

# The German Social Market Economy: A Concept of the Past?

SEBASTIAN SPERLING

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## Abstrak

Sejak Perang Dunia II, Jerman menerapkan konsep Pasar Ekonomi Sosial. Tujuannya adalah untuk mengambil manfaat berupa efisiensi dari sistem Pasar Ekonomi Liberal yang memberikan kebebasan kepada masing-masing individu. Secara prinsip, konsepnya berlandaskan kesetaraan dalam hal kesempatan untuk hidup serta perlindungan terhadap hak politik, sipil, ekonomi, budaya, dan sosial masyarakat. Untuk itu dibutuhkan peran serta aktif pemerintah. Di sisi lain, sistem Ekonomi Pasar Bebas lebih mementingkan perlindungan individu yang disertai dengan peran serta pemerintah yang minimal dan kebebasan pasar. Paradigma antara paham Pasar Bebas dan Pasar Ekonomi Sosial tidak hanya menjadi diskusi dan perdebatan hangat oleh masyarakat internasional di era globalisasi ini, bahkan di Jerman sendiri yang menjalankan konsep Pasar Ekonomi Sosial.

Tulisan ini membahas tentang model Pasar Ekonomi Sosial yang dijalankan di Jerman. Pertama-tama, dipaparkan konsep dasar yang berlandaskan hak asasi dan keadilan serta perkembangannya selama ini. Selanjutnya dijabarkan peran pemerintah beserta instrumen-instrumennya. Agar mudah dipahami, konsep ini oleh penulis dibandingkan dengan konsep Ekonomi Pasar Bebas. Pembahasan berikutnya, dikupas tantangan-tantangan yang dihadapi oleh konsep ini. Pada penutup tulisan, penulis mempertanyakan apakah sistem ekonomi yang dijalankan saat ini di Jerman masih cocok dan relevan serta menjadi pilihan tepat dalam era perekonomian sekarang ini?

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**I**n November 2005, the Social Democrats (SPD) and the Christian Democrats (CDU) signed their coalition agreement: After 39 years of opposing each other, the two largest German parties agreed to jointly form a government under the lead of CDU chairwoman Angela Merkel. The so-called 'grand coalition' faces major challenges: It needs to jumpstart the job market, boost economic growth and at the same time consolidate the state budget and reform social welfare regimes. During the tough negotiations about the proper means to reach these goals, one question became central: How much state does one need? Karl Schiller, German Minister of Economy 1966-

1972, suggested a seemingly easy answer that is still quoted frequently: "As much market as possible, as much state as necessary". However, just how much state is necessary? The question about the role of the state and its relation to the market is at the core of a global competition between two systems, namely the Anglo-Saxon liberal market economy and the European alternative of a social market economy.

### 1. The Basic Idea

After World War II, many voices in Germany called for a state-led economy similar to the one that later evolved in the former German Democratic Republic. Mainly due to the experiences of the Great Depression that preceded World War II, the system of a liberal market economy faced strong resistance. It was in the struggle of these two opposing systems that the model of a social market economy evolved; a system that tries to combine the efficiency of markets with social aims (see Broyer 1996 for a discussion of the factors that affected the emergence and shape of the system and Zweig 1979 for a detailed analysis of its origins).

Almost all state-led models – most notably those of the Soviet Union and the German Democratic Republic, bitterly failed and collapsed in the early 1990s, leaving

struggling relics of the state-led model such as Cuba and North Korea aside. Today the only two main systems compete each others are Liberal market economy (e.g. USA) and social market economy (e.g. Germany). (see Meyer 2002, p.9)

Proponents of liberal and social market economies agree on that economic activity should be primarily guided by market forces, since all attempts to organize economic activities in the political or societal system have failed. It is widely accepted that the market system can lead to the most efficient allocation of resources. The basic principle is competition.

However, while liberalists assume that free markets result in perfect results, proponents of social market economy take into account the historic experience that free markets tend to fail and produce inequalities, injustice and even inefficiencies, e.g. due to concentration of market power. Thus, the idea of the social market economy is that markets need to be shaped, and its results sometimes corrected, in order to achieve social justice and prevent exploitation. Thus, proponents of the liberal and social model disagree on the role of the state in the economic sphere.

Liberal market economies rely on "laissez-faire"-policies; the state merely guarantees political and civil rights and provides the legal

framework and some basic public goods such as education (Reichel 1998, p.5). Distribution of welfare is solely left to markets. On the other hand, a social market economy uses the efficiency of the market system and shapes and complements it in ways so that its results are socially just (Reichel 1998, p.6). It relies on a strong state, a high government share in GDP (about 50%) and both demand- and supply-side policies that aim at economic growth and full employment. It includes comprehensive social policies and maintains comprehensive welfare regimes funded by a progressive tax system. As a result, Germany is known for its "institutionalized high-wage economy combining high competitiveness in world markets with strong social cohesion and, in particular, low levels of inequality" (Streck 1995, p.2). The system therefore meets the expectations raised after World War II as summarized by Stephan Zweig:

"... the Social Market Economy was not advocated solely for its superior efficiency, but for its unification of the spiritual, economic and humane requirements of life. It was seen as an order beyond supply and demand, hoping to soften social strife, class differences and alienation of work." (Zweig 1980, p.8)

In Germany, the concept is largely connected to the name of

Ludwig Erhard (1897 - 1977), Germany's first post-war Minister of Economy (1949 - 1963) and second Chancellor (1963 - 1966) who based the model on ordoliberal ideas of the so-called 'Freiburg School' (see Broyer 1996, p.8). However, following the ideas of Walter Eucken, Erhard assumed that a guided economy that largely trusts on market mechanisms automatically leads to social justice and increased welfare that eventually makes social policies dispensable. Yet, this did not materialize; despite economic success, both social democratic and conservative governments further expanded the welfare state and generally increased the role of the state since the late 1960s. They strengthened demand-side policies, used tax-money to provide more public goods, such as a clean environment, and hedged against more risks. Eventually, Germany took a road that is much closer to what Mueller-Armack, another scholar of the Freiburg School, proposed. The 'founder' of the social market economy, Ludwig Erhard, initially had a much smaller role of the state in mind (Reichel 1998, p.7).

Hence, German conservatives, liberals and social-democrats all use the expression 'social market economy', but they mean quite different things. To put it simple, there is a more (ordo-)liberal approach (as proposed by Merkel's

CDU and the German liberals, the FDP) with a smaller state, and, on the other side, a more social-democratic approach (as fought for by the SPD) with a much more active state. In order to allow for a better understanding of the differences between liberal and social democracy, in the following, only the latter is contrasted to the classical liberal market economy.

## 2. The Normative Basis:

TABLE 1: DIFFERENCES BETWEEN SOCIAL AND LIBERAL MARKET ECONOMY

Social Market Economy	Liberal Market Economy
Primacy of politics: Coordinated market economy	Primacy of markets: Uncoordinated market economy
Universal freedom: Equal freedom for all	Negative freedom: Maximum freedom for the individual
Balance between productivity and social aims	Focus on productivity
Strong welfare state	Basic social security
Protection of all five sets of human rights	Focus on civil and political rights

### Five Sets of Human Rights

To develop a deeper understanding of the two economic models, one has to take into account the normative basis of both liberal and social market economy. They do have a different underlying understanding of freedom, and a different approach to human rights.

Liberalists recognize three basic types of freedom that need to be guaranteed in order to make markets work:

1. Freedom of action and private autonomy, including freedom of contract
2. Freedom of opinion, expression and religion
3. Freedom of disposal of property, including its use as means of production

However, what if a person does not own property? He or she then is dependent on those who do own property and can offer him or her a job. Hence, the jobseeker could be forced to forego his or her first two freedoms. In fact, if you are struggling to survive, the first two freedoms are rather meaningless: For instance, freedom of speech is rather useless if one has nothing to say (because of a lack of education) and one has no means to distribute one's message and get heard. Thus, the right of property needs to be qualified by the condition of equal freedom for all people affected.

The German basic law guarantees the right of private property. But it adds that property carries obligations if it is used in a social context (e.g. as a means of production), and that property can be seized for the public good (e.g. through taxation). Freedom of property needs to be restricted where it impacts on the freedom of others. Thus, the question that

liberalism ignores is asked in a social market economy: What does it need to make freedom of all citizens reality?

With this universal understanding of freedom, social market economy is based on existing international law: 1966, two United Nations treaties on human rights have been established. Until today, these have been signed and ratified by 149 nations – the most recent one being Indonesia.

The first treaty, the “*International Covenant on Civil and Political Rights (CCPR)*” is monitored by the UN Human Rights Committee and includes the basic civil and political freedoms mentioned earlier (freedom of speech, etc.). In liberal market economies, only these two sets of human rights need to be protected. However, how can equal political and civil rights be ensured under unequal economic conditions? Economic inequalities lead to dependency relationships and exploitation. Economic and educational inequalities hinder the use of political freedom. Ultimately, economic liberalism endangers political liberalism.

Hence, the second treaty, the “*International Covenant on Economic, Social and Cultural Rights (CESCR)*” monitored by the UN Committee on Economic, Social and Cultural Rights, contains a number of additional rights, whose protection stands at the core of a

social market economy. Among others, these include the rights of social and economic equality; access to the labor market and the right to earn a decent wage; social security and freedom from hunger; access to basic common goods such as education and healthcare; protection of human dignity at the workplace; and protection of labor rights and trade unionism.

Eventually, these rights ask for a form of social justice (see Reichel 1998, p.6). However, there is neither a commonly accepted measure of social justice, nor a commonly accepted ‘ideal’ level of social justice. Hence, a shared understanding of social justice needs to be developed within a society. Winners and losers of the process must agree on a common definition and measures to achieve it. It needs citizens that are capable to act and willing to compromise, and have faith that a just settlement of conflicts is possible.

In this sense, the social market economy is based on a different idea of man – one that does not regard individuals as selfish utility-maximizers, but as self-interested individuals who also care for social peace and the coherence of society.

To achieve a sustainable and widely accepted definition of the term ‘social justice’, a discursive political sphere is essential. For the political process, civil and political rights must be guaranteed for all members of society. Thus, eventually,

both political and civil and social, economic and cultural rights complement and require each other (Reichel 1998, p.9).

### 3. The Role of the State

On basis of the five human rights, both state and citizens face a couple of obligations. In Germany, the state uses economic and fiscal policies to ensure stable prices (something which is now done by the independent European Federal Reserve Bank), high employment and a balance of trade. In 1967, these aims of state policy were formulated in the so-called "Stability Pact". Secondly, the state offers social protection against risks that violate citizens' basic rights. It hedges against socio-structural risks (e.g. unemployment) and socio-technological risks (e.g. nuclear disasters). Thirdly, the state guarantees equal opportunities (access to education, culture, jobs), and safeguards citizens' dignity in economic and social contexts.

The state uses a whole range of instruments to fulfill this role and live up to the expectations:

- The state creates public demand to ensure stable growth. Applying Keynesian policies, the state smoothens economic cycles by saving money in times of booms and spending money in times of busts; for instance, even the new government - despite being committed to belt-
- tightening - agreed on an investment package.
- The state organizes social insurance against financial hardships (socio-structural and socio-technological risks) based on the principle of solidarity. Most importantly, social insurance regimes hedge against unemployment, health risks and accidents at work. A pension system and transfer payments such as child benefits or the promised parenthood-compensation payment also belong into this category.
- The state organizes the provision of public goods; goods that would be produced insufficiently (or would be too expensive) in the market sphere. They are either provided by state agencies, or the state controls and regulates private actors providing these goods. They are mainly financed by tax income and include infrastructure, culture, a clean environment, education, etc.
- The state promotes full employment, particularly by promoting labor through job agencies and organizing job placements, vocational trainings, etc.
- The state regulates markets in order to guarantee competition (e.g. through a Monopolies and Mergers Commission), and in order to protect consumers and/

or the environment (for example by establishing process or product standards).

- The state shapes the framework for a social partnership between employees and employers and a system of codetermination. On industry level, trade unions ('unity unions' that represent all workers in one industry) and industry associations decide on working hours, holidays and collective wages. On company level, co-determination functions through work councils in firms with at least five employees. Furthermore, supervisory boards have to consist of equal numbers of shareholders and labor representatives. Thus, the state makes sure that democratic legitimation is also given on corporate level (see Broyer 1996, p.13).

However, the citizens have duties too: A social welfare state can only function if its citizens assume responsibility for their own lives and request aid of the community only to the extent that their own efforts to earn a living have not met with success. The current reforms emphasize this personal responsibility, for example by combining welfare transfers such as unemployment benefits with the recipients' obligation to actively look for a new job. A heated debate evolves around how the exploitation of welfare payments can be avoided.

How can the social net be designed, so that it secures living standards in times of hardships while at the same time providing enough incentives to get into employment and out of the welfare dependency?

#### 4. Challenges Ahead:

##### The Battle of the Systems

The German welfare state and therefore the whole concept of social market economy is under pressure. Germany has experienced slow growth for the last decade and has high public debt - partly due to the re-unification (see Siebert 2003, p.4). High unemployment (more than 5 million Germans are registered jobless) and an ageing population put further pressure on the social welfare system. The solidarity principle is put to a test, since less and less employees have to contribute for an increasing number of welfare recipients. The individual burden grows. Moreover, the trend towards 'individualism' further strains society-wide solidarity (see Giddens 1998, p.34).

Germany also feels the pressures of globalization processes. Capital has become increasingly mobile and volatile, and an increasing number of powerful multinational corporations can easily withdraw from the grip of the state. Firstly, this leads to tax evasion. Multinationals juggle their budgets and shift their profit within their complex organizational structure until there is nothing left

to tax. Secondly, these multinationals use their bargaining power vice versa the state to push for reduced labor, environmental and consumer protection standards. The EU enlargement has furthered this trend.

Thus, societal trends, economic stagnation and economic globalization arguably torpedo the basis of social market economies. The neoliberal voices become louder. Already in June 1996, Klaus Friedrich claimed "the end of Germany's economic model" in the *New York Times* (Friedrich 1996). Many liberals and conservatives – pre-election Merkel was among them – argue that in the current crisis of social market economy, there can be only one medicine: Less state, more market, back to the liberal market economy. Is this so? There are at least four arguments against the conventional wisdom that globalization unavoidably requires a suspension of the social principle and an adoption of a liberal market model.

Firstly, a closer look at individual state responses to globalization pressures reveals that there is no uniform pattern. Instead, national institutions moderate the effect of globalization, as Linda Weiss has convincingly shown in her book 'Globalization and the Myth of the Powerless State' (Weiss 1997). Moreover, Layna Mosley has shown that the influence of international

financial markets is limited only certain state policies, while states still have "room to move" in most policy areas (Mosley 2000). Some states, most notably the Scandinavian ones, have in fact deepened state involvement and further developed the idea of a social democratic model of the social market economy. Nevertheless, despite all liberal predictions, they are highly competitive in global markets. They have developed a successful 'third way' as demanded by Anthony Giddens (1998). Thus, a reduction of state's share in GDP is not the only answer for globalized economies; in fact, Dani Rodrik (1998) has shown how and why economic openness and the size of the government correlate positively.

Secondly, liberal market policies – such as deregulation of the labor market – do not necessarily improve life chances of unemployed, and they do not necessarily make corporations more competitive. The US, for instance, has relatively low unemployment rates, but mainly due to a large low wage sector. The system is based on a labor force with limited skills. Thus, American corporations and the economy as a whole are highly flexible and can easily and quickly adapt to new market situations. However, social market economies such as Germany develop different strengths. Due to more stable corporate financing, long-term employment relations and



a generally better qualified workforce, German corporations can more easily follow long-term strategies (see Dore 2000, p.116).

The third argument is a normative one and is based on the five human rights secured by the two UN covenants. In times of increased insecurity and volatility, the need for a strong state that moderates the effects of globalization and cushions the falls of the losers is greater than ever (see Rieger & Leibfried 1998, p.363). Human development should be a progression. Securing only political rights and giving up the attempt to also balance economic, social and cultural rights would be a step backwards. The fact that Angela Merkel – despite voters' disappointment with Gerhard Schröder's government – failed to gain a majority for her neoliberal reform agenda underlines that a majority of Germans does not want to give up on these rights and principles.

Finally, hardly anything in the sphere of political economy is unavoidable, as globalization critics and proponents alike want us to believe. Globalization itself is man-made, and it follows rules that politicians set up, or deliberately decided not to set up. The global economic system in place – particularly in the capital market – is based on liberal ideas. There is a real possibility to change this, by adopting principles of the social

market economy on a global level. The goal is efficient global markets, embedded in a global society and a global set of political rules that secures civil, political, economic, social and cultural rights. Today, the 'unavoidability-argument' and the reference to allegedly overwhelming globalisation pressures is more often than not just a welcome and fashionable instrument used by many politicians to justify welfare cuts and unpopular reforms. There is a chance for a global social market economy.

### 5. Summary and Conclusion

The concept of social market economy aims at taking advantage of the efficiency of the market system and fitting it out for serving the freedom of the individual. It is about equal life chances and the protection of political, civil, economic, cultural and social human rights. Social market economy is based on solidarity and social partnership and the belief that all citizens are not only self-interested, but also care for the common good and social peace.

Social market economy is not an easy recipe. It is about achieving compromises and finding the right balance. Productivity and growth, flexibility and innovation have to be balanced with social justice and social security. Goals of rising living standards and free consumer choice collide with the aims of full

employment, ecological sustainability and long-term economic prospects. Current budgetary constraints, societal trends, economic stagnation and economic globalization make it necessary to discuss and agree upon new equilibriums. In particular, social welfare regimes need to be reformed, while the job market has to be jumpstarted.

Germany's federal system and its corporatist structure have made reforms difficult in the past, as Schröder's government has experienced. The 'grand coalition' has got the potential to overcome these reform barriers. However, it remains to be seen whether the new government manages to develop a coherent vision of a new social market economy. So far, a clear concept of a new 'third way' has not emerged.

Being Europe's largest economy, Germany's development will be watched closely. A successful reform of the welfare state that is sustainable and socially just and does not give up on the protection of social, economic and cultural rights could be a strong signal for Europe, which is still looking for its common economic paradigm. Ultimately, Germany could prove that not only relatively small economies such as the Scandinavian ones can successfully maintain social market economies, and that social market economy can serve as a

model on a global scale. After all, so far, the prevalent liberal order has not delivered what it had promised for all those developing countries that have subscribed to this economic paradigm – it is time to try the alternative. □

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