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The economic and Social Content of „Social Market Economy“

The notion of ‘Social Market Economy’ is again politically important. It figures as a constitutional norm in article I-3(3) of the draft for an European Constitution. So there are reasons enough to ask what the meaning of the notion is. It is very likely that it is not attractive in the broad public because of the profound knowledge of the writings of its theoreticians like Eucken, Müller-Armack, Lippmann or Erhard. The popularity of ‘Social Market Economy’ is rather due to its associative property, i.e. to the positive feeling, memory and thought, which is connected with words as ‘market’ or ‘social’. Thus the word order is highly suggestive: Like any suggestion it tries to influence our thinking by circumventing the rational part of our personality. Müller-Armack (1973, 181), who probably invented the term, enjoys the effects of his creation when he writes that the use of this notion led to substitute in the German language usage the word ‘capitalism’ (which he qualifies as emotional) by the more neutral notion of Social Market Economy. Partly this refusal of the notion ‘capitalism’ is due to the neo-classic standpoint of Eucken: As known, neo-classic abstracts from historical development and its different stages in order to deal with the mere ‘economic’, which it sees in utility maximisation by exchange. But neo-classic would not hail the word ‘social’ – in the strict sense of this theory it is meaningless.

1. The offspring of the concept: Liberation of the state by perfect competition

Ordoliberalism with its origins in the 30ths is the theoretical basis of what has later been outlined under the label of Social Market Economy. This concept should start a new political and social order. With some reservations it may be understood as an early German version of neo-liberalism. At the beginning, the hard core of this neo-liberalism was to complain the failure of laissez-faire liberalism in the domain of competition: It had allowed the formation of market controlling firms, which violently jeopardized the existence of small business. Thus, literally taken, the aim of neo- or ordoliberalism is to implement perfect competition in order to stop the threat for small business. Small business saw itself sandwiched equally by big firms, welfare legislation of the Weimar Republic and trade unions. Thus, in addition to the duties of the state as claimed by Adam Smith, the state has to organize and to grant perfect competition on all markets – the labour market included. It has to deprive of power big business as well as trade unions. Power- and thus pressure groups should lose their influence. Perfect competition, Eucken (1975: 293) emphasises, frees the state from private power groups. In this way the sphere of the state and of the private economy can clearly separated from each other. Private property in the case of perfect competition – he continues (Eucken 1975: 274, similar: 334 and 1989: 201) – means powerlessness; it is no longer possible to reduce the freedom and the right of disposal of other owners to the disadvantage of all.

Already 1932 Eucken formulates the outlines of what afterwards has become the capture theory of the state: The state is weak because he tries to be omnipresent as intervention state. If the State becomes aware, how big the dangers are which the interconnection with the 'economy' engenders, if he finds the power to free himself from the influence of the masses, then also in the traditional capitalist countries the ground is prepared for further development of capitalism in a new shape. (Eucken 1932, 318) The masses have destructed the traditional state structure of the leading capitalist countries, they have created the intervention state. Thus the old state system has been disintegrated. The organisation decays, in the frame of which the capitalism has come into being, the organisation, without which capitalism can neither develop its powerful forces nor exist at all. (314) It is worthwhile to note that modern predominant economic theory argues similarly.

Immediately after World War II the attack of Social Market Economy on power groups led to violent criticism of monopoly profits. The program of Christian Democrats (CDU 1949) argues that the laissez-faire economy has led to rent income of entrepreneurs instead of profit as income for entrepreneurial efficiency. The result is an anti-social income distribution. Only Social Market Economy is able to eliminate parasites in all domains. The political practice in this time however shows that the fight against monopolies was more a popular slogan than a serious concern. Anti-trust laws were legislated in West Germany only in 1958 after permanent pressure of the United States. As a consequence of pressure groups activities, these laws were not at all drastic. One of the main arguments of the adversaries of strict anti-trust legislation was that technical progress cannot be realised by small business. This was backed by the arguments of Kantzenbach (1966) who introduced a specific interpretation of workable competition in the German debate. He provoked hard critics by the traditionalist Hoppmann (1966). So it is not surprising that one decade later the accentuation changes: The authority of the state is now in the first line endangered by the trade unions as a monopolist in the realm of labour supply. Twenty years later Müller-Armack (1969, 134) comes to the result that it is a far-fetched idea to believe that entrepreneurs in a strict sense exercise power in our society. Even if big fortunes are invested in the firms, which serve as object for sensational reports in the newspapers: in fact they have far less power than other organisations such as the trade unions, the political parties and even the churches.

To prevent the power of trade unions on the labour market, Social Market Economy requires free contracts of employment. The state action has to be restricted to the supervision of the forms in which the economic process operates (property rights, competition and the like). In the area of the markets, and also on the labour market, there has to be freedom. This is the goal. (Eucken 1975, 189f) And further: Workers and employees are weakened in their social position by the removal of the free contract of employment. Men fall under a apparatus and in the hand of functionaries, who dominate them. (192) Trade unions are obsolete. For in perfect competition an anonymous economic process apportions income. Income distribution does not follow ethical guidelines; instead it is let to a ethically indifferent automatism. (Eucken, 1975, 300) But this indifferent principle of perfect competition is nevertheless the condition for the realisation of social justice (315), for it apportions income according to the service performed for the consumer.

2. The difference between the Welfare State and Social Market Economy

Under these conditions a majority for the project of Social Market Economy could be formed by small business and by all these workers who are at least indifferent to labour movement. But for reasons of stability of the new system positive experience is needed, i.e. full employment and social security. This leads to the question which theory explains correctly the functioning of developed capitalist economies. Is saving and investment brought to the full employment equilibrium by the interest mechanism or has saving to be determined politically (among other factors) by income distribution and investment by interest policy? So the stability depends on whether Keynesian theory of demand restraint or neo-classic theory are valid. If neo-classic does not prove its worth, permanent unemployment and low wages will be the central issue. (Modern neo-liberalism found a solution for this: Not – as neoclassic assert – the maximisation of output or employment is the very aim of the economy, but individual freedom: Neo-liberalism does not maintain the efficiency criterion of neo-classic, i.e. the statement, that perfect competition leads to maximisation of allocation efficiency.) Social Market Economy – even if it has to be understood as the precursor of modern neo-liberalism – maintains the neo-classic efficiency criterion. Müller-Armack (1956, 390) writes that on the basis of an economy with perfect competition both, free initiative and social progress as secured by the efficiency of the market, are combined: The principle of freedom on the market is joined to social balance. This is what Müller-Armack called the “irenic formula” of Social Market Economy.

This idea of social balance is what makes the difference between the Social Market Economy and the Welfare State of social democratic and Keynesian tradition: The “irenic formula” simply aims what is called ‘social peace’. Public social expenditures (the interference of the state in income distribution) depend on the intensity of social unrest. In contrast to this, Welfare State expenditures are based on labour productivity and the requirements of sufficient effective demand. As mentioned above, the leading idea in this case is that income distribution in favour of mass consumption (a political action) lowers the rate of saving, increases by this demand and leads to full employment. From a capitalist point of view, in both cases the final goal is to preserve the system, but it makes apparently a difference, whether this follows from the conviction that less autonomy of entrepreneurs (as based on the market – in particular in the realm of income distribution) helps to stabilize the system – or from the requirement of making preventive or immediate concessions to face social unrest. Or in other words: The welfare state concept is aware of the (possible) difference between the amount of welfare as feasible in the face of productive forces on the one hand and the effectively realised welfare on the other hand. It aims to bridge the gap by interfering with property rights on national income. Demand creation welfare expenditures are an *endogenous* variable in the system. Social Market Economy on the contrary basically trusts in the forces of competition and market. Social policy is *exogenously* determined by humanitarian convictions or by the necessity of concessions. The welfare state is inherently emancipatory: it is based on rational appropriation of the system and it is prepared to question it. Social Market Economy is profoundly paternalistic as patronizing care.

Eucken himself (1975, 301) makes the macroeconomic difference clear: He reproaches the distribution policy of Great Britain or the USA for using tax policy to come to more employment. This policy aims to prevent excess saving.

It sees a danger in high incomes, of which a great part is saved. Eucken denies this view and emphasises that, if saving is diminished, less investment is the consequence.

3. The future of the notion

The debate in Germany on Social Market Economy is rather confusing: Christian Democrat Party and employers associations have started a campaign for a 'New Social Market Economy' The difference between the old and the new concept can best be shown by the slogans 'Welfare for all' (Erhard) and 'Chances for all' (New Social Market Economy). The welfare formula is based on neo-classic promise, that perfect competition on all markets leads automatically to a maximisation of employment and output. This classic promise of the wealth of nations is apparently in conflict with reality: The experience is prevailing that less regulation on the labour market and less welfare state goes hand in hand with more unemployment and sluggish growth. (Exceptions are seen in particular in the United States and – to a certain extend – in Great Britain. But one should note that this is due to Keynesian conditions: low rate of interest, low rate of saving, high government deficits.) Given this experience, employers associations can no longer found their interest of lower costs on the promise of more employment. Thus the arguments turn definitely to modern neo-liberalism: Just as Hayek (1969) has underlined, the aim of the economy is not to fulfil the neoclassic performance criterion of maximising allocation efficiency, but to grant individual freedom on the market. The social result is open in the sense of the 'Open Society'. This undetermined outcome has to be accepted for reasons of positive evolution. For if political goals as full employment are set, this is only realisable to the detriment of freedom, which in turn is the precondition for positive evolution. The new aim 'Chances for all' refers to procedural justice as claimed by Buchanan and many other neo-liberal authors: *Formal* equality for all on the market, that is what the state has to grant. As the Christian Democrats leave the terrain of their traditional Social Market Economy, this terrain is now occupied by the new Social Democracy. This is combined with violent attacks against some aspects of modern capitalism such as the actions of investment funds and the like.

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