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KÖRÖSI, ISTVÁN¹

THE RENEWABILITY OF THE SOCIAL MARKET ECONOMY IN THE EUROPEAN UNION

The positive functioning of social market economy, in its totality, could be experienced in Germany, Austria, the Netherlands and a couple of other countries of North and Western Europe from the postwar years up to the 1970s. From the 1970s to the present, however, its erosion, distortion and decline in efficiency has been observed. Four main questions can be raised: 1. What are the main theoretical and conceptual elements of social market economy which are durable? 2. On what sort of economic policy strategy was it based on, and why was it successful in the period following the Second World War? What sort of crisis factors caused its erosion? Can social market economy be renewed, and what challenges does it face today?

The Theoretical Roots and the Concept of Social Market Economy

The principal, durable and constitutive elements of the classical system of social market economy will be first summarised. According to the main founders and classical representatives of social market economy, it was a theoretical economic and social policy system, an economic policy concept and a system strategy all at the same time. The theoretical foundations were laid down by Wilhelm Röpke, Alexander Rustow and their associates. It was also related to the economic policy concepts of the "Freiburg School", represented by Walter Eucken, Franz Böhm and their associates, also referred to as ordoliberalism (of the main assumptions of which are different from the present ideas of neoliberalism). The practical application of the idea of social market economy can be attributed to Alfred Müller-Armack and Ludwig Erhard.

The "Freiburg School" was named after a group at Freiburg University, the members of which defined themselves as *ordo-liberalists*. Their idea was based on a free economy and responsibly acting individuals on the one hand, and the relations between the individuals and the state on the other. The framework of the state guaranteed a free market system in which the individuals could unleash their creativity. According to Oswald von Nell-Breuning, the labour market in itself was not a correct notion, as labour is more than a commodity; beyond simple human subsistence, it is a way of self-improvement and perfection.

The two bottom pillars of the system of social market economy were the *ordo-liberal* concept of the Freiburg School and the Christian social teachings represented by Alfred Müller-Armack. Their common feature was the active, responsible and personal initiatives of individuals under the clearly defined roles and *Ordnung* policy of the state. They rejected the direction and intervention of large paternalistic states. But in order to enforce social justice, they equally rejected the unlimited role of the market.

Their concept of system theory and system policy was based on connecting individual freedom, economic efficiency and a responsible social commitment. It was argued that market control guaranteed fair conditions for competition and prevented cartels and the abuse of economic power. As indicated by its name, the idea of *ordo-liberalism* was based on connection of order and freedom. Its pillars were: a functional competition order of dynamic economy, a financial order securing the stable value (relative) of money, and a social order securing social justice with fair equalisation. *Ordo-liberalists* supported the expansion of markets and development based on innovation, while preventing the power concentration of markets; the dictate of big actors and collusion. According to them, these were secured by a complex system of the control of competition policy, the significant weight of numerous producers and consumers, small- and medium-sized enterprises, the existence of a large middle class (*Mittelstand*) and a vivid and efficient market competition. In the present, the distortion, the absence and the anomalies of these elements prevent the proper functioning of social market economy.

Current order based on the relative stability of the value of money was considered important due to the negative experiences of hyperinflation following the two world wars. Inflation disorganises the economy; as tax of the poor it bankrupts society. It leads to the further degradation of poorest of society, hinders foresight and parodies long-term investments and savings.

In Germany in the 1950s, which was the golden age of social market economy, crediting was based on savings; money distributing credits dominated as opposed to credits based on money creation. Ever since then, this situation has fundamentally changed and the quantity of money has been diluted. It was a classical principle of key importance that state intervention and activities should be decisively market-conform. In absolute terms, this was never established, and in the last few decades the efficiency of state intervention deteriorated.

Decisions on production were left basically to the market and production expanded according to market demands. Later, it became clear that the development of supply had a great role, as demand is induced by more developed products and services that are qualitatively new. Nowadays, this has a particular importance, as there is a large demand for novelties, even though there are limitations due to the narrow purchasing power. A good example is the dynamically expanding market of information products and services. The other dynamic field is the renewal and development of public infrastructure and services. In the early period of social market economy, the solution of these objectives had a dynamising impact; they can play, however, a similar role in the present, too. The basis of the expansion of production was that investment should be profitable to companies. Therefore, the interests on credits should not be higher than the net profit rate realised in the company sector.

The basic principle of social market economy was that market freedom should be combined with social compensation. (This compensation is not automatic and it does not result in the total equalisation of burdens.) It was assumed that based on principles of performance, social justice and fair distribution, the synthesis of economic efficiency and social welfare can be achieved. Centralised planned economy and "laissez-faire" capitalism were equally rejected. According to its founders, social market economy was an economic system which based economic efficiency on the principle of performance and social justice on redistribution. According to this concept, public welfare was expected emphatically from the performance and stand of individuals and companies in fair competition, while it was also evident that redistribution could reduce an

¹ Dr. István Körösi is Associate Professor of Economics at the Pázmány Péter Catholic University, Budapest, and Senior Research Fellow at the World Economic Institute of ERRC of the Hungarian Academy of Sciences

interest in better performance. It was believed that individual interests could be harmonised with public welfare. The basic means of coordination was fair competition, and its rules were fixed, supervised, guaranteed and secured by the state.

The main characteristic of the idea of social market economy is that an equilibrium is needed between individual freedom and public welfare on the one hand, and between performance and social justice on the other. According to Röpke and Rüstow, humans are intelligent beings with a right to free development, but not on the expense of others.

According to the *ordo-liberalism* of the Freiburg School, the state must create and maintain the institutions and frameworks of all economic activities. According to systems theory (*Ordnungstheorie*), a functioning and humanistic system is required that is served by system politics (*Ordnungspolitik*). Müller-Armack gained credits with the definition of the role of the state in system politics, while Erhard did the same with the determination of economic policy strategies and its main directions and practical implementations. Millions of individuals and companies strive to maximise their performance, and a well-functioning competition gives them the necessary framework to do so. In the process of development, priority should be given to a rational and economic behaviour and to increasing productivity and innovation. The successes of these policies were well demonstrated in the period of 1948–73, which led to a durable economic growth in Germany and in all the countries that followed that model.

It is not by accident that *ordo-liberalism* is rooted in Germany. Its main representatives all experienced the decline and collapse of the Weimar Republic, which demonstrated the full failure of a certain economic and social model. As the *ordo-liberals* stressed, state intervention should not be directed against market laws; rather, it has to promote their proper operation. Their original theoretical concept was in sharp contrast with “laissez-faire” capitalism and the vulgar liberal thinking of today, which has absolutely nothing in common with either *ordo-liberalism* or with the classical theories of Adam Smith.²

The founders of social market economy cannot be evaluated uniformly; there were significant differences in their views. Ludwig Erhard and Walter Eucken agreed that the intervention of the state should be limited, targeted and clearly defined. For the sake of public welfare, Wilhelm Röpke and Alfred Müller-Armack envisaged a relatively broad role for the state as being both justified and legitimate (Reinhard Marx, 2009, 80, p.). According to Müller-Armack, the principle of market economy should be connected to social equalisation. It is important to note that he proposed to solve this through market services. In 1938, during a Walter Lippmann Colloquium, Rüstow characterised *ordo-liberalism* as a “servant of humanitarianism”.

The *ordo-liberal* school is against free competition markets, because spontaneous and free markets can create large-scale fluctuations in the economy, leading to oligopolies that cause undesirable distortions and income differentiations, unrelated to real performance. Representatives of the Freiburg School such as Walter Eucken or Franz Böhm preferred taking steps against the restraints of competition and the concentration of economic power. Alfred Müller-Armack and Wilhelm Röpke placed emphasis on a state-induced and supervised social security system, while they also stressed the importance of individual responsibility and self-

reliance. In 1946, Alfred Müller-Armack defined the “term of social market economy”, which is based on competitive economy. It induces free initiatives, while regulating the policy of social progress. Social market economy is a system of an economic idea, and at the same time, an economic policy program and its application, which in Germany and other countries have gone through many changes. According to the definition of the principle of social market economy by Müller-Armack, “Provide place for free market economy as much as possible, and to state intervention as much as needed for its smooth functioning.”

Walter Eucken had two significant works: “Foundations of National Economy” and “Principles of Economic Policy”. The titles are clear indications that one of the founders of social market economy considered it important to summarise the consistencies of national economy and to establish the cornerstones of economic policy. As far as the works of Wilhelm Röpke are concerned, the “Social Crisis of Our Age”, published in 1942, received prominent international attention. This work was published in Hungary as early as 1943 with the title of “Third Road”. His other important work was “Civitas Humana”, written in 1944 and published in English in 1948 with the title “The Moral Foundation of Civil Society”. In these works, he stressed that society needs a firm value system and moral foundations. His economic thinking had two key elements: monetary stability and a balanced budget. Guaranteeing firm financial relations is the basis of stability and durable economic growth. According to his views, the state should be strong and efficient, and it should guarantee the institutional frameworks of a well-functioning market economy.

The major aim of social market economy is to increase welfare. Social market economy and the welfare state are closely connected, but they are different and sometimes even contradictory in many fields and respects. The former considers the principle of performance as a cornerstone and places emphasis on individual initiative and work on the one hand, and on success in fair market competition on the other. Redistribution is an organically connecting element, but it is considered only as a tool for promoting social justice, and not as increasing welfare. The proper functioning of social supply systems is an important objective of social market economy, but it does not contribute to welfare.

In the greater part of the second half of the 20th century, the notions of social market economy and the welfare state were closely connected. The original concept of the welfare state placed emphasis on the well-functioning of welfare systems; i not just about a donor state. Later, the centrality of performance and individual initiatives were gradually pushed into the background, replaced by more extended and bureaucratic systems, and, with the growth of a paternalistic welfare state, the general neglect of performances. The result was a great increase in the deficit of welfare expenditures, connected with budget deficits of the state to a large extent. The unlimited growth of welfare state payments has become unsustainable.

It must be stressed that the social supply systems of the welfare state should not be abolished, but rationally rebuilt and made sustainable from a financial point of view. Social market economy is still functioning, but, in the succinct words of András Schlett (Schlett 2010), the traditional “time of the welfare state is up”.

The practical implementation of social market economy took different forms in the framework of different models. As the Scandinavian, Anglo-Saxon or Rhine models of market economy demonstrate, there is strong competition among these models or socio-economic systems.

² The two classic works of Adam Smith are the “Wealth of Nations”, published in 1776, and “Theory of Moral Sentiments”, which appeared in 1759.

Scandinavian models, in terms of their economic, financial and social acceptance, seem to be successful, as they can find a compromise between the renewal of the welfare state and the increase of efficiency. "Flexicurity" is the combination of flexibility and security both in economy and social supply. The Scandinavian countries effect significant economic growth and structural modernisation; their active labour market policy combines employment security with the flexibility of the labour market. These policies connect large-scale social solidarity with the efficient use of resources and the protection of the environment.

The Anglo-Saxon models place emphasis on increasing economic efficiency and promoting performance. They implemented large-scale privatisations which partly enforced structural modernisation, but these also lead to negative consequences (British Railway). This model pays less attention to the losers of structural modernisation. Financial services are developed, and the model is more successful in the stabilisation and encouragement of entrepreneurs. Innovation and R&D is strongly encouraged, and the sustainability of development is secured.

Germany represents the classical example of the continental (Rheine) model, with the problem of slow growth, rigid regulations and the reform constraints of welfare systems, due to high contributions. Due to these reasons, domestic investments are permanently low, with high unemployment and the flowing of capital abroad. The problems of competitiveness are compensated with high technological levels and the high quality of goods and services. (Kötros, 2010)

In social market economy, the resources for social justice and progress are secured through the economic efficiency of the market and an increase of the national income. The economic and social policy spheres are closely interconnected. Social justice should not be based simply on just redistribution; the proportionality of performance should also be taken into account (pensions). The extent of redistribution can depend on historical traditions, broadly accepted social, political and economic preferences and performance capacities. Switzerland and Sweden are good examples, as a similar level of welfare is achieved through very different levels of redistribution and the role of the state. If the incentives for performance are reduced, the efficiency of market economy and its operational capacities can deteriorate. According to Hans-Tiemeyer, "If there is no satisfactory performance, then there is nothing to be distributed, as in the absence of proper redistribution there can be hardly any functioning market economy." Redistribution should not mean the equality of poverty. According to Ehard, "Not the rich should be more poor, but the poor should be more rich." Personal responsibility should be particularly stressed, as everybody should forge their destiny according to their abilities. The middle class (Mittelstand) should play an important role in the development of economy and flexibility. This means the promotion of the development and role of individual careers as an important counterbalance against excessively large companies.

According to the classical representatives of social market economy, this system was conceived not simply as a sum of market economy and the social state, or that of competition and redistribution, but as a system policy that secured social stability in order to avoid crisis. These characteristics provide an explanation as to how from the 1970s up to the present these factors and considerations changed and practically disappeared. In the past 40-45 years, an increase of the disfunctioning of the role of the state and the economy can be experienced, while crisis factors have deepened and become more permanent.

The Relation of the State and Market – Priorities of Economic Policies and their Application

Social market economy assumes a strong and active state. In many fields, self-regulating markets function badly, or do not function at all. Market competition, even with proper competition policies, can function properly only if the following criteria are met: 1) there is a great number of producers and consumers; 2) there is no unilateral market supremacy and vulnerability; 3) there are proper information- and decision-making possibilities; and 4) the control of actors and the bargaining positions among them are balanced. In principle, the state should intervene only if any one of these conditions is missing. In the past decades, there has been a substantial deterioration of these factors. The power of transnational companies has drastically increased, and the growth of oligopolistic relations has shaken the foundations of social market economy.

For the sake of public welfare, the state should increase its role in public health, education, R&D, the protection of environment or the development of public infrastructure. As the share of these sectors is fortunately increasing, this should be reflected in the financing of the state budget. It would be appropriate to both keep and place a part of the public services or some of the infrastructure into public ownership. The state has system policy duties, and it should be a matter of concern how these can be better served.

In social market economy, the state has an eminent role in finances, development policies or policies related to external relations and integration. An active cyclical policy has particular importance. According Müller-Armack, cyclical fluctuations are necessary concomitants of any development. Since the crises of the 1970s, the state has been less able to influence these changes. In the development of infrastructure, a larger state role would be needed. The best examples for this are road constructions, the development of public transport or energy systems (gas and oil pipelines, electric networks, etc.)

The achievements of the most important economic policy objectives cannot be simply left to market automatism, and nowadays this is especially the case. The transparency, reliability and consistency of economic policies have rather deteriorated, and in the EU countries this contributed to the deepening of the crisis both in the 1970s and after 2008. It is no question that this calls for the renewal of social market economy. Various elements of economic policy (price policy, market policy, trade policy, agricultural policy, monetary policy) should be harmonized with one another; they should follow the same principles, and should constitute a unified whole that is free of internal contradictions and does not eliminate itself. (Köpke)

The principal theoretical and economic policy content of social market economy is unambiguous, although there are differences among its theoreticians and economic policy makers. The differences are particularly substantial on which countries can be considered social market economies. Germany is the model state, followed by Austria and the Netherlands. Scandinavia is a special case, particularly due to its individual welfare models. France, and in general Western Europe, can be considered as a social market economy, but in terms of the extent, proportions, and directions of state intervention, there are great differences. The European Union defines itself as a social market economy, and since 2007, this idea has been fixed in the Lisbon Treaty ("globally competitive social market economy"). Beyond this commitment, the practical question still remains whether divergence or convergence is greater

among the 28 countries. In order to answer this question one needs to consider whether differences in the systems are more important than those in the levels of development.

The question arises as to what are the main causes of erosion and the recent unsatisfactory functioning of social market economy. The answer can be found by looking at Germany, but Germany's problems are not unique; they can be found in other countries as well, and often in more serious forms. Before going into more detail, it is worth looking back at the initial difficulties. The introduction of social market economy in the summer of 1948 was far from smooth. The currency reform worked out by Erhard in the June of 1948 was introduced in practically a single day (in one night between June 20 and 21). After the introduction of the DM, in half a year, due to price and wage related problems, there were two motions of no confidence in the economic council. From the allied forces, the American General Clay expressed his anxieties to Erhard, as, according to his experts, the whole process was going badly, and the currency reform was a basic mistake. Erhard answered the following: "Mr General, you should not worry, my experts say the same". In the months that followed the introduction of the DM, the prices started to increase, and the DM had to be devalued against the dollar. The trade union first urged for price control, and later they demanded the introduction of an economic state of emergency. In November 1948, they called for a general strike.

The economic reform, however, gradually bore its fruits. The German industrial production increased by 50% by the end of the year, and through keeping inflation under control, the market was stabilised. Erhard pledged himself to the magic economic policy triangle (Erhardian objectives), that is, securing the relative value stability of money, reaching full employment as much as possible and achieving external equilibrium. Later, after the 1967 mini-recession, this idea was extended to a magic quadrangle after the growth objective was added. According to Erhard, individual economic and political freedom should be conceived in unity. Freedom can be achieved only if it is connected with responsibility. According to his views, the ethics of responsibility should be preferred against the ethics of intentions. Erhard originally understood the attribute "social" not as substantial redistribution; he believed that through the increase of welfare the role of social policy would gradually decrease and diminish.

In Germany, the main period of social market economy was between 1948-73. According to economic historians, the 1950s could be considered as the "golden age", while the period between 1960 and 1973 was only a "silver age", as growth and welfare dynamics gradually decreased, and shadows appeared.

The Factors of Erosion and the Crisis of Social Market Economy

The main internal reasons for the loss in dynamism of social market economy were the following: the slowing down of economic growth, particularly the reduction of the rate of growth of productivity; and the emergence of the deficit of state budgets, leading to an internal debt, which was due to an increase of the extent and burdens of social contributions, particularly that of wage contribution (Lohnnebenkosten). The costs of administration in state expenditures accelerated, while the efficiency of state investments decreased. The increase of individual and company real incomes slowed down. As result, by the first part of the 1970s, both in the German economy and all over Europe, serious and permanent crisis issues emerged. In the world economy a new era started independently of the 1973 oil price explosions, which only provoked and aggravated the crisis processes.

The crisis factors of social market economy have remained with us ever since. The system was built on free initiatives, the increase of performance and social progress. These, however, assume a satisfactory economic growth and financial stability. In their absence, social market economy is doomed to failure. From the outside, the impacts of globalisation had the same negative consequences. The global optimisation strategies of TNCs are in contrast to national social strategies and policies. The two key elements of social market economy (order and freedom) have been eroded. Order was replaced by crises, and freedom was reduced by the crisis of "culture of stability" (Fuecken). The formerly more-or-less balanced competition was limited by the excessive power of TNCs, sometimes dictating market conditions. Globalisation created a trap for Europe, and Europe losing ground became a long-term trend. The competitive advantages of the USA remained, while Europe had to face growing expansion and competition from China and the other emerging countries.

Under globalisation, the scope and possibilities of national economic policies have been greatly reduced.³ The unit costs of the functioning of social market economy have greatly increased, and have proved to be much higher than that of the American, Chinese or Far Eastern economies, where the costs of the social security systems are minimal or much lower. The gradual building up of these systems has already started, and these costs will continue to grow in the future. Europe was forced to pay these costs, which reduced the competitiveness of the Continent in sectors with lower value added. This constraint can be made advantageous, but under the conditions of low economic growth it is by no means easy.

As a program of the humanisation of society, the elimination of poverty, the treatment of migration or the role of social policy has always received a great emphasis in the policy of social market economy. The Freiburg School considered labour as important in two aspects: as sources of value creation on the one hand, and as an area of human development and self-realisation on the other. They attributed particular importance to individual entrepreneurs, and family-owned and small companies in the humanisation and development of economy. But in practice, the possibilities of self-employment were reduced by the expansion of big industrial and service companies, and the possibilities of increasing productivities and income were diminished.

Migration has always been one of the basic problems of the German economy. After the Second World War, Germany had to face and cope with a great number of refugees and deported people (reaching more than 5.5 million.) Until the construction of the Berlin Wall, between 1949 and 1961, more than 3.3 million people emigrated from the GDR to the Federal Republic. In 1989, a last big migration was one of the main factors of the collapse of the GDR, and after the reunification the last wave meant ca. 1.5 million people.

One of the big waves of external migration was in the period between 1960 and 1972, and it affected about 2.2 million people, mostly from Turkey, Greece, Yugoslavia and Italy. The process was generated by a growing demand for labour with very mixed impacts. In Europe, the free movement of labour and individuals is part of the four freedoms and the single market. At the same time, external migration is restricted, except in a couple of shortage sectors.

³ The relations and conflicts of social market economy and global capitalism are analysed by Katalin Botos (2011). She points out that the challenges of globalisation cannot be avoided, but the mechanical copying of the American model is far from necessary.

Migration has remained a critical issue. One of the important missions of the renewed social market economy would be the creation of jobs, as migration creates tensions both in the receiving and sending countries, depriving the latter from their highly trained and most dynamic labour resources. For the sending countries this means losses in terms of economic growth or state revenues (taxes and contributions). Brain drain is a serious loss for many countries. In these respects, Europe is on the losing end mostly in relation to the United States. The loss of trained labour and researchers is also a problem for Central Europe (Hungary and the Czech Republic).

While the importance of human capital is increasing, there is a high level of permanent unemployment and the degradation of labour. The solution would be the improvement of the quality of the labour force and a better coordination of the demand and supply sides of the labour market through the development of training and re-training. Many emerging countries have understood the importance of this, and they have made greater efforts than Europe. In fact, the solution of this question could be one of the key factors of the renewal of European social market economy. In economic policies, good training and the creation of new jobs should be placed into the foreground, without it no progress can be expected.

The increase of welfare is the essence of social market economy; this can only be achieved through the joint increase of performance and incomes. Between 1950 and 1973, in Germany and in other developed European countries, the rapid wage increases were based on a rapid productivity growth. One of the most important causes of the crisis of the system, following 1973, was the slowing down of productivity growth, while lagging behind wage growth substantially increased. The stagnating, or in many EU countries the decreasing, level of real wages seriously constrain the increase of purchasing power. While an increase of performance without an increase of incomes is contrary to social justice, it also limits the expansion of the markets and the possibilities of growth of the GDP.

In Germany, Austria, the Netherlands and Scandinavia, the share of labour incomes in GDP increased in the dynamic periods of social market economy. In the 21st century, in an age of the revaluation human capital, there is a redistribution of incomes in favour of trained labour. In the 21st century, the main bottlenecks are the highly trained human resources, which should have been reflected according their merits. But this process is greatly hindered by globalisation, particularly by the shifting of these activities to low income countries through the possibilities created by modern ICT technologies and the promotion of long-distance working.

In the period between 1950 and 1973, the number of poor people in Germany and in the above-mentioned countries decreased substantially. Economic catching up was accompanied by a social one. Today, this would be particularly important.

The question arises especially in transforming Central and Eastern Europe. Catching up assumes the connection of creating opportunities, training and the creation of jobs. Quality of work is based on good training. Comprehensive and active social policies (and not only passive social aid policy) should be an integral part of any economic policy, and this should be the case in Europe once again.

The individual free initiatives were important elements of the system of social market economy, and they were radically pushed into the background. In Germany and in other Western European countries from 1960 onwards, there has been a reduction of self-employed in total

employment (except in Austria in the tourism sector through family enterprises). By now, free initiatives in training and re-training have remained important; life-long learning is playing an increasing role in enhancing the quality of the labour force, in job opportunities, in capacities of value creation, and in individual and social welfare.

The other key element of social market economy was the cooperation of employees in companies and their participation in decisions (Mitwirkung or participatory systems). In TNCs, these possibilities were limited, and in most cases they simply do not exist. The excessive weight of TNCs limits the possibilities of competition or the role of small- and medium-sized companies; thus, the existence and functioning of social market economy can be greatly distorted. The economic structures are formed not by competition and economic policies, but rather by the interests and strategies of TNCs. Consequently, since the 1970s, the scope of economic policy decisions has gradually diminished.

In the name of global competition, it has become a general trend that TNCs and most of the companies claim deregulation, which target and force out the reduction of social policy burdens (cuts in taxes and in social and company contributions). The global flow of capital, the reallocation of investments, technologies and jobs abroad, particularly with regard to Asia, has placed tremendous pressures on European social market economy. The capital is global but the work is always local. Of course, an increasing share of products and services are sold on global markets and there is an increasing global migration. It is difficult to respond to this challenge. At the same time, one should call attention to the fact that the per capita capital inflow into the Scandinavian and Benelux countries is extremely high, while the costs of labour force are expensive, due to high wages, taxes, additional contributions and the costs of infrastructure. This is far from surprising, as the highest value added and profits are created by a highly trained and highly productive labour force. This is very promising in terms of the future of an efficient social market economy in Europe.

The increase of investments primarily depends on their rentability. On average, in the German manufacturing industry, the net rate of profit has been around 2% for decades. (In the innovative sectors it is significantly higher.) The increase of real incomes, particularly that of real wages, has slowed down significantly and has practically come to a halt. No durable economic growth and healthy social market economy is possible without the dynamising of investments and consumption. In order to do so, new supplies and innovations would be needed, as only new technologies can give impetus for new products and investments in new capacities. The state can boost this process through the improvement of the framework conditions of innovation. The weak capital supply of SMEs, particularly in Hungary and Central Europe, is a serious obstacle for the successful emergence of the middle class and the operation of small- and medium-sized companies. In addition, they are forced into manoeuvrings when they can only survive through the exploitation of regulatory gaps. In Hungary, the recent growth credit program of the Hungarian National Bank, through cheap, accountable and advantageous financing, is a promising step forward. (Bod Péter Ákos, 2013)

The functioning of social market economy is greatly distorted by the efforts of companies, particularly that of large companies, for growing state subsidies, tax preferences and favourable redistribution. The role of personal influences and connections has increased. This distorts competitiveness. In the economic and social spheres it erodes the attitudes of rule obeying. Social market economy is built on fair competition, subsidiarity and solidarity, and, therefore, it

calls for stepping up against manipulations that distort competition both in the production and market spheres. Excessive redistribution is equally undesirable.

The efficiency and renewal of state roles are greatly hindered by speculative capital flows, and the flight of capital out of a country can aggravate the crisis. The strategies of big oligopolistic companies are often in conflict with national interests. Social market economy should be competition-centred and normative. In the 1950s and 1960s, in Germany and throughout Europe, these requirements were largely fulfilled. In the golden age of social market economy, the "efficient market" was a reality. Nowadays, market competition is distorted and manipulated. Just as the 2008-09 developments have demonstrated, "the crisis made the social market economy model relevant." (Bod Péter Ákos, 2009, 172. p.)

The conditions of the functioning of a free social market economy were comprehensively analysed by Zoltán Csefalvay and György Matócsy György (2009). Based on lessons drawn from economic history, they presented the experiences and conclusions of models of European economic development. They stressed the importance of the joint achievement of economic growth and equilibrium. According to them, the development of human and economic resources is the key question and the Archimedean point of any future building strategy.

The main objective of social market economy is the increase of welfare. Germany is still performing well in terms of the achieved level of welfare and social justice, while in terms of its increase the case is different. In most of the EU countries, there are problems with the structure of the redistribution and the efficiency of use of resources. The requirements of social justice are very differently met. For many, in the 21st century, welfare has not yet increased. In the EU, particularly in the East and South, the strength and welfare of the middle class has so far decreased. German social market economy was built on a broad and strong middle class. Its strengthening and expansion was one of the most important measures of success. Its promotion, therefore, should be one of the most important objectives of any economic policy.

The German model of social market economy is a well-coordinated market economy. According to experts, however, the extension of dirigisme, and the substantial growth of state expenditure in GDP, implies a distancing from the system. Some claim that when the state must pay less aid, because everybody is in their right place and subsistence is secured without aiding is the best social market economy. (The children in the family, the students in the school, the workers in the workplace, and the old in their deserved retirement)⁴

The Prospects and Conditions of the Renewal of Social Market Economy – in the Context of Globalisation and National Interests

The key factor of the renewal of social market economy is the creation of a knowledge- and work-based economy and society. One of its main and most challenging tasks is the harmonisation of individual and public welfare. Economic growth and fiscal balance should be jointly secured; they need an interactive approach. Instead of the former unilateral economic policies, i.e., prioritising either demand or supply, emphasis should now be placed on their balancing and simultaneous implementing. Technology policies can play an important role of

how companies can identify and then satisfy the new possibilities of markets. Sustainability needs a complex approach: the economic, financial and environmental aspects should be harmonised, combined with social acceptance.

The badly deteriorated balance between the real economic and financial spheres can be gradually restored only through the total mobilisation of all of the means of social market economy. This assumes a return to performance orientation and the oppression of speculation, particularly in those financial sectors which were the starting points of the crisis. Emphasis should be given to national policies, and the building of the Europe of Nations can only be carried out through policy coordination. This coordination should be achieved through the acceptance and recognition of differences in cultures, national traditions, historical heritages and values. The basic principle of social market economy is the humanisation of economy.

Social market economy is not an artificially created ideology or a fabricated construction. It is a pragmatic and value-oriented approach, built upon the analysis of circumstances and necessities of our age. Instead of artificially constructing a system, it focuses on the motivations of human attitudes and action, on the accepted values of society and on the policies of harmonisation of aspects of economic development and social justice. It tries to mobilise the primary movers of development and to keep them in motion. The final objective is not an ideal state, but rather a gradual progress in responding to the actual possibilities and requirements. Economy is not just for itself; it should serve the individual.

The social market economy of the 21st century is still based on market factors, but it rejects the omnipotence of the self-regulatory automatisms of the markets. It accounts for the limitations of market forces; it considers it important to keep its destructive forces in check. The role of the state in the regulation and maintenance of market order, in defence of the collective social aspects and public welfare, and in the generation of modernisation, have remained unchanged. This assumes the combination of direct or indirect interventions depending on conditions. Direct interventions can be preferred when it is obvious that public solutions are more advantageous than private ones. Subsidiarity and solidarity are unchanged principles.

The renewal of social market economy depends to a large extent on the restoration and strengthening of value systems. New and consistent economic strategies and economic policies are needed, similar to those which in the middle of the 20th century proved to be the engines of development. We are faced with multiple deficits which hinder development and which should be eliminated. What are these obstacles and deficits? In the Hungarian economy and society these multiple deficits are numerous, and they are inherited from the period before the systemic change. According to Béla Kádár's inaugural lecture at the Hungarian Academy of Sciences, these deficits were rooted "in the low functional efficiency and irrationality of state-owned economy, in a related resource scarcity, in the relative expansion of consumption aiming at forgetting 1956 and the legitimisation of the regime ("goulash communism"), which lead to heavy external indebtedness. The per capita external debt was the highest in the region, and it was twice as high as the regional average." (Kádár B., 2008, 172. p.) Later, Hungary integrated into the global economy, and the integration of the financial sector was particularly rapid.

Globalisation is the main characteristic and determining factor of our age. We are experiencing a rapid and fundamental transformation in world politics: world economy, international power relations, the growth of population, technological progress and the relation between humanity

⁴ On the reform of social insurance and the pension system, see Katálm Botos (2014) and József Botos - Katálm Botos (2006).

and the environment. From the perspective of the development of social market economy, the fundamental changes were the following: the emergence of transnational companies; changes in the international financial system; the acceleration of global capital flows and the loss of control over speculative financial movements. The share of the speculative financial sphere has expanded in extraordinary proportions, particularly in relation to real economy. The gains from financial speculation were far above the possible net profits realised in the sectors of real economy. In the 21st century, this is an acute problem; it is a crisis factor which largely threatens the normal functioning of economies (international financial bubbles).

Economic policy has decisive impacts on competitiveness, catching up and welfare. From this point of view, the participation of Hungary in European integration had extraordinary importance. As it has been indicated, the balance of membership in terms of the exploitation of factors of convergence and the success of adjustment was largely dependent on the quality and efficiency of economic policies. (Palánkai Tibor – Miklós Gábor (2014))⁵

As result of liberalisation in the GATT and other trade organisations, international markets have become more open, while the parallel development of international institutional and regulatory mechanisms was lagging behind or often they were simply missing. The TNCs and the big banks were strongly counter-interested in the development of any international regulation, and neo-liberalism (ultra-liberalism) served the political and ideological background. It became clear that the basic elements of the Washington Consensus were contrary to the requirements of 21st century development. The reduction of the role of the state (de-statisation) contradicts social market economy, as it calls for a rational, well-functioning and strong state. No-one denies that an oversized and exuberant state is undesirable and creates more damage than good, but there are broad fields which call for rational regulation. (The connection of global information networks should be technologically, legally and economically regulated).

In terms of international integration, the renewal of social market economy should be closely connected with the revitalisation of the European model, originally supported by Konrad Adenauer, Robert Schuman or Alcide De Gasperi among others. The principle of performance and social justice should be once again related to one another, whether it is the economy, the legal system or governance. In the 21st century, these require more complex and better composed policy mixes than any time before.

In the 21st century, rationally regulated and, in terms of the provision of public services, well-functioning market economies are needed. All the main state functions have been unambiguously ameliorated. The regulatory functions have remained important (legal, economic or institutional aspects of market regulation). Service provision is supported by the growing role of public services. Development function, among others, serves the renewal and operation of broad fields of public infrastructure. Cohesion is important from the point of view of strengthening the social character of market economy through solidarity and redistribution. Between 1970-2014, as a result of the increasing role of the state, the share of redistribution in the GDP increased in all of the developed countries.

From the point of view of development, what matters, in fact, is not the size, but the efficiency of state regulation. With regard to the process of the renewal of social market economy, the question arises as to how the state can efficiently operate under the conditions of the challenges of globalisation. Under the circumstances of open markets and the free flow of capital the importance of efficiency of national policies has greatly increased. The favourable international economic positions of Scandinavian countries demonstrate the importance of good economic and development policies, which has made possible the maintenance of financing a highly developed social service systems. (Experiences of the consolidation of the Swedish budget, as result of the correction of the negative anomalies of the welfare state in the middle of 1990s.)

According to Béla Kádár, "the main driving forces of development in our age are not the natural resources or the abundance of capital, but the availability of human capital" (Kádár B., 2008, 173. p.) European or Hungarian economies should be built on a value- and knowledge-based economy, and on the qualification of labour. The quality of human resources has an utmost importance. It depends basically on the quality of education and training and the existence of networks of initiatives and innovation. Europe and Hungary were successful primarily in the quantitative development of general and higher education, while in qualitative improvement they lagged behind. Education and training are investments into the future; they equally serve the enrichment of the individuals, the family or the whole of society. Those who fall out of education are usually pushed out of the labour market as well.

For the sake of promotion of human development, human ecological aspects should be particularly stressed: the relation of man and nature and the protection of the living environment. This type of attitude would support the objectives of sustainable development as well. In the process of increasing the value creating capacities of human capital, the state, the companies or the individual have an equal role and responsibility. (Kőrösi, 2010, 110. p.)

In research and development, a large part of Europe is behind the US, Japan or South Korea. In this respect, only the Scandinavian countries have a good international position. Hungary's lagging behind is larger in terms of the level of human resources than in material production. Within transformation into information society, man, culture and creativity are more important than technologies or financing. The content, quality and strength of the value system are the most important components of social capital. In this respect, the deficits are serious. Besides the elimination of the deficiencies of the education and health system, the quality of development policies and governance ("good governance") is equally important. Social and economic problems can only be solved together. The upgrading of human capital is a key factor of the renewal of social market economy. According to Kahane (quoted by Tibor Palánkai), "information and knowledge are new production factors. They are unlimited, renewable, infinitely inter-changeable and re-usable resources." (Kahane, 2006: 24). Development no longer depends on average labour and capital, rather on knowledge and well-trained human resources.

In our age, the performance and prospects of countries (economic growth, inflation, employment or financial position) are primarily determined by the impacts of global integration and systems of international economic relations. Therefore, the success of the renewal of social market economy, to a great extent, is dependent on the success of integration into the system of international economic relations. In this process the quality of national economic strategies and policies can play a decisive role. In our age, social market economy should be competitive under the conditions of global and regional integrations. It is by no means accidental that several

⁵ Palánkai Tibor: Kutatások az integráció-értéség témaköréről. (Research on the Theme of Integration) Európai Tudós, Műhelytanulmányok no. 86.

elements of the European models have now been introduced in the USA or China (the extension of health care and pension systems, the development of social institutions, etc.).

The erosion and crisis of social market economy were caused by the dysfunctioning of the state and the market. From the 1970s, the consequences of growth and financial deficits lead to a substantial change in the course of economic policies and thinking. In the EU, the control of inflation became a priority even before the introduction of the euro. Following the 2008-2009 crisis, the consolidation of state households became unavoidable. In the years after 2010, in many countries, the reduction of budget deficits did start successfully, but the consolidation of accumulated indebtedness takes more time. The deficit of the state household is still striking in France, Italy, Britain or Spain, not to mention the unsustainable indebtedness of Greece. In terms of indebtedness, Central Europe is in a better position than Western Europe. The stock of debt of Visegrad countries (except Hungary) is below the 60% of the Maastricht threshold. Hungary was also successful in the reduction of deficit after 2010. The share of indebtedness to the GDP is around 77%, which is similar to the German level, and is below that of several other EU countries. From the point of view of the future of social market economy in Europe, the reduction of financial imbalances and remaining on the path of durable and sustainable economic growth is a basic criterion.

The globalisation, integration, regionalism and transformation of the economic role of the nation state are processes of fundamental importance in 21st-century Europe. The impacts of external factors are increasing as the global factor plays a growing role. Regionalisation is based on the exploitation of organic energies and it contributes to increasing competitiveness in Europe. The increase of competitiveness assumes joint impacts in human capital, modernising investments, exploitation of local advantages and good infrastructure. Economic policy favouring training and education, encouraging innovation and securing quality human capital are the main factors of development. The role and responsibility of such policies in generating development is increasing. (Kőrösi, 2010, 102. p.)

In the second half of the 20th century, the former European models of social market economy gave adequate answers to the challenges of the epoch. The resumption of a new and viable model of social market economy in the 21st century requires for the coordination of values and development demands of states, civil organisations or individuals. It assumes the professional analysis of crisis factors how they can be reduced and eliminated. The different demands of subsidiarity, solidarity and competitiveness should be harmonised desirably in a way that they end in a positive sum game.

The renewal of social market economy is a long-term objective, but it requires permanent short-term management (taking into account the different time horizons of politics and economic policy decisions). Nowadays, economic structures to a large extent are shaped by the decisions of transnational companies. In order to renew the system, the role of national strategies and policies should be increased. In a well-functioning social market economy, a responsible and ethical way of thinking and action on all levels of the individual, companies or states are indispensable, and that is the only way by which public confidence can be restored. Social market economy can be renewed only on the basis of realities and fundamentals, by strengthening the human and civil value systems and the role of families and the whole society.

The model of social market economy of the 21st century has remained viable and renewable.⁶ The objective should not be utopian and idealistic; it should aim at the creation of a "humanistic economy and humanistic society", as it was defined by Röpke.⁷ We should bear in mind, however, that the economic and social circumstances of the present are fundamentally different as they were in classical times. The negative impacts of globalisation should be consciously moderated and economic policies should find ways of rational assertion and the protection of national interests both in European integration and generally in the system of international relations. The state of social market economy should be strong and should be based on the democratic support and active participation of the whole society and economy; this is the only guarantee for its successful renewal and operation.

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⁶ On the criteria for the viability of social market economy, see the study by László Csaba (2008).

⁷ The volume containing Röpke's writings was published posthumously in 2000. A The title contains Röpke's expression. The Nobel Prize winner Amartya Sen also published a study entitled "Economy worthy of a human being".

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