves setting and monitoring legislation but also actually creating certain economic areas is set out in the Maastricht Treaty on the establishment of the European Union (now article 173 TFEU). With regard to the aims of »industrial policies«, it refers to »consulting, coordinating, taking initiatives, guidelines, indicators, best practice« and »specific measures« (article 173, paragraphs 2 and 3 TFEU), that open up broad potential for intervention that spans economic, social and territorial issues, research and development, space flight and tourism (see Titles XVIII to XXII TFEU). However, here we seek in vain for the competitive functions that form the basis of freedom and the control of power as the foundation of European order (Lambert, 1997, 175). A current example is that of the crisis in the French automotive industry, where these kinds of policies have over the years had a significantly detrimental effect on competitiveness (Hawranek/Hülse, 2012).

With reference to the Treaty of Maastricht, Clapham (2004, 23) had already diagnosed a significant potential for tension in terms of regulatory policy between the concept of an open market economy with free competition and the concept of intervention.

It is also disquieting that the goal of »a high level of employment« (article 2, first point of the TEU, Amsterdam) is replaced with the words »full employment« (article 3, paragraph 3 of the Treaty on European Union). Although article 146 TFEU once again only refers to a high level of employment, if it came down to an argument about whether the actions that the EU should demand of the Member States go far enough or are appropriate, then the wording of the Treaty on European Union would no doubt take precedence over that of the Treaty on the Functioning of the European Union.

The fact that the European Union places great value on the »social« aspect should on the one hand be welcomed because it is in line with the intentions of the Social Market Economy. But on the other hand, we can deduce from the host of direct taxation measures and the fact that the Social Market Economy is given equal priority with other goals such as growth, full employment, price stability, welfare, industrial policy and the environment) that it is no longer considered to be a system that is able to achieve all these goals (Bünger, 2007, 7). There is a clear tendency to overextend the harmonisation processes in areas such as taxation, welfare, science and the environment. As a result, the necessary competition in the system unfortunately falls by the wayside (Clapham, 2004, 23; Franke, 2003, 234 et seq).

From a European perspective, it is certainly right that there should be minimum welfare standards, but this should suffice (see Schlecht, 1994, 796). This provides the temptation that countries that have excessively high welfare costs in relation to their economic capacity – for historic reasons and for reasons linked to attracting votes – will be inclined to establish these as minimum standards at EU level and thus contribute to raising rivals' costs (Bünger, 2007, 5).

There is only incidental mention of the criticism that the EU Commission can largely tackle any issue that it thinks is in need of regulation (despite the requirement for subsidiarity). The effect of surprise means that national parliaments are always on the back foot and often are left to simply announce the required changes via their governments. Of course the executive bodies – the EU Commission and Council on the one hand and national governments on the other – find this very convenient because it makes it difficult to ascertain whether and to what extent there is a silent agreement between the executive bodies, as Enzensberger believes (2011, 53). In any event, it is true that citizens are now barely able to identify democratic responsibilities.

A brief look ahead: »Ordnungspolitik« as a challenge for the whole of Europe

The Social Market Economy is not an isolated concept that relates only to the economy. Rather, it is integrally linked to the whole social system that includes economic, welfare-related and social aspects, as is shown by Erhard's and Müller-Armack's explanations about the formed society. In this sense, the Social Market Economy follows the liberal tradition in taking the values of the Enlightenment and applying them to modern societies based on the division of labour.

So *Ordnungspolitik* has to take on the same significance as environmental policy, not only for Germany but for the whole of Europe. In Germany this task could be taken up by the Federal Economics Ministry, which still needs to be strengthened. (→ **A LOOK AHEAD**).

NOTES

1 | The initial members of the European Coal and Steel Community (ECSC), the European Economic Community (EEC) and the European Atomic Energy Community (EAEC) were Germany, France, Italy and the three Benelux countries.

2 | Cf. »Ludwig Erhard und die europäische Integration«, Ludwig-Erhard-Stiftung, Bonn: In plain text. Informationen zur Sozialen Marktwirtschaft, 05/2012.

3 | Because regulations have developed over time and become deeply embedded, it would be a never-ending task to seek to create an internal market through the almost complete harmonisation of respective norms. In contrast, the 1978 verdict by the European Court of Justice proposed the following route: if a product has been legally produced in one of the Member States, then it may be traded not only in that state but also in every other Member State. This does not exclude a limited degree of discrimination against the state's own nationals. A country may to a certain extent demand special laws for products that are manufactured within its borders. A good example of this is the famous German Purity Law of 1516 for beer (Franke, 2012, 82 et seq).

4 | The EU Charter of Fundamental Rights has still not been ratified and does not form part of the Lisbon Treaty. However, by being referred to in article 6, paragraph 1 of the Treaty on European Union, it has achieved a certain amount of legal force. A protocol has given the UK and Poland the right to opt out, and this is to be extended to the Czech Republic.

SOURCES AND RELATED LITERATURE

- *Bergmann, Jan* (2001): Recht und Politik der Europäischen Union. Der Integrationsverbund vor der Osterweiterung, Stuttgart
- *Bergmann, Jan* (2012): Art. »Lissabon-Vertrag«, in: Bergmann, Jan (ed.): Handlexikon der Europäischen Union, 4., revised and expanded edition, Baden-Baden 2012, pp. 619–622
- *Bünger, Klaus* (2007): Zur Erosion der marktwirtschaftlichen Wirtschaftsverfassung der Europäischen Union, position paper by the liberal political foundation the Friedrich-Neumann-Stiftung, Potsdam, 05/2007
- *Busch, Berthold* (2008): Zur Wirtschaftsverfassung der Europäischen Union [position papers, articles on Ordnungspolitik from the Cologne Institute for Economic Research, no. 31], Cologne
- *Clapham, Ronald* (2004): Wirtschaftsverfassung für Europa, in: Aus Politik und Zeitgeschichte, no. B 17/2004, pp. 21–28
- *Enzensberger, Hans Magnus* (2011): Sanftes Monster Brüssel oder die Entmündigung Europas, Berlin
- *Fels, Gerhard* (1997): Freier Welthandel und konvertible Währung: Deutschlands Rückkehr zum Weltmarkt, in: Ludwig-Erhard-Stiftung (ed.) (1997), pp. 417–440
- *Franke, Siegfried F.* (2003): Neuorientierung der Ordnungspolitik. Erfordern Globalisierung und New Economy eine neue wirtschaftspolitische Konzeption? In: Schäfer, Wolf (2003): Konjunktur, Wachstum und Wirtschaftspolitik im Zeichen der New Economy, Berlin, pp. 203–243
- *Franke, Siegfried F.* (2010): Impliziert die Ablehnung des »Marktes« eine Distanz zu Verfassungsprinzipien? [Speech given at the Kloster Banz educational centre, Bad Staffelstein, 26–28 Mar 2010] (www.siegfried-franke.de)
- *Franke, Siegfried F.* (2012): Europa am Scheideweg. Statt Vertiefung und Erweiterung nun die Eurokrise? Marburg [in particular Part I: Von der Ursprungsidee der europäischen Einigung bis zur aktuellen Erweiterungs- und Vertiefungspolitik der Europäischen Union]
- *Guth, Willfried* (1997): Europäische Integration und Soziale Marktwirtschaft, in: Ludwig-Erhard-Stiftung (ed.) (1997), pp. 441–464
- *Hawranek, Dietmar/Hülsen, Isabell* (2012): Fluch der Herdprämie. Peugeot kämpft ums Überleben. Der Niedergang des Autoherstellers zeigt, dass die Industriepolitik Frankreichs gescheitert ist. Unternehmen und Politik haben die Globalisierung verschlafen, in: Der Spiegel 33/2012, 13 Aug 2012, pp. 56/57
- *Jeaner Allianz zur Erneuerung der Sozialen Marktwirtschaft* (2012): Wirtschaftsverfassung statt Wirtschaftsregierung. Frankfurter Aufruf für eine ordnungspolitische Weichenstellung in Europa, in: Frankfurter Allgemeine Zeitung, 22 Jun 2012
- *Lambert, Martin* (1997): Erhards europapolitische Vorstellungen und neue Herausforderungen für die Europäische Union, in: Ermrich, Roland (ed.) (1997): 100 Jahre Ludwig Erhard. Das Buch zur Sozialen Marktwirtschaft, MVV, Düsseldorf, pp. 173-178
- *Ludwig-Erhard-Stiftung* (ed.) (1997): Soziale Marktwirtschaft als historische Weichenstellung. Bewertungen und Ausblicke. Publication in honour of the 100th birthday of Ludwig Erhard, Düsseldorf
- *Mestmäcker, Ernst-Joachim* (2011): Die Wirtschaftsverfassung der EU im globalen Systemwettbewerb [Universität Halle-Wittenberg, Institut für Wirtschaftsrecht: Beiträge zum Transnationalen Wirtschaftsrecht, vol. 100, 03/2011]
- *Schlecht, Otto* (1994): Soziale Marktwirtschaft für das ganze Europa! In: Ludwig-Erhard-Stiftung (1994): Grundtexte zur Sozialen Marktwirtschaft, vol. 3: Marktwirtschaft als Aufgabe, ed. Herrmann-Pillath, Carsten/Schlecht, Otto/Wünsche, Horst Friedrich, Stuttgart, Jena, New York, pp. 789–803
- *v. Wogau, Karl* (2005): Soziale Marktwirtschaft in der EU, in Hasse, Rolf H./Schneider, Hermann/Weigelt, Klaus (ed.) (2005): Lexikon Soziale Marktwirtschaft, 2., current and awaited edition, Paderborn, Munich, Vienna, Zurich, pp. 381–384 et seq



»ORDNUNGSPOLITIK« AS A CHALLENGE FOR THE WHOLE OF EUROPE

The Social Market Economy and the German constitution

The term »Social Market Economy« is not to be found in the German constitution. At an early stage, Nipperdey (1960, 1961) was of the opinion that the free development of the personality pursuant to article 2, paragraph 1 GG and the principle of a social federal state as set out in article 20, paragraph 1 GG cover and substantiate the Social Market Economy in terms of constitutional law. However, the German Federal Constitutional Court and authoritative notes on the constitution repeatedly emphasise the economic neutrality of the constitution. The only agreement was that fundamental freedoms must continue to be protected and that a distinct command economy is not permitted (see also Franke, 2010c, slides 9 et seq).

However, the **Social Market Economy** is officially mentioned in the »State Treaty«.¹ According to the preamble and article 1, paragraph 3, it provides a basis for further economic and social development and in article 11, paragraph 1 the former GDR committed to »formulate its economic and financial actions in such a way that they are in harmony with the Social Market Economy«. However, during the changes that were made to the German constitution as a result of reunification, this was not incorporated into the constitution as a fundamental aim.² This is somewhat surprising in light of the fact that another national objective that was also included in the preamble and in article 1, paragraph 3 of the State Treaty – environmental protection –

did in fact make the leap to being included in the constitution (article (20a GG). It may be argued that this was not necessary, because environmental protection is already included in article 1, paragraph 1 (human dignity) and in the statement that Germany is a social state in article 20, paragraph 1 GG.

The significance of the text of the constitution in the political sphere

We may ask why the Social Market Economy has still not been incorporated into the constitution, in light of the clear statement in the State Treaty and the reference in article 5, third point of the Unification Treaty to the fact that national objectives may be incorporated in the constitution. On the one hand, it is certainly absurd to claim that politicians are flirting with a command economy. However, it should be conceded that there is an aversion to clear legal parameters. Norms that either do not exist or that are in need of interpretation provide room to manoeuvre, which can be put to good use by political parties in their quest to win votes.

Another argument rests on the fixed (with good reason) requirement that changes to the constitution must be approved by a two-thirds majority in the Bundestag and the Bundesrat (article 79, paragraph 2 GG). If it is not possible to win this majority in favour of explicitly incorporating the Social Market Economy into the constitution, then it is necessary to take the arduous route of persuasion and to repeatedly carve out an exemplary policy as is implied in article 2, paragraph 1 and article 20, paragraph 1 of the constitution.

As previously mentioned, this is an arduous task, especially as the Constitutional Court is unlikely to deviate from its view that the constitution has to remain neutral in terms of the economy and only excludes the formation of a socialist controlled economy. Potential interpretations in this context take place in the political sphere. Obviously, the various economic, social and political actors all have their own particular agendas. However, persistence can bear fruit. As already mentioned in the introduction to the individual arguments, former SPD Economic and Finance Minister Karl Schiller led German social democracy down the path of the market economy. Even if there are different interpretations of the Social Market Economy – as a goal, a tool or a mixture of both – none of Germany's major parties oppose the market economy or are interested in introducing elements of a planned economy.

Wiggle room and dangers at European level

If it is not possible to lay down clear constitutional norms for the Social Market Economy within our own sphere, then it is hardly likely to be achieved at European level. The historical development of the 27 EU Member States (which will grow to 28 when Croatia joins in 2013) has led to a range of different social and economic structures, although they are all based on the common acceptance of fundamental freedoms. It is therefore understandable that the process of European unification has led to a host

of different aims initially being given equal importance – as in the Treaty of Lisbon – but then necessarily and repeatedly resulting in compromises because of the speed of change in an era of globalisation. So it depends on the powers of persuasion of the political directions that are represented in the European bodies to decide whether and to what extent certain interpretations are given temporary or permanent priority.

However, if the EU signals that it wants the disciplining power of the markets to have no or limited effect, at least in key areas, then it is no surprise if those involved feel all the writings and political statements have little credibility. An example of this is the EU's sovereign debt crisis. It not only threatens the existence of the euro as a common currency but it is also increasingly causing strife between Member States.

The euro was introduced with a promise of monetary stability. It was formally agreed that neither the EU nor the Member States would be responsible for the liabilities of other Member States (»no bail-out«; article 125, paragraph 1 TFEU).³ And in June 1997 in Dublin the European Council approved the Stability and Growth Pact with the stipulation that sanctions would be imposed in the event that permitted debt levels were exceeded. In terms of the market economy, the logic is clear: if other states do not jump in to help, then the state that has high levels of debt is obliged to pay higher interest rates on new borrowing. When combined with the threat of sanctions as contained in the Stability and Growth Pact, this ensures tighter budgetary discipline.

However, the protagonists questioned their implementation, because the sanctions were linked to the approval of a qualified majority in the Ecofin Council. »Sinners, or at least potential sinners, get to sit in judgement on sinners.« In the end, every breach of the debt criteria has gone unpunished, and there has even been no comment on the fact that Brussels was presented with false figures. And France and Germany have come together to ensure the dilution of the 2005 Stability and Growth Pact.

It also does not exactly build trust when the Treaty on the Functioning of the European Union stipulates that a state can be given assistance in the event of »exceptional occurrences beyond its control«. In terms of legislation, it is somewhat remarkable that what was intended to be an exception is starting to become the rule (article 122, paragraph 2 TFEU).⁴

So against this backdrop it is hardly surprising that the chronically indebted members of the eurozone have been able to borrow at favourable interest rates. The true market interest rate will continue to be afforded little significance, firstly because the rule and the exception to the rule (article 125 paragraph 1 and article 122, paragraph 2 TFEU) continue to be inverted, and secondly because although the Stability and Growth Pact has been tightened up verbally, there are still questions about the imposition of sanctions. Indeed, sanctions should be imposed by the Commission after the inverted approval procedure, if the Council does not veto them within ten days, but there are countless opportunities to exert political influence before such a proposal is made. Just as in the past there has been no approval of the imposition of sanctions, in future there will also be no approval of the prevention of sanctions imposed by the Commission.

Finally, the new clause 3 in article 136 of the TFEU which states that a permanent »crisis mechanism« (European stability mechanism [ESM]) will be introduced also serves to deprive the bail-out ban of all credibility; indeed it serves to find a way of circumventing market-driven interest rates. There is also cause for mistrust in that article 32 of the ESM scheme is not subject to any administrative, judicial or legal controls. The value of an audited and published annual report is also moot if the ESM is allowed to appoint its own auditors.

The fact that the deactivation of meaningful market indicators in the long term leads to reduced competitiveness, weakens other economic sectors and brings with it negative effects on distribution has been clear for many years in the extreme way that agricultural policy has been pursued. In addition, long-standing, established institutions will fight hard for their survival. But there is no point in just complaining. There is no question that the sovereign debt crisis has to be tackled and replaced with a well thought-out concept because of its lasting impact on the financial sector, the economy and welfare, particularly pensions. Of course the problem arises when a long-term institution is created that experience has shown is almost impossible to break up.

Improving competitiveness as a cross-sectional regulatory task

In light of the aforementioned dangers, it is essential that unbiased, free competition be afforded greater priority. It lies at the heart of the market economy which, when understood properly, is »social« in itself. It reflects all the values of the Enlightenment. It is based on democratic principles, is enlightened and liberal, efficient and eco-friendly, social and hence deeply ethical (for more details see Franke, 2010, 78 et seq). (→ **INTRODUCTION**).

Awareness of the function of the Social Market Economy as a form of fairness that is inherent in competition has to be constantly and repeatedly raised through education and training. This starts small in schools, colleges and seminars and moves on to bigger initiatives. To once again turn to Karl Schiller: his idea of »concerted action« that is anchored in the Stability and Growth Act but that has been ignored for many decades did in fact point in the right direction. It may be that he initially underestimated the stubbornness, self-interest and indeed fear of officials, but he was right when he said »that [...] »concerted action« at least offered a guarantee that economic policymakers could show the organised groups [...] the overall economic limits of their actions« (Schiller, 1984, p. 17). For some time now, the idea has been gaining new popularity in the form of job summits, round tables and high-level talks, although in an ad hoc and largely uncoordinated form that looks at individual problems but fails to focus on the big picture. It would be desirable to revive this in a more organised and institutional form, then it would reflect Müller-Armack's »Ireneformula« (→ **INTRODUCTION**).

If this were to succeed, then attention could be turned to the next step of affording competitiveness the same significance as equality, non-discrimination, environmental protection and animal welfare. In pursuit of these aims, articles 8, 10, 11 and 13 of the TFEU act as integration or cross-sectional clauses which the Union has to use to measure the extent to which its proposed policies tally with the aforementioned aims. The argument that it is not necessary because Title VII dedicates a whole series of articles to competition is not valid. Even a fleeting glance reveals that undertakings are generally prohibited from making agreements (article 101 Abs. 1 TFEU) and the Member States are not allowed to favour certain consumers or undertakings (article 107, paragraph 1 TFEU). However, this does not preclude the Union as a whole from giving competitiveness less priority than other goals when formulating policy.

It is clearly an ambitious goal to establish an regulatory cross-sectional clause at European level. But it is worth persisting and continually striving towards this goal, as this is the only way to win back the trust of everyone involved. In the long run, the market economy and democracy depend on trust (Franke, 2011, 11 et seq).

GLOBAL COMPETITION BETWEEN ORDER SYSTEMS

Order systems: the concept and its expression

The term »order system« combines two sub-topics that to some extent describe the intersection between »system« and »order«. In brief, a system describes an underlying and unadulterated principle of order within a society. So a system comparison is then an abstract diametric presentation of different systems. With regard to politics, we should point to the contrast between »democracy« and »dictatorship«, whereas with regard to the economy there is a typical contrast between the »market economy« and the »centrally planned economy«.

The word »order« describes the specific characteristic of a »system«. Specific orders are located on a particular point in the continuum between the principles of abstract systems. They are dependent on socio-cultural characteristics, values and traditions and may be postponed depending on current conditions (cf. Schlecht, 1994, 789). However, if specific thresholds are exceeded, this changes the basic systemic quality of an order. To illustrate this with an example: the order of a country still remains oriented towards democracy and the market economy irrespective of whether it is Friday, Saturday or Sunday that is generally chosen as the day of rest, or even if there is no particular specified day. Irrespective of this day of rest, the quality of the system changes if suddenly political parties are banned or if free market activities are only possible in fringe areas.

The social order of a country in the broader sense is demonstrated in three areas: political order, social order and economic order. In anonymous mass societies based on the division of labour these orders can be broken down into further sub-orders such as competition, ownership, labour market, welfare, etc. (Eucken, 1975, 14 et seq, 341 et seq). Eucken (1975, 332) also stressed the central aspect of the interdependence of orders. Different system principles in the various orders and sub-orders lead to contradiction and conflict and hence to sub-optimal results, because the economic agents, regardless of which order they are part of, act in accordance with different rationalities: in the words of Herder-Dorneich (1983), they fall into »rationality traps« that they find are difficult to escape (Franke, 2000, 79–82).

Linked to this is a broader social concept that is characterised by a consistent connection between the foundation of a regulatory framework, central social aims and values and the necessary means and tools to implement them. From this we can deduce that the Social Market Economy is not only an economic but also a social concept in the broadest sense that sets out clear principles with its plea for the linking of a free democracy under the rule of law and a free rules-based market economy. In this it is reacting to practical necessities but always has to be careful not to lose sight of the basic principles that provide its »compass« (Müller-Armack, 1959/1966, 257 et seq; Schlecht, 1990b, 607).

More recent manifestations of order: a number of »third ways«?

Taken to its extreme, we can say that any specific order that does not present itself as a totally unadulterated translation of a system is a »third way«. Seen in this way, the concepts of democratic socialism and ordoliberalism can both be described as third ways. The term »the third way« gained particular attention thanks to the ideas of Czech economic reformer Ota Šik,⁵ whose work had a major influence on the Prague Spring. With his »humane economic democracy« he wanted to give socialism a human face (Šik, 1967; 1971; 1972; 1979).

Later, Giddens (1999), for many years Director of the London School of Economics and Political Science, seized on the idea of the third way in order to combine socialism and democracy.

The idea of the third way had of course been used previously by German thinkers in their work on the revival of liberalism. Rüstow (1949, 446 et seq), one of the pioneers of ordoliberalism, described the implementation of total competition as a third way. By this he meant competition that is not distorted by monopolies, subsidies and protectionism, so free, rules-based competition.⁶

The Social Market Economy has also been described as a third way. But caution is advised. Müller-Armack (cf. Konrad-Adenauer-Stiftung [2010; 2012]) and Schlecht (1990a; 1990b, 600) emphasised that this should not be understood as a mixture of order systems in the sense of a random point on a continuum, as is repeatedly the case in the works of Šik and Giddens. The Social Market Economy is and remains based on the principles of an undistorted free market that allows decentralised decision-making on price mechanisms and rejects the subordination of people to centralised economic planning.

Recently the terms »Capitalism 2.0« and the very similar »Capitalism 3.0« have heralded some new ideas that have in fact been discussed at the Economic Forum in Davos. Proponents insist on the importance of competitive structures and reject dirigiste state interventions. One of the central ideas is reform of the financial system in order to once again revisit the uncoupling of the financial economy and the real economy. The financial economy has to take on a function that serves the real economy and hence society as a whole.

Other aspects of the »new capitalism« aim to create greater ethical awareness in order to prevent excesses such as the explosion in top executives' pay and bonuses and the view of workers as simply being cost factors.

In the cold light of day, this provides a modern label for the aim of dismantling and preventing monopolies and cartel-type structures and – based on an economy that is fundamentally oriented towards the market and competition – giving sociopolitical goals more priority, as was intended in the idea of the formed society (Heuser, 2010; Lindbeck, 2007; Scharmer, 2010; Friedrich-Ebert-Stiftung, 2009).

The interplay of specific economic orders in a global world

The World Trade Organization (WTO) has over 150 members comprising around three-quarters of all the countries in the world. Its members include all the industrialised nations, the emerging nations and many developing nations. So we can conclude that »the real, existing global economic order [...] [is] the result of the interplay of different economic orders« (Eisele, 2011, slide 11). Eisele divides the main national economic orders into six categories (2011, slide 12), though there are of course some intersections:

- 1 MARKET ECONOMIES,
- 2 COMMAND ECONOMIES / STATE ECONOMIES,
- 3 FEUDAL ECONOMIES,
- 4 CORPORATIVE ECONOMIES,
- 5 PATRIARCHAL ECONOMIES AND
- 6 OLIGARCHIC / CLAN ECONOMIES.

All these orders reflect the value system of a society (degree of enlightenment, attitudes towards people, religious traditions) and the way that power structures have evolved over time.

The USA and UK continue to follow a market economy model that is closer to classical liberalism than the German model of the Social Market Economy. However, particularly in the USA, protectionist tendencies continue to arise, something that does not tie in with classical liberalism.

On the other hand, China has allowed largely unbridled competition while at the same time trying to increase future prosperity through state regulation, which has also now for some time focused on environmental protection. Therefore the system has a patriarchal structure. It is a matter for debate whether this system is better described as a »socialist market economy«, a »hierarchical market economy« or »state capitalism«.

In India – which still has a strong caste system – the corporative economy still predominates, whereas several of the Arab states have a mixture of a religiously motivated patriarchal economy and a feudal economy. Developing countries often have oligarchic and clan economies.

Promotion of and competition between order systems

The multiplicity of order systems and their cultural, religious and historical backgrounds have here only been outlined in brief. A free democracy under the rule of law linked to a Social Market Economy would be the best guarantee of the peaceful co-existence of nations and increased prosperity for their people. But it is clear that we have to be very cautious when promoting this kind of social order. Germany can be a role model but must not be tempted to wag the finger. And promoting the Social Market Economy on a global scale is many times more difficult than current attempts to promote it in the EU.

Instead, it seems likely that the competition between order systems will result in the Social Market Economy beginning to stand out from the rest. The idea is that mobile production factors seek out the most favourable location and so cause politicians to »design and implement more attractive institutional value-for-money offers« (Wohlgemuth, 2008, 679). But at this point the interdependency between the economic system and the political system becomes clear. The reaction to mobile factors relies on two main policies. Firstly, domestic and international mobility must be possible, and secondly, politicians must react appropriately and not decide to forcibly restrain mobility.

The example of the forcible suppression of the Prague Spring in 1968 shows that economic freedom is always threatened when there is no political freedom. This may be conciliatory in tone but in terms of the promotion of human rights it is a basic requirement for the competition of order systems.

A free democracy under the rule of law linked to a Social Market Economy would be the best guarantee of the peaceful co-existence of nations and increased prosperity for their people.

NOTES

1 | Treaty on the Establishment of Monetary, Economic and Social Union between the Federal Republic of Germany and the German Democratic Republic dated 18 May 1990 (State Treaty).

2 | Treaty on the Establishment of German Unity between the Federal Republic of Germany and the German Democratic Republic (Unification Treaty).

3 | See the Treaty of Maastricht, Art. 104b, paragraph 1

4 | This »exception« is also given priority over the rule in the Maastricht Treaty: Art. 103a, paragraph 2. The first bail-out for Greece expressly refers to Art. 122, paragraph 2 TFEU, while the objection made by the Advisory Council of the German Economic Ministry was ignored. The Council argued that it was not the budget that had resulted in Greece losing control but rather that the difficulties lay in behaviour that consciously contravened the treaty.

5 | Ota Šik (1919–2004) was a Czech economist and for a short time deputy prime minister of Czechoslovakia. He coordinated the economic reforms during the time of the Prague Spring. In August 1968 the Soviet Union and its Warsaw Pact allies used force to end this experiment. Šik was in Belgrade at the time and he then moved to Switzerland where he gained citizenship. He later took a professorship at the University of St. Gallen. Towards the end of his life he devoted more of his time to his passion for painting.

6 | Recently there have been several studies on the »common good economy« as a third way. We will not be going into this here because the arguments cannot answer the objection that it is ideology that determines what constitutes the common good.

QUELLEN UND WEITERFÜHRENDE LITERATUR

- *Aus Politik und Zeitgeschichte*. Supplement to the weekly magazine *Das Parlament*, no. B 16/17-2001 [special edition on the »Third Way« with articles by Roland Sturm, Alexander Gallus and Eckhard Jesse, Hans Vorländer, Lothar Funk and Frank Eckhardt, 13 Apr 2001
- *Eisele, Rainer* (2011): Eine europäische »wettbewerbsfähige Soziale Marktwirtschaft« im Kontext globaler Wirtschaftsordnungen, speech given at the conference entitled »Wettbewerbsfähige Soziale Marktwirtschaft oder Utopie?« at the Evangelische Akademie Bad Boll, 03/04 Feb 2011
- *Eucken, Walter* (1975): Grundsätze der Wirtschaftspolitik, 5th unrevised edition, Tübingen 1975 (1952¹)
- *Franke, Siegfried F.* (2000): (I)rrationale Politik? Grundzüge und politische Anwendungen der Ökonomischen Theorie der Politik, 2nd revised and expanded edition, Marburg
- *Franke, Siegfried F.* (2010): Der doppelt missverständene Liberalismus, Marburg
- *Franke, Siegfried F.* (2010a): Mit oder gegen die Marktwirtschaft zur »sozialen Gerechtigkeit?« In: *Franke* (2010), pp. 73–90
- *Franke, Siegfried F.* (2010b): Zur Wiederbelebung der »Irenischen Formel« im Rahmen der Sozialen Marktwirtschaft, in: *Franke* (2010), pp. 63–72
- *Franke, Siegfried F.* (2010c): Speech entitled »Impliziert die Ablehnung des »Marktes« eine Distanz zu Verfassungsprinzipien?« at the »Extremismus« conference, Hanns Seidel-Stiftung, directed by Prof. Dr. Eckehart Jesse, Kloster Banz, 26–28 Mar 2010 (www.siegfried-franke.de)
- *Franke, Siegfried F.* (2011): Vertrauenserosion. Eine Gefahr für Politik, Gesellschaft und Wirtschaft, Marburg
- *Friedrich-Ebert-Stiftung* (2009): Forum Soziale Demokratie. Kapitalismus 2.0: Irgendwie anders – irgendwie besser [Politische Akademie, Policy No. 31, 08.2009 (<http://library.fes.de/pdf-files/akademie/06705.pdf>), printed: 06 Jun 2012]
- *Giddens, Anthony* (1999): *The Third Way, The Renewal of Social Democracy*, Cambridge, 1998
- *Goldschmidt, Nils/Wohlgemuth, Michael* (ed.) (2008): *Grundtexte zur Freiburger Tradition der Ordnungsökonomik*, Tübingen
- *Gregosz, David* (2012): *Wirtschaftspolitische Megatrends bis 2020. Was ist in den kommenden Jahren zu erwarten? Analysen und Argumente*. No. 106. 08/2012. Konrad-Adenauer-Stiftung
- *Herder-Dorneich, Philipp* (1983): *Gesetzliche Krankenversicherung heute*, Cologne
- *Heuser, Uwe Jean* (2010): *World Economic Forum. Kapitalismus 2.0*, 03 Feb 2010, in: *Zeit Online* (Argument-Davos printed: 17 Aug 2012)
- *Konrad-Adenauer-Stiftung* (2010): *Geschichte der CDU. Dritter Weg* [Eckhard Jesse] (www.kas.de/wf/de/71.8581), as at: 09 Aug 2010, printed: 17 Aug 2012)
- *Konrad-Adenauer-Stiftung* (2012): Müller-Armack, Alfred [Friedrun Quaas] (www.kas.de/wf/de/71.5890), as at: 25 Jun 2012; printed: 16 Aug 2012)
- *Leipold, Helmut* (1994): *Interdependenz von wirtschaftlicher und politischer Ordnung*, in: *Ludwig-Erhard-Stiftung* (1994), pp. 723–738
- *Lindbeck, Assar* (2007): *China: China's evolving economic system* [Project Syndicate] (www.project-syndicate.org/print/china-s-evolving-economic-system), 27 Apr 2007, printed: 17 Aug 2012)
- *Ludwig-Erhard-Stiftung* (1988): *Grundtexte zur Sozialen Marktwirtschaft*, vol. 2: *Das Soziale in der Sozialen Marktwirtschaft*, ed. Hohmann, Karl/Schönwitz, Dietrich/Weber, Hans-Jürgen/Wünsche, Horst Friedrich, Stuttgart, New York
- *Ludwig-Erhard-Stiftung e. V.* (1994): *Grundtexte zur Sozialen Marktwirtschaft*, vol. 3: *Marktwirtschaft als Aufgabe*, ed. Herrmann-Pillath, Carsten/Schlecht, Otto/Wünsche, Horst Friedrich, Stuttgart, Jena, New York
- *Müller-Armack, Alfred* (1959): *Die Soziale Marktwirtschaft nach einem Jahrzehnt ihrer Erprobung*, in: Müller-Armack, Alfred (1966): *Wirtschaftsordnung und Wirtschaftspolitik*, Freiburg i. Br., pp. 251–265
- *Nipperdey, Hans Carl* (1960): *Wirtschaftsverfassung und Bundesverfassungsgericht*, Cologne and elsewhere
- *Nipperdey, Hans Carl* (1961): *Soziale Marktwirtschaft und Grundgesetz*, Cologne, 2, new revised edition, Cologne and elsewhere
- *Rüstow, Alexander* (1949): *Zwischen Kapitalismus und Kommunismus*, in: *Goldschmidt/Wohlgemuth* (ed.) (2008), pp. 423–448
- *Scharmer, Otto* (2010): *Kapitalismus 3.0. Die sieben Akupunkturpunkte des sozialen Organismus*, in: *Infos 05/10 Anthroposophie im Dialog* (www.bertelsmann-stiftung.de/bst/de/media/xcms_bst-dms_31799_31800_2.pdf), printed: 17 Aug 2012)
- *Šik, Ota* (1967): *Plan und Markt im Sozialismus*, Vienna
- *Šik, Ota* (1971): *Demokratische und Sozialistische Planwirtschaft*, Zurich
- *Šik, Ota* (1972): *Der Dritte Weg*, Hamburg
- *Šik, Ota* (1979): *Humane Wirtschaftsdemokratie – Ein dritter Weg*, Hamburg
- *Schiller, Karl* (1984): *Betrachtungen zur Geld- und Konjunkturpolitik*, Tübingen
- *Schlecht, Otto* (1990a): *Die Soziale Marktwirtschaft ist der Dritte Weg*, in: *Frankfurter Allgemeine Zeitung*, 05 Mar 1990
- *Schlecht, Otto* (1990b): *Soziale Marktwirtschaft: Rezept und Lebenselixier für ganz Europa*, in: *Goldschmidt/Wohlgemuth* (ed.) (2008), pp. 593–609
- *Schlecht, Otto* (1994): *Soziale Marktwirtschaft für das ganze Europa!* In: *Ludwig-Erhard-Stiftung* (1994), pp. 789–803
- *Streit, Manfred E.* (1992): *Das Wettbewerbskonzept der Ordnungstheorie*, in: *Goldschmidt/Wohlgemuth* (ed.) (2008), pp. 683–696
- *Streit, Manfred E./Wohlgemuth, Michael* (ed.) (1999): *Systemwettbewerb als Herausforderung an Politik und Theorie*, Baden-Baden
- *Wohlgemuth, Michael* (2008): *Zur Einführung: Manfred E. Streit* in: *Goldschmidt/Wohlgemuth* (ed.) (2008), pp. 677–682



PROF. DR. SIEGFRIED F. FRANKE

- Born 1942, attended school in Bielefeld, gained his degree in Freiburg im Breisgau and went on to acquire doctorate and postdoctoral qualifications in Dortmund. He also holds a qualification in wholesale and international trade.
- Until April 2010, Head of the interdisciplinary Department of Economic Policy and Public Law at the University of Stuttgart.
- Since February 2012, Herder Professor of Economic Policy at Andr ssy University in Budapest.
- Member of numerous scientific and business-related associations.
- Main areas of research and teaching: political policy and decision-making in democracies, including labour market, education, regulatory, tax and environmental policy-making.
- Numerous publications and lectures.



DAVID GREGOSZ (CO-AUTHOR)

- Born 1983, studied for a Joint Degree in Political Sciences (Diploma) and Economics (Bachelor) in Marburg.
- From 2009 to 2012 freelance researcher and then Coordinator for Fundamental Questions on *Ordnungspolitik* in the Economic Policy Team of the Konrad-Adenauer-Stiftung's Central Department of Politics and Consulting.
- Since July 2012 Coordinator for International Economic Policy in the Policy Dialogue and Analysis Team of the Konrad-Adenauer-Stiftung's Department of European and International Cooperation.



PAETRICK SCHMIDT (ILLUSTRATOR)

- Born 1980, studied Communications Design and Media in Wismar, visiting student in Leipzig und Berlin.
- Freelance artist in Wismar since 2009.
- Since 2009, editorial illustrator with work published in magazines such as Focus, Das Magazin and Zitty Berlin.
- Individual exhibitions at the Staatliches Museum Schwerin (2010), the K nstlerhaus Schloss Pl schow (2010), the Ahaus Arts Association (2010), the Golden Pudel Club in Hamburg (2011); group exhibitions in Kiel (2011), Rostock, Karlskrona and Danzig (2012), Frankfurt/Oder (2013); travel scholarships to the USA (2009) and Japan (2012).

CONTACT FOR ENQUIRIES AT THE KONRAD-ADENAUER-STIFTUNG

PAUL LINNARZ

Regional Representative for Economic Policy
Social and Economic Governance Programme Asia

Tel.: +81 3/6426-5041
Fax: +81 3/6426-5047
E-mail: paul.linnarz@kas.de

THOMAS YOSHIMURA

Project Coordinator
Social and Economic Governance Programme Asia

Tel.: +81 3/6426-5045
Fax: +81 3/6426-5047
E-mail: thomas.yoshimura@kas.de

MATTHIAS BAUER

Coordinator for International Economic Policy
Political Dialogue and Analysis Team
Department European and International Cooperation

Tel.: +49 30/26996-3516
Fax: +49 30/26996-3551
E-mail: matthias.bauer@kas.de

MATTHIAS SCHÄFER

Head of the Economic Policy Team
and the Social Market Economy Project Group
Department Politics and Consulting

Tel.: +49 30/26996-3515
Fax: +49 30/26996-3551
E-mail: matthias.schaefer@kas.de

CVETELINA TODOROVA

Coordinator for Fundamental Questions
on *Ordnungspolitik* and the Social Market Economy
Economic Policy Team
Department Politics and Consulting

Tel.: +49 30/26996-3595
Fax: +49 30/26996-3551
E-mail: cvetelina.todorova@kas.de

EDITORIAL INFORMATION

Publisher

Konrad-Adenauer-Stiftung Japan Office
OAG-Haus 4F
7-5-56 Akasaka, Minato-ku
Tokyo, 107 0052 Japan

Design, typesetting and printing

Design: racken GmbH, Berlin
Typesetting: nonymos, Berlin
Illustrations: Paetrick Schmidt
Drawings on pages 9, 10, 11, 12, 13, 97: Heidi Krull,
Berlin, drawing on page 97 based on an illustration by
Aleksandar Velasevic
Translation: RedKeyTranslations, Hanover
Printers: PrintX Co., Ltd., Tokyo

The whole work is protected by copyright. It may not be used in any way without the permission of the Konrad-Adenauer-Stiftung e.V. This particularly applies to reproductions, translations, microfilming, digital storage and processing.

The contents of this book were originally published by the Konrad-Adenauer-Stiftung e.V. in German language under the title »Soziale Marktwirtschaft – Was heißt das konkret?«.

This is a translation of the 1st Edition
Copy deadline: 1 March 2013
© 2013 Konrad-Adenauer-Stiftung e.V.

www.kas.de/japan/en

978-4-9906899-3-3

THE SOCIAL MARKET ECONOMY STANDS FOR ...

...sound national finances.

» Any attempt that is rooted in a sense of benevolence to spend more money on putative well-being than the income that is flowing into the treasury is a contravention of sound and proven principles. « (LUDWIG ERHARD)

...recognition of the social partnership and collective bargaining. Workers and employers are in better position than the state to organise their industrial relations.

» Everything must [...] be done in order to once again shift the emphasis of responsibility for life from the state to the place that clear thinking and experience have shown is its natural home, [...], decentralised non-governmental organisations [...]. « (WILHELM RÖPKE)

...functioning competition between businesses, wherever possible without the distortion of subsidies. Competition is a guarantee of innovation.

» If there is no or insufficient competition, this compromises the steering power of market prices as envisaged in the constitution. The production and distribution of goods is steered in the wrong direction. But this faulty steering of economic cooperation is not the key issue. More serious is the disturbance to social justice within the free market economy. « (FRANZ BÖHM)

...fair participation in a meritocracy. This affects opportunities in the labour market, the possibility of advancement through education and integration assistance for migrants.

» An essential element of a positive family policy is to give our youth equal opportunities for their lives and for advancement that suit their inclinations and talents and that are not linked to their parents' income or wealth. « (LUDWIG ERHARD)

...valuing the family and civic engagement.

» We believe there are an infinite number of things that are more important than the economy: family, community, country, every single form of social integration [...]. « (ALEXANDER RÜSTOW)

...open markets that – in a globalised world – are not regulated by duties or trade restrictions.

» In foreign trade we strive for the greatest possible freedom, in order to re-emphasise the principle of the global division of labour that is to the benefit of all. « (LUDWIG ERHARD)

...an independent monetary policy that concentrates on the main- taining price stability.

» All attempts to create a competitive system are in vain if a certain degree of monetary stability is not guaranteed. So monetary policy is the key element of a competitive system. « (WALTER EUCKEN)

...a »strong« state that sets guidelines but that does not interfere in every area of people's lives.

» But now a strong state is not one that interferes in everything and draws everything to it. On the contrary, a truly strong state is not characterised by interference but by the independence of interest groups and the unyielding assertion of its authority and dignity as the representative of the people. « (WILHELM RÖPKE)

...providing a safety net for life's risks while upholding the principle of subsidiarity.

» Economic freedom and compulsory social security do not go well together. So it is necessary for the principle of subsidiarity to be recognised as one of the most important principles of social security and that self-help and personal responsibility should wherever possible be given priority. Therefore compulsory state protection has to stop at the point where individuals and their families are once again in a position to take responsibility and look after themselves. « (LUDWIG ERHARD)

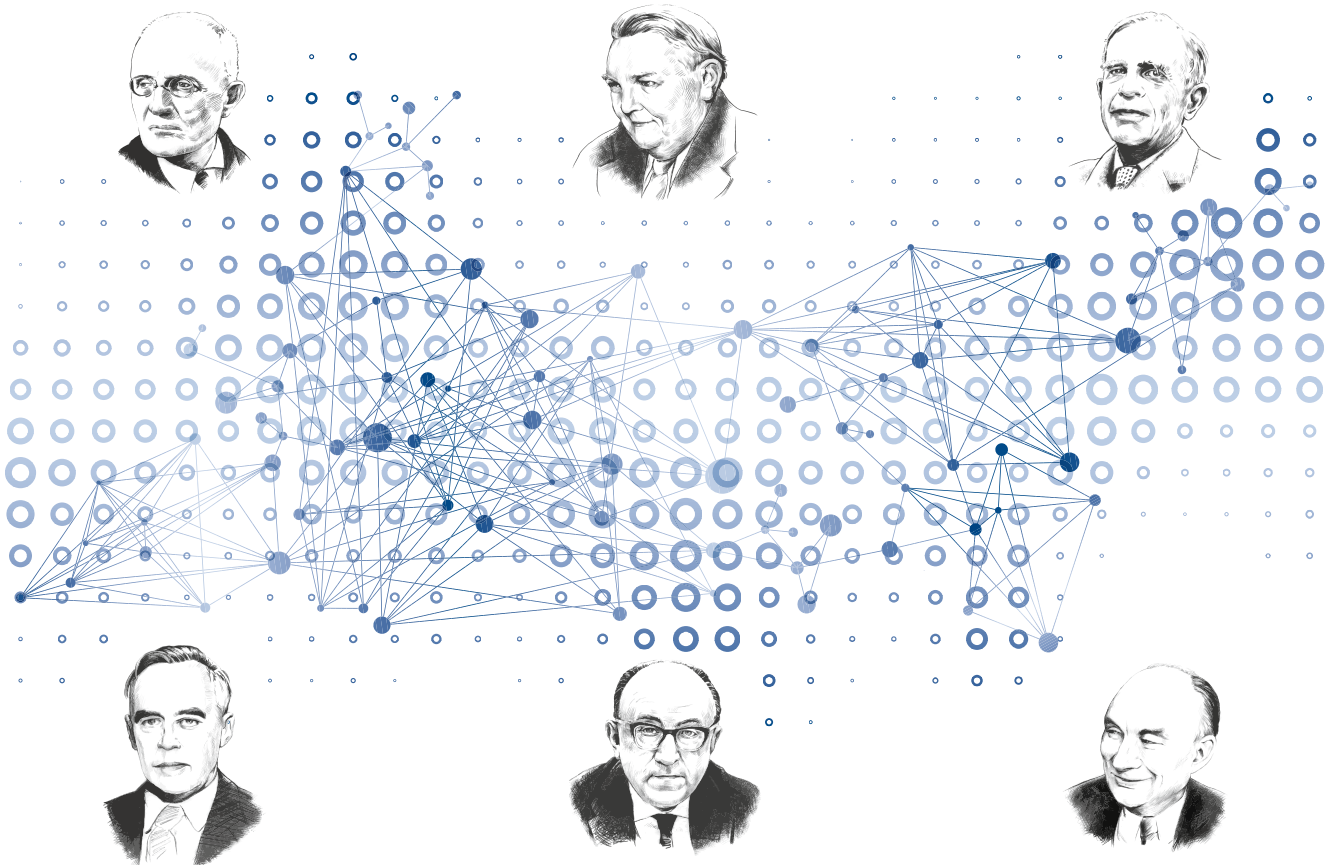
...the acceptance of differences in income, as long as the gap between rich and poor does not yawn too widely. This is when state distribution policies take over.

» It became clear that distribution of the national product through the price mechanism [...] is better than distribution based on the random decisions of private or public bodies. [...] But even this distribution mechanism is open to question and requires adjustment. [...] Income inequality leads to the production of luxury goods while the urgent needs of low-income households remain unfulfilled. This is where distribution within the competitive system requires adjustment. « (WALTER EUCKEN)

WALTER EUCKEN

LUDWIG ERHARD

WILHELM RÖPKE



FRANZ BÖHM

ALFRED MÜLLER-ARMACK

ALEXANDER RÜSTOW

According to the founding fathers, the Social Market Economy is based on a competitive system whose constituent principles include the guarantee of private ownership, rules on liability, freedom of contract and economic freedom, monetary stability, free market access and reliable and principled economic policies drawn up with a view to the long term. In a Social Market Economy it falls to the state to adjust the institutional framework so that microeconomic activities do not come into conflict with social aims and the freedoms of others.

...protecting nature, sustainable business and resource conservation.

» The need to protect the public against environmental damage means that the economy recognises and fulfils its obligation to develop new technologies that protect people from harm. « (LUDWIG ERHARD)

...a fair taxation system that asks individuals to make a contribution to the community in accordance with their performance.

» For example, it is extremely contradictory when citizens complain about their intolerable tax burden while at the same time expecting the state to provide the assistance that in turn gives it the moral justification to raise taxes still further. « (LUDWIG ERHARD)

...strong free enterprise and commitment to small and medium-sized businesses. The assumption of responsibility and risk is a major force in driving society forward.

» The assumption of responsibility [...] implies a system in which business-owners not only safeguard their economic livelihood but at the same time fulfil an economic duty, even if this is not always obvious to the individual. The business-owner is not even aware of this economic duty, but still fulfils it if the freedom to set prices and the driving force of competition are protected and vibrant within a free market economy. « (LUDWIG ERHARD)

...a flexible way of thinking that does not interpret freedom and social equity as opposites.

» The market economy is the most good-natured, strong-stomached and vital economic system that can be devised. As long as certain minimum conditions are met, it is astonishing how long it somehow continues to deal with poisons, foreign bodies and heavy loads. [...] But I would add that the digestive power of this strained system is not limitless. The longer the strain continues, the more obvious the damage becomes and in the end the system can no longer bear the load. « (WILHELM RÖPKE)

...fundamental considerations of »Ordnungspolitik« that should be enforced at European and global level in the interests of a stable economic system.

» If we successfully exercise the Social Market Economy in Europe, then at the same time we must pass on to other countries our inner sense of social responsibility, for which we have found solutions on a human scale. « (ALFRED MÜLLER-ARMACK)

...an ethical foundation for the economic and social system.

» Self-discipline, a sense of justice, honesty, fairness, chivalry, moderation, public-spiritedness, respect for the human dignity of others, strong moral values – these are all things that people have to bring with them when they enter the market and compete with each other. « (WILHELM RÖPKE)

...belief in people's talents and abilities, i. e. their capacity for freedom. This starts with the principle of personal responsibility, the protection of property, freedom of contract and decentralised decision-making.

» Civic freedom is an illusion unless it is rooted in the basic economic freedoms of the free movement of capital and labour, and the right to private ownership and to secure honest profits. « (ALFRED MÜLLER-ARMACK)



**Konrad
Adenauer
Stiftung**

The Konrad-Adenauer-Stiftung is committed to the promotion of these principles – in Germany, Europe and around the globe.



www.kas.de/social-market-economy