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## The social market economy: birth of an economic style

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**discussion paper**

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**The Social Market Economy:**

Birth of an Economic Style

Sylvain Broyer

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## **Abstract**

This paper relates the political decision-process which allowed Germany to transform its planned economic system into a Social Market Economy after the Second World War. The central problem of the paper is to understand how the Social Market Economy emerged in Germany. Was it primarily an imported model of organization of the society and of the economy, or did it evolve mainly from the political and economical history of Germany? The argument of the paper is that the choice for a liberal market economy did not come naturally to Germany: the industrialization of Germany and the economical and political constraints that Germany faced after the war shaped a critical juncture which allowed a "liberal revolution".

## **Zusammenfassung**

In dem Papier wird der politische Entscheidungsprozeß dargestellt, als dessen Folge Deutschland von einer Zwangswirtschaft in eine Soziale Marktwirtschaft transformiert wurde. Zentrales Problem ist es zu verstehen, wie, d.h. nach welcher Logik, sich die Soziale Marktwirtschaft in Deutschland herausgebildet hat. War es ein im wesentlichen importiertes Modell zur Organisation einer Gesellschaft und einer Volkswirtschaft oder hat sie sich als eine erwartbare Folge der geschichtlichen Entwicklung von Politik und Wirtschaft in Deutschland herausgebildet? In dem Papier wird die Meinung vertreten, daß die Wahl für eine liberale Marktwirtschaft nicht gleichsam „naturwüchsig“ zustande gekommen ist: Die Industrialisierung Deutschlands und die ökonomischen und politischen Einschränkungen, denen Deutschland nach dem Krieg unterlag, haben sich zu einer Konstellation („critical juncture“) verdichtet, in der eine „liberale Revolution“ möglich werden konnte.

**Key words** : Social Market Economy; Ludwig Erhard; Walter Eucken; Ordoliberalism; Freiburg School; FRG.

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## 1. Introduction

The second world war was a conflict of ideologies. The victory of some and the defeat of others reshuffled the political game between the belligerent countries. The winners try to impose their conceptions in order both to establish their new powers and to ensure a stable political situation in Europe. The defeated parties, particularly Germany, tried to restore a relative national autonomy, that was challenged by the material consequences and the international treaties on the conflict resolution. So, more than a simple economic reconstruction, the defeated countries have to face a real transformation of national policy.

The question of their political and economical organization then resolves around power relations between the western Allied nations, the communist bloc and the different lobbies remaining in those countries. But ideologically wounded by the conflict, the losers have a very limited range of choices regarding the political direction they can take.

On its western side, which is influenced by the Anglo-Saxon countries, Germany exhibits an interesting arbitration model which lays the foundations of the Social Market Economy. The emergence of such a model based on a market economy could be considered as a liberal revolution for Germany, breaking with a tradition of socialism and collectivism. Thus, regarding the limited political autonomy of Germany at this time and the revendication of the allied nations, the question of the political origin of this rupture should be asked.

This paper assembles some of the elements of this model of political and economical organization, now known as the "German Model" or "capitalisme rhénan" as Michel Albert described it (Albert [1991]), and asks if it can be traced to this Anglo-Saxon influence, or if it presents (and to what extent) characteristics mainly derived from the political and economical history of Germany.

Fisrtly the constraints that West Germany had to face for its reconstruction after the war would be examined. My point is to demonstrate that in spite of good global statistical indicators, the economic system reached a primitive level, which with the march into liberalism wanted by allied authorities demanded economic reforms (2.). It will be then shown how the Social Market Economy succeeded in emerging through economic legal transformation supported by Ludwig Ehrard (3.). The foundations of this model will then be

mentioned, exploring the theoretical discourse of Ordoliberalism (4.), in order to identify what elements are plainly peculiar to it (5.).

## **2. The Economical and Political Constraints for the Reconstruction of West Germany : Between International Assistance and Allied Occupation**

The first constraints are obviously material ones. The needs are huge for repairing the infrastructure and providing for the population's subsistence. However it must be noted that if the national economy could not fulfill the needs of the population<sup>1</sup>, it was not destroyed but only paralyzed because of the destroyed transport infrastructure. The productive potential at the end of the war is still 11% higher than its level of 1936 (Grosser [1988b]) in spite of the dismantling politics, thanks to the high rate of investment imposed by a war economy. Particularly, the steel potential is assessed at 90% of what it was before the beginning of the war, and to between 80 and 85% for the chemical and mechanical industries (Wahl [1991]). Then the main problem of the German economy after the war is not to reconstruct the means of production, but to convert its industry to fit the needs of the population and to transform a war-economy into a peace-economy. The quickness with which Germany restore its capacities can be explained in part by the fact that the financial and time investment of a reconversion is less than reconstruction. Nevertheless, two others factors are relevant for the postwar German economic structure.

First, the continuous flow of refugees from the East, which was not halted until the construction of the Berlin wall in 1961. By April 1950 West Germany had already 9 million refugees, an increase of 21,6% over the 1939 population<sup>2</sup> bringing almost immediately larger labor force.

Secondly, the programs of international aid have a major importance in the material reconstruction of German society and economy, insofar as they allow some substantial savings. The contribution of the Marshall Plan to Germany between 1948 and 1952 alone amounts to \$ 1.4 billions. This assistance will play a double role by permitting import of necessary missing raw materials to reduce scarcity and by releasing means of production from this task for the capital goods and construction industries. Thus, the contribution of the mining industry to net industrial production sinks from 42% in 1950 to 36% in 1954, whereas this fraction rises respectively from 19% to near 21,2% for the

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<sup>1</sup> Agriculture covers only 35% of the food needs in 1945.

<sup>2</sup> My calculation based on figures in Röpke [1950].

processing industry and from 18% to 21,14% for the construction industry in the same time period<sup>3</sup>.

Yet post-war west Germany's economic situation is the subject of a heated scholarly debate. The idea of a paralyzed but non-destroyed economy, which could easily restart, is held above all by historians like Abelshäuser, Petzina or Hardach (Abelshäuser & Petzina [1981], Hardach [1980]). German liberal economists like Willgerodt or Lenel, however, challenge such general statistics, because according to them they do not reflect the reality of the economic system. "*Die Kapitalausstattung Westdeutschlands im Jahre 1948 wird vielfach als besonders günstig eingeschätzt, weil das industrielle Anlagevermögen rein technisch die Kriegszerstörungen und Demontagen ziemlich gut überstand. Aber es kommt für eine funktionsfähige Wirtschaft nicht nur auf das industrielle Anlagevermögen an*" (Willgerodt [1994:65]).

From their calculations it appears that the capital which could be used for a peace-time economy in 1949 represented less than 35,7% of the capital stock of 1939 (Hoffmann [1965:253]). In housing, 20% was destroyed, 20 % damaged, and more importantly, outside the rural areas, inhabitable housing was just a little more than 50% (Willgerodt [1994]). Finally, food intake was reduced from 2200 calories per person per day in 1944 to 1000 and less in 1947.

These statistics reflect the chaos of post-war Germany's economy. In Gutmann et al.'s words: "Die deutsche Bevölkerung verlor schnell das Vertrauen in die arbeitsteilte Wirtschaftsweise. Sie hatte meist Geld, aber das Geld hatte kaum Wert. Auf dem Papier waren viel noch durchaus vermögend, aber niemand wußte, welchem Wert ihre Anlagen hatten, oder ob sie ihnen bleiben würden. Die Preise waren nach wie vor gestoppt. Praktische Bedeutung hatten die Stopppreise jedoch nur für Lieferung an die Besatzungsmächte und für rationierte Güter. Das Geld hörte auf, allgemeines Tauschmittel zu sein; es wurde durch den Naturalaustausch mehr und mehr verdrängt. Allenfalls wurde es zu horrenden Schwarzmarktpreisen für Sachgüter in Tausch genommen" (Gutmann, Hochstrate, Schlüter [1964:2]).

The situation was difficult for firms as well. If they could produce something, they had to deliver it with priority to occupation authorities or leave it to supply instructions. Firms were not in control of their products, and had inventory problems, because of the stalled imports and the forced increased exports as a result of the dismantling of the industrial apparatus and forced deliveries to allied authorities. Firms were therefore obliged to participate in *Kompensations-geschäft*, i.e. swapping.

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<sup>3</sup> My calculation based on figures in Statistisches Bundesamt [1972].



To allow their firms to survive, German businessmen tried to escape from the Allied orders by producing “free” articles, which were not requisitioned or whose prices were not fixed. Thus, instead of producing goods that were needed and demanded, they produced articles like ashtrays, lamps, tiles, etc. in great quantity. They also participated in illegal activities on the black market.

Finally, even if the production capacities of Germany were not completely destroyed, more important still is the fact that the economic system was simply unable to operate at all. The coordination of the agents could neither be ensured by the market system, because money had lost its exchange standard value, nor by a central plan insofar as the exchanges were no more in control of the legal authorities because of the swapping and the black market. For Walter Eucken, the German economic system had degraded to a very primitive economic system. (Eucken [1952]).

The international assistance has some attached strings with repercussions on German economic organization. In exchange for a financial aid, which is attributed 85% in budgetary form, the Marshall plan, by means of the O.E.C.E., binds the European aided countries to economic cooperation and to an opening of their markets. An objective of this program is to integrate the European economies into the world markets and stabilize their political situation. But the constraints are not only institutional ones, they are mostly due to the structure of the German economy. The confinement of the Soviet zone deprived the FRG of a part of its agricultural capacities and modified the sectoral distribution of industry between primary and secondary, which had been carried out in the old *Reich* territory according to an East-West logic. So agriculture, which reached 20,5% of NDP for the period 1930-1934, represents only 10,6% for the western zone<sup>4</sup>. Domestic supply was then insufficient and subjects the German markets to international market pressures requiring a surplus in other sectors. Germany had no longer an self-sufficiency in organization, which accounted for the strength of its development during the first half of the twentieth century (Bilger [1960]). The situation forces it to open its markets and subscribe in a certain way to the principles of economic liberalism.

From a political point of view, the trusteeship exercised by the occupying forces is a determining factor. The Potsdam conference, that sets the principles for the political action in the different zones, displays the objectives of demilitarization, denazification, decartellization and democratization. But beyond these common general principles, the Allied powers will apply in their own zone original and specific administrative principles, because (among others reasons) of the absence of a strong central administration<sup>5</sup>. These

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<sup>4</sup> Hardach [1980:223].

<sup>5</sup> France was fiercely opposed to the creation of a central governmental administration. The only created entity was a council of control, which gathered the military administrators of the

agreements mark the end of German sovereignty. According to Alfred Grosser, Germany became an "object". By reason of the principle of democratization, a relative autonomy persists only in the administration of the "*Länder*" through of their president-ministers. A political debate will be as well instituted when the Allies decide to erect common ramparts to communism with a unified zone, which was first economic and later political. It is on these levels that some German personalities could infuse some new ideas in the political and economical reconstruction of their country.

### 3. Emergence of the Social Market Economy

The American and English policies are economically very active. In spite of difficulties, the two countries retained from the Potsdam conference the idea to make of Germany a single economic entity and set down objectives for the German economy in this manner. The conceptions on the nature of the objectives nevertheless diverge. The British zone, which was at this time dominated by Labor influence, turns into a high centralized administration without repulsion for planning and nationalization. The authority of Kurt Schumacher, the SPD's main leader, contributed in this zone towards developing the idea of a German socialist democracy. With agreement of the *Deutsches Gewerkschaft Bund*, he directed the later debates on the extent of the co-determination law for an economic democracy. On contrast the Americans have a more liberal view and aim their policy toward the return to greater economic equilibrium and the forced decartellization of the German economy<sup>6</sup>. Their mistrust towards big German firms and especially the cartels is explained by the close relations they had with the Nazi State. The American authorities would replace the "Organized Capitalism" of the 20's (Feldman [1981], K. Hardach [1980]) with a capitalism free from all influences of the State and the different lobbies, bounding the economic power in order to limit the political power of Germany.

The question of the choice of the economic system became great importance during the debates on the creation of the "Bizone"<sup>7</sup>. It is within the Council, the legislative instrument of Bizone's administration, that the economic orientation of the future FRG will emerge. The Americans outwards succeed in putting through their point of view, but this time with the support of the German

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occupying zones. The application of the council's decision remained in the hands of the commanding officers of each zone.

<sup>6</sup> During the 1930's, Germany had approximately 3000 cartels (Grosser [1988a]).

<sup>7</sup> The Bizone was an American and English common administrative zone with regard to the economy, supplying, post, finances and transports. It was placed under the strict authority of the occupying forces and didn't possess political power.

politicians. The election of this Council, made up of 52 members elected by the *Landtage*, establishes the CDU-CSU and DP liberal alliance, which decides in favor of the market economy and blocks the SPD in its centralization program. By 1948 the choice is taken in favor of the system of the market economy by means of two laws. Beyond the material constraints, these laws inscribe West Germany in a system which is not historically familiar to Germans.

The first of these laws concerns the monetary reform instituting the *Deutsche Mark* on 20 June 1948. It aims at the re-establishment of healthy economic bases, which means the reduction of inflation<sup>8</sup> and the resolution of the Nazi state's debts. This law was prepared long in advanced by the American authorities in collaboration with the Bizone's economic council. The second law, without which this embedding in the system of the market economy would be incomplete and even unsuccessful (Ehrard [1948a]), concerns the liberalization of prices and means of production. This law of 24 June 1948<sup>9</sup> do not abolish immediately the command economy (*Zwangswirtschaft*) of the military Allied authorities, but means an irreversible turn toward the liberalization of the German markets (Art 2 §1 of the annex of this law<sup>10</sup>) in the explicit aim to inject some dynamism in the production and to help fulfill the monetary reform (Preamble of the law, *Ibid.*). It decrees the liberalization of prices except on products which do not directly threaten the supplying of the economy, threaten the realization of certain centralized economic programs, or whose scarcity could lead to monopoly behavior<sup>11</sup>. In all, more than four hundred products will be released from more than 10 years of complete economic planning. The fundamental interest of this second law for my subject is that it was passed without the concertation of the Allied authorities with the sole responsibility of Ludwig Erhard, director of the economic council since the spring of 1948.

His action was decisive for the construction of the FRG's economic system. First Bavaria's finance minister in 1945, then director of the economy of the occupied zones and member of the London conference about the preparation of an independent German democratic state, he had been always trusted by the American authorities. He was supported too by the Christian Democrat Party, which allowed him to obtain the economic post in the Adenauer's cabinet

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<sup>8</sup> The CPI increased continuously from the end of the war and by the time of the monetary reform It was a 30,34% higher level than in 1938 (My calculation based on figures in Statistisches Bundesamt [1972]).

<sup>9</sup> "Gesetz über Leitsätze für Bewirtschaftung und Preispolitik nach der Geldreform", in Gesetz- und Verordnungsblatt des Wirtschaftsrates des vereinigten Wirtschaftsgebietes [1948].

<sup>10</sup> "Anlage zum Gesetz über Leitsätze für Bewirtschaftung und Preispolitik nach der Geldreform", *Ibid.*

<sup>11</sup> That means that were remained contingencies on consumption and production on the following products : necessary raw materials for industry and agricultural exploitation, first necessity products and Energy.

and the title of vice-chancellor in 1957. He was also Chancellor between 1963 and 1966. If he remains famous for being the "father" of the "German economic miracle" and the founder of the postwar monetary order, he derives the principles of his political action from an Ordoliberal doctrine and a particular conception of the Social Market Economy. The ideas and concepts developed or defended in this school of thought are easily recognizable in his political trajectory, as for instance the social direction given to the Market Economy (Erhard [1948a]) or the terse terms he uses to condemn the ultra-liberal *laissez-faire* credo (Erhard [1948b])<sup>12</sup>. This course will be helped by the active participation of some of the main founders of this doctrine in the pre-FRG economic administration<sup>13</sup> and later in Konrad Adenauer's and Ludwig Erhard's CDU's governments, either at the Economic Ministry or at the council of Advisors (*Sachverständigenrat*)<sup>14</sup>. Their policy will allow Germany to overcome the consequences of the war economy and to go progressively from the *Zwangswirtschaft* to a market economy, including the realization of the Social Market Economy.

#### 4. The Ordoliberal Foundations of the Social Market Economy

The concept of the Social Market Economy would be developed by Alfred Müller-Armack in 1947. This "economic style" (*Wirtschaftsstyl*, Schefold [1995a]) refers to an economic and political order, which is designed on the basis of the rules of a market economy, that is however enriched with institutionalized assured social complements limiting the negative consequences of a free market economy and with legislative instruments aiming to fight economic concentration and misuses of powers<sup>15</sup>. It is

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<sup>12</sup> In a speech from 1948 following the laws of the 18th, 20th and 24th June, L. Erhard asserts : "[...] *sie [the planned Economy] mußte abgelöst werden durch eine Marktwirtschaft, die nichts zu tun hat mit dem Schlagworten, die ihr angeheftet werden und die aus der Rumpelkammer des Liberalismus stammen. Nicht die freie Marktwirtschaft des liberalistischen Freibeutertums einer vergangener Area, auch nicht das «freie Spiel der Kräfte» und dergleichen Phrasen, mit denen man hausieren geht, sondern die sozial verpflichtete Marktwirtschaft, die das einzelne Individuum wieder zur Geltung kommen läßt, die den Wert der Persönlichkeit oben an stellt und der Leistung dann aber auch den verdienten Ertrag zugute kommen läßt, das ist die Marktwirtschaft moderner Prägung*" (Erhard [1948b:48]).

<sup>13</sup> For instance 6 main members of this school of thought were members of the economic council and thus responsible for preparing the monetary reform.

<sup>14</sup> It is relevant to notice the participation of Alfred Müller-Armack (Erhard's adviser and "junior minister" for Economy), Walter Eucken (member of the Bizone's scientific council and later of the Ministry for Economy) and Wilhelm Röpke (Erhard's and Adenauer's adviser).

<sup>15</sup> "Soziale Marktwirtschaft, d.h. eine nach der Regeln der Marktwirtschaft ablaufende, aber mit sozialen Ergänzungen und Sicherungen versehene Wirtschaft [...]. Sie allein bietet auch in ihrer soziologischen Schichtung zwar keine ideale Hierarchie, jedoch eine Ordnung, in der durch

considerably based on works and reflections conducted at the Freiburg School. This school was partly managed by Walter Eucken since 1933, and is founded in the economic literature with the terms of Ordoliberalism or *Ordnungstheorie*. This system of thinking offers a reflection from the experience of the economic policies particularly observed in Germany during the industrialization process. The declared aim consists in taking advantage of the efficiency of the market system and fitting it out for serving the freedom of the Individual. In this way Walter Eucken defines the "principles of economic policy" in order to find an "efficient and man's dignified order" of economy and society (*leistungsfähige und menschenwürdige Ordnung*, Eucken [1940], [1952]).

The analysis developed by the Ordoliberal movement directs its critiques of the consequences of a totally free market system at the freedom of individuals. A market system works by means of self-determination and self-control of agents' decisions taken in accordance with the information that markets convey (Hayek [1937]). It can follow asymmetrical positions of the agents according to the power they have on producing and obtaining information. This is the case of monopolies like the state or cartels, the position of which allows them to bypass markets constraints and impose rules on the markets that are favorable to them (for instance market-dominating strategies, powers on contracting, concealment of information, etc.). Eucken saw in the precarious social situation at the beginning of the twentieth century an expression of the misuse of these powers, reflected in the extremely low wages rates, the precarity of the working conditions, and so on (Eucken, [1952]). A main idea of this form of German Neoliberalism consists in showing that the socially baneful consequences of the market are neither due to the market process nor to the nature of Capitalism, but to particular forms of markets and to the behavior adopted by economic agents according to these forms. The misuse of power in the economic sphere leads not only to inefficiency in the allocative process because of monopoly behavior but also to a loss of freedom of other agents that can undermine their basic rights. An example of that conception could be the anticompeting practices of technical or tariff barriers at the entrance of a market, which can distort the right of free business and the right of free contracting.

Concerns about individual freedom and the respect of his fundamental rights by and in the economic sphere make *laissez-faire* policies incompatible with the defense of a state based on the rule of law or *Rechtsstaat* (Röpke [1950]). Ordoliberalism derives political consequences from economic theories developed in the first period of industrialization, particularly Adam Smith's theory, and shows in particular that liberalism, as understood in these economic theories, is an incomplete translation of the concept of political liberalism which arose in eighteenth-century England. The freedom of the

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*weitgehende Neutralisierung der Machtpositionen und eine Aufteilung der Macht ein erträgliches Minimum gesellschaftlichen Zwanges der Entfaltung persönlicher Freiheit nicht in Wege steht*" (Müller-Armack, [1948:148]).

individual in the economic sphere does not have to be understood as the right of free exercising an economic activity without legislative rules. Economic activity is an integrated part of the citizenship and so entails rights and duties.

The solution, which is then chosen by the Ordoliberals, consists in writing an economic constitution which completes the political constitution. It lays the principles for the efficient functioning of markets according to the values protected by society, by means of common determination and control. This economic constitution must realize a "competition order" that conforms to the *Rechtstaat*, and emphasizes in this way the regulation of private and public economic powers. For the private sector, a cartel office will be in charge of dismantling existing monopolies or cartels, of the preventing new concentration processes, and of imposing competition emulating behavior on cartels or monopolies that cannot be dismantled. For the public sector, the Ordoliberals adopt the Christian principle of the subsidiarity of the state<sup>16</sup>, in order to give it a relative neutrality, which allows it a behavior in conformity with market principles. Its economic action is the subject of a precise definition, according to which its role is to ensure the application and respect of the principles set by the constitution, to act on the framework but not on the process of the economy.

*Ordnungspolitik* and *Prozeßpolitik* are legacies of this logic. In its theoretical understanding, the first concept calls for norm definitions which express the principles of the competition order (for instance the system of the property rights), the second features measures which bring the existing economic and social order into conformity with the designed competition order (for instance social policy or competition policy). Thus, unlike "laissez-faire" policies where the threat to individual freedom lies in the public sector, Ordoliberalism stresses the role of private economic powers in threatening this freedom. The basic idea of specifying behavioral norms consists in the legal creation of a competition order, which is designed to retain only the benefits of market competition. Eucken calls this order *Leistungswettbewerb* (Eucken [1952]), the efficiency of which, in terms of market allocation and social justice, is inversely proportional to the concentration of markets or to economic power. The conception of *Leistungswettbewerb* translates a believe in the general equilibrium that can only be reached within a legal framework<sup>17</sup>.

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<sup>16</sup> See the 1891 encyclical *Rerum Novarum*.

<sup>17</sup> The emphasis of the role of the legal framework on the economic efficiency is a very topical subject for the modern economic science. In this way many economists tried to establish a parallel between the *Ordnungstheorie* and the *constitutional Economic* (Hutchinson [1981], Vanberg [1988]). They follow the more general idea of the efficiency of behavioral norms, which is the heart of the paradigm of the *New Institutional Economic*. A lot of work can likewise be found on the comparison of the German and American schools (Hutchinson [1984], Schimdtchen [1994], Tietzel [1991] and Streit [1992]). It should be added, however, that if the

To reinforce this framework, it was decided to entrust the monetary policy to an independent organism, whose goal is the guarantee of monetary stability. This system must prevent the money supply from coming a political instrument of the state and provides economic agents a greater transparency of markets. This solution is adopted because of the impossibility of a return to the gold-exchange standard in the world economy (Eucken [1952]). "The Ordoliberal justification of the independence of the central bank" (Dehay [1995]) has to be understood as a second-best solution to ensure the goals of price and monetary stability.

Since market competition ultimately remains a hard social process, it is advisable to help people who cannot integrate themselves in such a society, who are excluded or disadvantaged. A social policy is thus justified but will be a element of dissension and of divergence among different theorists of the Freiburg School. Three theses on the nature of social policy can be identified within the movement. The first, which is a radical one, is defended by Hayek and supposes the incompatibility of every social measure with a market system (Hayek [1957]). The second thesis, the basis of which is developed by Alfred Müller-Armack and in a relative sense by Wilhelm Röpke, considers the sociological measures of town and country planning, subsidies to the emergent industries and to innovation, the defense of the *Mittelstand*, the co-action between the salaried staff and the employers, and so on, are the responsibility of the state. The social state here has the aim to ensure the stable growth of society without destroying its features and to reduce differences between the social classes (Müller-Armack [1948], Röpke [1950]). This view will be close to the second step policy of the Social Market Economy in the late 60's. A third conception of Ordoliberal social policy, that can be described as a middle around, is expressed by Eucken. He recognizes the social reasons for such a policy, but he does not want to strike a blow to the market mechanism. The social policy resulting from such concerns takes an exclusively subsidiary character and tends to disappear when all people are integrated in the market society. The market is implied to be the best social policy (*marktwirtschaftliche Sozialpolitik*, Lenel [1971]). These diverging points of view explain the fact that the Social Market Economy does not contain a commonly accepted measure of social justice. The only consensus that can be seen in the non-radical theses is that of a subsidiary redistribution of income and of the widening of capital ownership (Lange [1988]), in order to aim at a working-class capitalism or a society without classes.

The Ordoliberal movement was of course not alone in defining the Social Market Economy as it was politically implemented. In spite of the presence of members of this school in the highest places of society, democratic interaction allowed only a partial adoption of their principles. The competition laws in 1957

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theoretical basis are comparable, the aims of these two theories are different and make the German school closer to the old institutional tradition of J.R.Commons' reasonable capitalism (Broyer & Dutraive [1995]).

are an example of that (Blum [1980], Lenel [1989], Thieme [1991]). However, Ordoliberalism sheds light on a great part of the ideas which define the policy model of the Social Market Economy. It offers an analysis of economic systems (Schefold [1995a]) that is subdivided into two steps. The first step consists in identifying categories (market forms, monetary forms, property rights system, etc.), the set of which defines two ideal types : the pure market economy and the pure centralized planned economy. The second step is to compare these ideal types to real types, i.e. concrete economic systems existing in time and space, in order to identify the parts of the real type which prevent the efficient functioning of the ideal type in society. So, the Eucken's competition order offers a pragmatic answer for the problems Germany faces with its reconstruction, drawing inference from the political and economical experiments that Germany had been undergoing. The real type is placed above the ideal type, allowing political economy to go from pure theory to something a pragmatic, if not a doctrine. In this method, which is called "morphological analysis", Eucken realizes a synthesis between historicism and theory which use the latter to fulfill the requirements of the first. The systematic development of this thought can thus be used as a heuristic for a political idea. Social Market Economy uses the theoretical developments of the Freiburg school to apply its values system. Style and system complement one another (Schefold [1995a], [1995b]), giving to the first the theoretical background it needs for defining its action and giving to the second a political aim to reach.

## **5. An Economic Style Inherited from the Industrialization Period of Germany**

Ordoliberalism and Social Market Economy intersect around a common plan, the origin of which lies within the Freiburg School. This movement is set up from 1938 as a reaction against the "Crystal night" and gathers academics and ecclesiastics, scientifically and ideologically opposed to the Nazi regime<sup>18</sup>. The works, that are managed there by economists and jurists, define the economic principle of Ordoliberalism. But one cannot neglect the fact that the Freiburg School was first a place for defending the liberal ideas in German society and that it goes beyond just the issues of Ordoliberal economic policy. It is only in this consciousness that the economic policy they defined, and particularly the place of the Christian doctrine, can be understood<sup>19</sup>. These liberal values

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<sup>18</sup> See RübSam & Schadek [1990] and Rieter & Schmolz [1993] for a detailed history of the Freiburg school.

<sup>19</sup> It is most probably by reason of a strict Anglo-Saxon reading, that the severe wellcome the economists gave to the political recipes of the young FRG in spite of its success and the



address not only the Nazi regime, but exhibit moral commitment against all collectivist tendencies familiar to German history.

Germany's period of Industrialization was indeed characterized by heavy economical and political collectivization. Unlike what happened in Great Britain, this period of social transformation was not really accompanied by a liberalization process. Politically the constitution of 1871 meant a backward step of the liberalism espoused by the Frankfurt *Paulskirche* constitution of 1849. Later the Weimar constitution could not ensure democracy. This bears witness to a "German backwardness" for choosing the liberal way (Hardach [1971]). From an economic point of view, this period is characterized by a high institutionalization process for facing the technically necessary transformations (cartellization) and defending the interests hurt by this transformation (unions and guilds), and by always increasing state interventions in order to reduce the instability due to the economic climate and to arbitrate interference due to the actions of these lobbies. Thus, instead of liberalizing the economy, industrialization gives rise in Germany to a highly organized economic society based on the play of public and private powers and "counterpowers". This reality is translated in the concept of "organized capitalism" (*organisierter Kapitalismus*) which reaches its paroxysm between the two world wars (Feldman [1981]). This organization was strengthened by ideas current at that time in Germany. It expressed the conceptions of Gustav Schmoller (1838-1917), taking up the thesis of Adam Müller (1779-1829) and Friedrich List (1789-1846) favorable to self-sufficient and concentrated capitalism, justified by the sense of identity of societies and nations and therefore opposed to the universalism of the English liberal philosophy (Gonnard [1930]).

However the Weimar constitution started a liberalization process of economic life. Article 151 assessed that "Die Ordnung des Wirtschaftslebens muß den Grundsätzen der Gerechtigkeit mit dem Ziel eines menschenwürdigen Daseins für alle entsprechen". It reveals another debate, about "economic democracy", that can itself be understood as a consequence of organized capitalism and its misuses of economic power. This other concept was widely developed by the ADGB<sup>20</sup> during union meetings in Breslau in 1925 and Hamburg in 1928 under the direction of Fritz Naphtali. It proposes a democratization of the economy in order to pull the worker from the statute of an object to an economic subject, by means of parity representation between salaried staff and employers in factories and firms. This concept lays the basis for parity *Mitbestimmung* rights (Hamm [1980]). However this democratization does not go together with economic liberalism. Democratization requires collectivization of the economy which is considered as the only way of ensuring freedom for the individual (Naphtali [1928]). This debate will have a strong influence on economic analysis in Germany, showing the insufficiency of

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difficulties of the Ordoliberal theorists to explain their theories can be explained (Hutchison [1981:§5]).

<sup>20</sup> *Allgemeiner Deutsche Gewerkschaftsbund.*

political democracy and the necessity to complement it with economic rules of law.

It is within this scope, on the question of the economic powers, of ensuring the freedom of the individual in economic sphere and democratization of the economy, as well as the rejection of the Nazi ideology, that the developments of Ordoliberalism and the Social Market Economy come. They search for an answer to the problems posed by the industrialization and the division of labor in Germany and break with the tendencies of a *sozialistischer Zeitgeist* (Blum [1980]).

Nevertheless this liberal revolution does not mean a boundless support for all to the classic liberalism. On the contrary, German neoliberalism is based on Kant's liberal philosophy, which differs from the English one (Bréhier [1961]). This philosophical basis frees their liberal conception from a particular value system and allow their view to be based on reason alone. The aim is to define a rational economic policy free of any political ideology, that has handicapped Germany for a long time (Eucken [1952]). Moreover this philosophy gets away from the English one according to the definition of the freedom itself. On the contrary to the classical liberalism, Ordoliberalism does not understand the essence of liberty as a free exchange process between agents (Peacock & Willgerodt [1989]), but considers it as the free action of the individual within a given framework, respecting a certain form of ethics or a set of rules. The individual is free in the sense that the rules protect him from others, ensure his sphere of freedom and increases his possibilities for action. The rules, understood as laws, so describe a superior form of rationality, expressing a common rationality<sup>21</sup>. The economic constitution realizes this ethics and ensures the freedom of agents in the economic sphere by means of control on their behaviors. In this way it would be incomplete to judge the efficiency of German competition laws only on its carteldismantling capacities. These laws have to be considered too as behavioral constraints on economic activities of the firms.

Two other characteristics make German postwar liberalism different. The state still conserves the strong social tradition started from the end of the nineteenth century (Kott [1995]), which is imposed on it by the basic law (Article 20 §1). This characteristic remains strongly inherited from the later debate of economic democracy on the principles of parity representation between capital and labor (*Mitbestimmung*). However, parity principle of these relations does not express the ideal of the Social Market Economy and only expresses the ideal of *Wirtschaftsdemokratie* (Grosser [1988a]). In Müller-Armack's work, Social Market Economy only refers to a *Mitsprache in den sozialen Fragen* without parity representation (Müller-Armack [1960]). The latter is considered

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<sup>21</sup> See Rawls [1993] for the development of this theme.

from a liberal point of view as a danger for the respect of property rights (Hensel [1967]). Nevertheless, it conforms to another characteristic of German liberalism, one of control on the behavior of agents in the economic sphere, by means of a right of access to decisions affecting the concerned parties. This character is validated by the constitution in the obligation to use his property "for the good of the community" (Article 14 §2). This principle is directly translated from the Christian doctrine (Gonnard [1930]).

## 6. Conclusion

Social Market Economy based on the theoretical ideas of Ordoliberalism defines a specific model of political and economical organization, which goes beyond the strict opposition between classical liberalism and socialism based on the conception of property rights. It asserts itself as a truly "third way" (*dritter Weg* Röpke), which seeks in its own liberal philosophy a solution to the structural problems, that Germany faced since its industrialization. It tends to define an economic democracy which can resolve the conflict between political liberalism and market principles, focusing on the question of equality of economic powers and the institutional coordination of agents. It is certainly in its liberal objective that Social Market Economy presents its greater originality according to the political and economical history of Germany. If the question of economic democracy has been long debated in Germany, it is only with the works of the Freiburg school that a solution in terms of liberal market economy is proposed. The American influence was perhaps determining for the choice of this system, but German postwar Capitalism is not based on an imported model and establishes, beyond the material and political constraints Germany had to face in the wake of the war, an alternative economic style.

Contrary to appearances, this question of the specificity of Germany's political model remains of continuing relevance. The construction of the European Union and even the economic reforms in France, like the monetary reform with the independence of the central bank, and the coming social and fiscal reforms, seem largely inspired by this model. Tracing the old German tradition on which the style of the Social Market Economy is based allows one to question the nature of the efficiency of this model. Does it come from the highly institutionalized, solidarity-favoring structure of German Society, from the basic definition of economic policy referring to this model, or to the articulation of the two, i.e. the adaptation of this model to German society? And to say that the Social Market Economy takes advantage of the specificities of the German society signifies questioning its possible applicability to other economic systems, at least with the same success or the same acceptance of other peoples.

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