

THE ORIGINS OF THE GERMAN SOCIAL MARKET ECONOMY

THE LEADING IDEAS AND THEIR INTELLECTUAL ROOTS

Konrad Zweig

“Intellectual work achieves more in the world than practical work. Once the realm of ideas is revolutionized, reality can not hold on.”

From a letter by Hegel (26.10.1808)

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KONRAD ZWEIG studied economics and political science at the University of Vienna. After taking his degree, he joined the research and teaching staff of the Kiel University Institute for World Economics, where he published a number of papers on international capital movements and the interdependence between foreign trade and the trade cycles in England during the nineteenth century and up to the First World War. In these, he tested certain pre-Keynesian assumptions of German dynamic trade cycle theories based on the links between highly developed capitalist countries and still pre-capitalist economies. For a short time during the 1930's, he also acted as economist to the then chairman of the AEG. (German General Electric Company). He was engaged on a study of the economic background of the disputes between the English currency and banking school, when the events of 1933 terminated his work at Kiel.

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FOREWORD

The rapid economic development in the German Federal Republic, particularly during the Fifties and Sixties, has frequently been commented upon abroad. Common to these evaluations is the emphasis on the growth of the GNP of employment, prices and other economic data. Not much attention, however, was paid to the spiritual bases and origins of the new German economic policies. The great and continuing German discussion about economic orders is little known in the English speaking world.

This is regrettable because the German debate rests on experiences which no other European country shares to any similar degree. The break with Liberalism started in Germany during the last quarter of the 19th Century; since then an economic system which is aptly described as Interventionism gradually evolved in Germany. The National Socialist economic policies deliberately took over Interventionism and "perfected" it as the counter model to Capitalism and Liberalism, strictly regulating every sphere of economic and social life. During these decades most other Western countries pursued market policies, though not infrequently interlaced with numerous interventions by the state. The two wars fortified such Interventionism which, to various degrees, became politically accepted in the Western world, even in peacetime, as a tool of national economic management.

Yet West Germany deliberately pursued a different path: while in the important European countries the Welfare State or Plannification dominated the economic and political scene, men like Ludwig Erhard, Alfred Müller-Armack and their liberal, freedom-minded collaborators, Walter Eucken, Franz Böhm, Wilhelm Röpke, Alexander Rüstow, and many others opened the way towards a new and comprehensive understanding of a free market and socially-orientated economic order. The Social Market Economy became the hallmark of the political and social aspirations of the Founding Fathers. By this designation they intended to express two fundamental thoughts: one, that a market economy has great advantages and over an interventionist or command economy, particularly as a much superior provider of goods, thus rapidly increasing living standards. Two, the market order, in conjunction with conforming economic and social policies, can serve most excellently the aims of social security and protection. In other words, market economics and social security do not exclude each other. Social progress such as protection against poverty, unemployment, illness and old age must not be pursued in conflict with the rules of the market — an aspect which the promoters of the authoritarian Welfare State ignored. On the contrary; in Germany, the market and social protection are indissoluble and support each other.

I can see the great merit in Dr. Konrad Zweig's essay is in clarifying and describing the leading ideas of the German position to an English-speaking

public. His paper shows a profound knowledge of the historical roots; but at the same time, his chief aim is to sharpen public awareness for a spiritual alternative, the compatibility of a competitive market and social protection.

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November, 1979

INTRODUCTION

Towards a new beginning in Britain (1979) and in Germany (1948)

The present attempts in Britain to move economic policies towards a liberalised market economy point to some parallels with the origins of the Social Market Economy in Germany and the new beginning after the war. In the case of Germany the break was even more fundamental, as it meant a severance from the collectivist tradition which had existed since the last third of the 19th Century. Yet the break was achieved, and the basic ideas of the founders of the Social Market Economy remain intact to this day, despite deviations in practical policies and adaptations to changing circumstances during the Sixties and Seventies.

The main purpose of this paper is to present the fundamental principles as they were worked out by the founder generation. Though they were often attacked – partly from ignorance, partly from the totalitarian ideologies of a vocal minority – they met with a wide consensus and acceptance in Germany.

Social Market Economics

"The Social Market Economy is not primarily an economic order, but a leading idea or programme. An order is a concrete realisation, but a leading idea gives direction for human action." (*Seraphim* in an essay in honour of *Erhard* in 1957.) It is the programme, as it were, which this paper tries to describe, though in Germany programme and reality broadly have coincided over the last 30 years. As a programme, the Social Market Economy may now have added relevance for this country's new beginning, despite the historical and sociological differences between the two countries.

The application of this programme has led to the outstanding success of German economic performance. Even in the last few years Germany has better succeeded in coming to terms with the oil crisis and recession of 1973 than most other industrial countries and it would appear that Germany is again better prepared to deal with the renewed threats of today.

There could be no greater vindication and tribute to the men who, not presentiment of the future impact of their thinking on Germany, began to build the intellectual foundations of a socially orientated liberal economy some 50 years ago and laid down the guiding principles during and after the National Socialist dictatorship.

This does not imply that they proposed inflexible axioms: it was and still is a search for an economic and social framework for the efficient production of means of material well-being and personal freedom in a socially balanced order

and adapting to changing circumstances, yet based on the rejection of central direction, collectivist controls and discretionary interferences.

The advice to the King of Prussia, allegedly given by Prince Hardenberg at the beginning of the 19th Century: "We must do the same from above as the England do from below," was now reversed; this time the new beginning was to be made from below with the state strictly protecting the new liberal rules of operation, but not running the economy. It is ironic that Germany, after some 80 years of interventionism and state socialism, turned to the English liberal philosophies of the 18th and 19th Centuries, while the U.K. was turning its back on these traditions and embracing discredited German planning and interventionist policies.

The original ideas of a Social Market Economy were not based on a party political manifesto, but on philosophical views about the proper working of an economic system and the analysis of different economic orders, both present and past. This led to the judgement that a free and socially geared economy was superior to dirigism and authoritarian planning. At the same time it was claimed that a free and competitive organisation was the best guarantee to meet the expectations of a life of personal freedom and dignity, which no collective or planning system can ever give.

Even in its earliest days of most pressing material needs, the Social Market Economy was not advocated solely for its superior efficiency, but for its unification of the spiritual, economic and humane requirements of life. It was seen as an order beyond supply and demand, hoping to soften social strife, class differences and alienation of work. It was based on the wish of bringing together through Liberalism of what was most poignant in Socialist, Catholic and Protestant ethics.

This ethical and social aspect was never dissociated from the more narrow considerations of the material benefits of following the rules of a competitive market. The desideratum for a socially equitable order was inextricably weaved into quest for the best economic order of a society with its ever changing technologies and human expectations.

The Economic and the Spiritual Aspects

The liberalism would never have been accepted in Germany had it not been for this strong association with compassion and all-embracing social considerations.

From its earliest beginnings the Social Market Economy was supplemented by a wide net of social protections, because pure market economics entailed risks which the population was not prepared to bear without the expectation of social security in case of need. Furthermore, it soon became obvious that market economics yielded the material results on which to fund this protection of the community in the widest sense. Not only health, unemployment, old age, but improvement of the social environment, of the work place, of towns, culture, education etc. As the community became richer, all these social outlays were

improved and wherever possible they were improved in conformity with market principles. Advocates of market economics in Britain must not overlook that the enormous success of West Germany rested on the indissoluble unity of Market and Social Orientation. This was the basic premise from which the founders, e.g. Eucken, Erhard, Müller-Armack and Röpke started in the 1930s and followed up, after the War, with the support of wide sections of the population.

Alexander Rüstow, one of the leading founders, expressed this overriding necessity to build the market on an ethical basis in numerous books, papers and speeches: "The Social Market Economy must be the servant of humanity and of trans-economic values. All social, ethical, cultural and human values are more important than the economy, yet the economy must prepare the ground for their fullest development. For this reason the economy must not take on forms which are incompatible with these trans-economic values. Hence, we are opposed to a planned or interventionist economy, because such an economy ends in collectivism. Only a socially orientated market economy yields personal freedom and the opportunity for the realisation of the transcendental values. The constitution of the market economy must never overlook these moral considerations and the fact that man is in the centre of things."

INTELLECTUAL ROOTS

The Austrian School and the English Classics

The concepts of the Social Market Economy have many roots: The rigorous restatement of the market principles and of the intellectual failures of interventionism were much influenced by the Austrian analytical school, particularly the writings of Ludwig von Mises, the leading anti-inflationist and anti-interventionist of his time.

The famous Austrian economist Eugen von Böhm-Bawerk had already examined before World War I the effects of state intervention, monopolies and trade union power on prices, wages and employment. In an essay in 1914, *Macht oder ökonomisches Gesetz?*, he demonstrated that interventionism cannot undo the principles of the market and the price mechanism, but will lead to economic dysfunctions and mis-allocation of resources through distortions of market and prices.

Mises elaborated on both the motives and the bankruptcy of interventionism in his writings after the 1920s: "Liberalism (in contrast to interventionism champions private property, because it expects a higher standard of living from a free market organisation, not because it wishes to help the owners of the means of production. The surplus in the production of goods, the result of a liberal order, concerns even the poorest and it is by no means the particular interest of the rich...."

The system of the hampered market economy or interventionism does not want to eliminate the market altogether. It desires that production and consumption should develop along lines different from those prescribed by the unhindered market. However all methods of interventionism against the market are doomed to failure. Hence the Government must add to its first measure more and more regulations and restrictions until a point is reached in which all economic freedom of individuals has disappeared. The interventionist measures result in conditions which from the point of view of their own advocates are more unsatisfactory than the previous state of affairs they were designed to alter."

The influence by the Austrian school led in turn to the English Classics, little studied in Germany before the Weimar era. Adam Smith, David Ricardo and in particular John Stuart Mill showed that acceptance of free market forces did not exclude "sympathy" (Smith's word) for the under-privileged and concern within social questions in an economy steered by the invisible hand. They were agreed that a system freed from mercantilistic errors would raise "opulence and wealth". Mill, the social reformer, expresses views much in line with his liberal successors of some hundred years later: "Even if the Government could comprehend within itself, in each department, all the most eminent intellectual capacity and talent of

the nation, it would not be the less desirable that the conduct of a large portion the affairs of society should be left in the hands of the persons immediately interested in them. A people among whom there is no habit of spontaneous action for a common interest — who look habitually to their Government to command or prompt them, who expect everything done for them, have their faculties only little developed and their education is defective in one of its most important branches." (*Principles*, Book V Chapter XI).

Adam Smith had already distinguished between two economic objectives: "First to provide a plentiful revenue for the people to provide for themselves, and secondly to supply the state with a revenue sufficient for the public services." (*Wealth of Nations*, 1776. Book IV).

It was also Adam Smith who had clearly recognised that free competition may lead to unethical excesses, a critique often repeated over the following 200 years, not least by the opponents of the Social Market Economy. In his *Theory of Moral Sentiments*, Smith had this to say in 1759: "In the race for wealth, honours and preferments, the individual may run as hard as he can to outstrip all his competitors. But if he should jostle or throw down any of them, the indulgence of the spectator is entirely at an end. It is a violation of fair play, which they cannot admit to and the offender becomes the object of their hatred and indignation. He dares no longer look society in the face, but imagines himself as if he were rejected, and thrown out from the affections of all mankind." (Book 11, Chapter 2).

The originators of the Social Market Economy were well aware of this dichotomy and attempted to build ethical principles into their system to shield it from such mistaken attacks.

History and Sociology

The thinking in terms of economic orders or styles — so important to the development of the new German economics — owes much to the historical and sociological studies of Spiethoff, Sombart and Max Weber.

Spiethoff, though convinced of the necessity of timeless analytical economics, strives also for the understanding of historical economic constellations, the influence of religion, custom, law and specific organisations (urban, village agricultural, etc.). His task is to give typical examples of economic social life, which he calls 'economic styles'. Similarly he examines the typical styles of French, English and German mercantilism, liberalism etc. Mises's book on *Socialism* (1922) is an object lesson for such an analysis of styles.

Sombart's *Modern Capitalism*, published just before 1914, is a panorama of the historical path of European economic life. It deals in great detail with the phenomena which created the unique history of capitalism, its cultural, psychological, technical and religious background. He works out the different economic ordering principles which underlie the various historical structures.

Weber's immense sociological and historical studies linked the world religions with their economic manifestations. His basic tenet, that in the social sciences, understanding of economic relations requires the understanding of all cultural contents and their meaning, was applied to a vast conspectus of historical facts, from which he abstracted his famous Ideal Types.

These thoughts led Eucken to distil from the historical multitude of economic orders the two main types: the centrally directed Command Economy and the Free Market Economy; and he outlined the mechanics of their workings and their order-political operational rules.

It may be said that the early theoreticians of the Social Market Economy fulfilled an old wish (1927) of Schumpeter's: "If only one could mix Edgeworth with Sombart! But the future will achieve this."

The Social Question in Germany in the late 19th Century, and the Kathedersozialisten

The strong social accompaniment of post-1945 views has its sources in Germany's preoccupation with the social question (*Soziale Frage*) since the late 19th Century. Coupled with names once famous in Germany – Adolph Wagner, Gustav von Schmoller, Lujo Brentano – 1872 saw the founding of the Society for Social Policy (*Verein Für Sozialpolitik*), a body both anti-socialist and anti-free market, in the vanguard of social reform.

Adolph Wagner (1835–1917), the most prominent member of this group (*Kathedersozialisten*) accepted the "wisdom" of Adam Smith's analysis, but declared "Smithianism" had by now (1871) become obsolete. Social needs could only be provided directly by the state, and for this reason the state must enlarge its activities at a rising rate. Social concern and competitive markets were for Wagner totally incompatible. The state becomes supreme in all spheres of social life and economics.

Though Wagner's early teaching followed John Stuart Mill's principles closely, by the time he became the celebrated professor in Berlin, he saw in competition and free prices (including wages) the prime cause of much of the destitution of the working class. Low wages, job insecurity, and alienation on the one hand, with the luxury life of the rich on the other were, in his opinion, the effects of following the principles of the British economists and the non-interference with the rights of property and the freedom of trade and occupation. Freedom of competition – though leading to higher productivity – has many evil consequences: immoral distribution of incomes, exploitation of the weak, unjust prices and the limitation of opportunities for the emancipation of the poor. Wagner agreed with much of socialist critique, but he emphatically rejected socialism as such. He asks therefore that economics must become an ethical and moral science and he defines social policy as a deliberate intervention by the state into the economic processes of production, distribution and consumption. Competition and prices must be regulated and economic liberalism must be

controlled, because "Millions can not be made without brushing up against prison."

On social grounds Wagner was an advocate of nationalisation and communalisation, but he also was a sharp opponent of cartels, trusts and monopoly structures.

Stripped of his mistaken interpretations of the English Classics and Liberalism, some of Wagner's suggestions for social reforms, when taken in conjunction with re-establishing market rules, were echoed some 80 years later by Röpke, Rüstow, Müller-Armack etc. They valued Wagner's, precepts for example the essential role of peaceful arbitration in conflicts between labour and capital with strikes being a last resort; promoting co-operatives; transfer payments to the less well off; support for small and medium size businesses to prevent the alienation of mass society; profit sharing and general humanisation of relationships in factories and other economic enterprises; an improved balance between city and country. Even the Basic Law of West Germany (1949) reiterates an ethical maxim alluded to by Wagner in a speech in 1871: "Private property has its obligation; its use should also serve the public weal." (para 14).

Wagner's fame was widespread and he received an honorary degree from Cambridge. Keynes writes in his *Memorials of Alfred Marshall* in 1925: "I remember Wagner at a luncheon party at Marshall's, a representative of a generation of economists which is now almost past."

Gustav von Schmoller (1838-1917), Wagner's colleague in Berlin and the archcritic of the Austrian analytical school, concentrated primarily on meticulous and immense historical economic research, denying validity to economic generalisations. These historical studies made Schmoller also a fighter for social reform, attributing the social question of his time to the misapplied English liberalism existing in Germany.

He congratulates his country that "hawker's" economics had been turned into a moral science, freeing it from the insidious aspects of competition and the pricing system. His historical studies and his somewhat overstated critique of the Classics – much influenced by the "promoter's" excesses of the 1870's – must be seen as the foundation of his passionate desire to provide his country with the necessary comprehension of the social problems of the time and advice upon their solution. History and statistics were his instruments towards this end, anticipating in this respect the American Institutional school.

Wagner and Schmoller had immense influence on practical politics and their presentation of the *Soziale Frage* led to the introduction of the German social insurance legislation of the 1880's.

The preamble to the first law of 1881 gives a good example of the philosophy of the *Kathedersozialisten*; "The reflection that this law introduces an element of socialism must not prevent this path towards social improvement. It is nothing entirely new, but the furtherance of the modern idea of the state grown out of

Christian culture to serve the well-being of the community and in particular the poor and the sick."

Yet Wagner and Schmoller, the two most representative members of this late 19th Century school remained implacable enemies of Liberalism and Socialism and the most prominent advocates of ever increasing interventionism, with dire effects on Germany over the next 70 years.

Yet after 1948 their academic successors achieved to combine liberalism and social concern into a viable system — the Social Market Economy.

Philosophical Anthropology

One more strand of German thought had great impact on the development of the post-war economic ideas: Philosophical Anthropology.

It was Müller-Armack in particular who was inspired by philosophical anthropology as taught in Germany in the 1920's, attempting to overcome the age-old dualism of idealistic (Hegelian) and materialistic (Marxist) interpretations of history: social history is not predetermined, but it is subject to what man makes of his own values and opportunities. History is not a unique process, but offers mankind the chance to create styles, economic orders and systems of spontaneously grown institutions.

The Market Economy is such a spontaneous and not a man-made order; disproving the erroneous belief that there is no freedom of decision and that historical processes are predestined, unavoidably ending in collectivism and socialism. Likewise, the optimistic thesis of the 18th Century that history is a process of limitless progress and growth, can no longer be maintained.

The Social Market economy is not an apocalyptic vision and the ineluctable process. It starts from given realities, the market and its forces, and tries to use these anonymous forces to create a satisfactory economic order, personal security and an improved social environment.

Carl Menger, the co-founder of the Austrian school, anticipates these ideas of spontaneous orders not imposed by authority and legislation in his famous book on the methodology of the social sciences (1883): "Some social phenomena which serve human welfare to the highest degree, are not the result of legislation or authoritarian direction from above. The Market, competition, money, prices, interest rates etc., are the unreflected results of social movement. How is it that these institutions form themselves without being consciously willed by society?" The new liberal school in Germany sees in the preservation of the inner co-ordinating principles of these spontaneous institutions the prime task of a liberal economic and social policy.

It is the synthesis of these four different strands of thought which is the specific character of the "leading ideas"; and their application which brought about the German "economic miracle".

EARLY BEGINNINGS

The Freiburg Groups During the War

Though several German economists and jurists (e.g., Eucken, Böhm, Röpke, Rüstow, etc.) were studying aspects of market economics during the inter-war years against the mainstream of the Weimar Republic's planning and interventionism, the main impetus towards a regeneration of a liberal economy came from two sides during the National Socialist dictatorship: the Freiburg groups and the secret memorandum of 1943/4 by Ludwig Erhard.

Soon after 1938 Freiburg became the secret centre for a number of social scientists, historians and theologians discussing the social and economic problems Germany would face after the downfall of the Nazi Dictatorship. Broadly, there were three groups. The Freiburg Council largely concerned itself with the reconstitution and regeneration of the state. This group was complemented after 1942 by a second group, known as the "Bonhöffer circle", dealing with the future politico-economic structure on Christian lines. The third group was formed in 1943 under the chairmanship of Erwin von Beckerath and included a large number of anti-Nazi economists. Their main concern was to sketch out a free and socially aligned economic order to be put into operation after the war. The programme of this group — expressed in a number of secret papers — had many affinities with the eventual programmes of the post-war Social Market Economy.

Ludwig Erhard's Secret Wartime Memorandum

Erhard circulated his secret memorandum at the height of the war, and at the greatest danger to himself and his addressees. In this paper he spelt out a free market economy as the goal for defeated Germany's future economic and social constitution. His two basic principles for the future were stated: "The paramount objective is a free market economy dependent on competitive individual efforts and proficiency and its self regulating rules.... The tasks of the state is not to run the economy, but to provide the necessary legal and institutional framework for its proper functioning under the rules of law. To define the role of the state will be one of the most important problems of the post-war economy."

By these words written during the war, one is reminded of Burke some 200 years earlier: "It is one of the finest problems of legislation, namely to determine what the state ought to take upon itself to direct by the public wisdom and what it ought to leave, with as little interference as possible, to individual exertions." Such thoughts were very alien to interventionist Germany under the Kaiser, Weimar Republic and the time between 1933 and 1945.

Erhard elaborates on his war-time theme time and time again. In newspaper articles in 1945 and 1946 he writes: "It is quite wrong to think that free competition suppresses social involvement. On the contrary, collectivism causes disturbances in the economy and crises, which hinder social progress. If in future the state prevents the formation of special social privileges and artificial monopolies and stimulates the natural balance of supply and demand, then the market will regulate the application of all economic forces in an optimal way and correct all failures."

AFTER THE 1948 CURRENCY REFORM

Erhard's Speech before the Bizonal Council, June 1948

The proponents of a free market economy were all agreed, that its take-off was contingent on a currency reform eliminating the large money overhang which had accumulated through the inflationary monetary and fiscal policies after 1933.

In a crucial debate in the Bizonal Economic Council (17/18 June 1948) on the imminent currency reform, Erhard (by then Director of Economic Administration) expounded the new resolutions: "We must find our way back to a market organisation free from controls. In place of interventionism, we must insist on personal responsibility and performance. The market is not a diabolic invention to subdue particular classes. On the contrary, it is the only organisation of economic life which creates a just and optimal distribution, a function which no collectivist authorities can replace... we must eliminate uneconomic enterprises and cannot carry lame ducks indefinitely. Individual risk bearing must be rewarded, yet the penalties of mistakes cannot be shouldered by the community.... Profitability must be restored in order to steer capital into the appropriate channels.... Inflation must be squeezed out through strict monetary disciplines making the individual to run after money and not after goods. Only such policies will raise the National Product and enable us to carry out our social responsibilities."

Jacques Rueff, the French economist, summed up in 1949 this *volta face* in Germany: "People and things have not changed after the currency reform. What has changed and brought about success was the turning away from interventionism and controls towards the rules of the market and the operation of the price mechanism.... This new beginning ought to be studied by social scientists and politicians in many other countries."

Germany's new economics were now largely concerned with the supply and not the demand side of the economy. Supporting the policy inversion after 1948 was the growing economic and sociological literature, the roots of which went back to the inter-war years and which had to go underground or cease completely between 1933 and 1945. The country was fortunate that at this juncture it had a number of outstanding economists and social scientists who could now speak and write freely and give advice as to the shape and contents of liberal policies.

The Market and Social Organisation

In the main, two lines of thought came to the fore, though largely supplementing and supporting each other: the *Ordo* liberalism of Eucken, Rüstow, Böhm and others, also known as the Freiburg school to which Hayek must be added

(despite his reservations as to the meaning of "social" and his fears that the pursuit of social aims may be in collision with individual freedom).

The other line is connected principally with the names of Müller-Armack (later Secretary of State to Erhard), who coined the expression of "Social Market Economy", and Wilhelm Röpke, both of which had foundations in Christian ethics and philosophical anthropology. Also Erhard had strong leanings to their way of thinking. He was also greatly influenced by his teacher, Franz Oppenheimer, the "Liberal Socialist".

Briefly, their thesis was this: the growing material benefits of the competitive market can solve or at least soften class conflicts and lead to some convergence of interests between entrepreneurs and workers. The Social Market Economy is not Utopia, it tries to establish an equilibrium of the ideals of freedom, social justice and economic growth.

THE ORDO LIBERALISM

The Meaning of Ordo

In 1948 the first volume of *Ordo* was published, founded by Eucken and Böhm. It had the portentous subtitle: *Yearbook for the Order (Ordnung) of Economy and Society*. In the foreword the question is posed, "What kind of order is required for a humane and economically successful life?" In opposition to central planning and interventionism, *Ordo* is anchored in the insight that only competition via prices can solve the problems of society. Competition does not permit the fossilisation of social hierarchies. It is the appropriate order for social rise (and decline) based on individual initiative and performance.

Röpke relates a significant conversation between Eucken and a prominent member of the British interventionist economics establishment not long after the currency reform. In connection with foreign trade problems, this British Labour Party representative authoritatively advocated intervention through strict quantitative export and import controls and no reliance on market forces. When Eucken objected on liberal market grounds, the British economist replied he would not discuss theories and that this was British policy. Eucken answered prophetically: "For this reason the British economy falls from one crisis into the next."

Ordo's programme rejects *laissez-faire*, which already Adam Smith had denounced as tending to promote monopoly positions both of labour and capital. It is also disdainful of the middle way, the compromise between market economics and central direction, a mixture which is bound to end in inefficiency, strife and dissolution. In the competitive order as visualised by the *Ordo* social scientists specific interest groups must not be allowed to construct the economic order. Individuals — households and firms — must have the freedom to act, where competition can be arranged, though the state must intervene where competition can not be realised. Only competition promises to guard against authoritarianism, both from private economic groups and from the state.

Eucken borrowed the concept of *Ordo* from medieval scholastic philosophy. In the terms of Thomas Aquinas, *Ordo* co-ordinates in a unique way the Creator and the World. There is only one order which meets the reason and nature of man. *Ordo* is such a universally meaningful arrangement in contradistinction to changing and destructive orders throughout history. Following the Eucken of around 1948 the idea of *Ordo* owes its revival to the necessity to discover properly functioning and humanly decent principles for the economy, society, law and the state.

In Eucken's and Böhm's view it is the competitive order which most closely fulfils the criterion of *Ordo*: it is the only means which enables the individual to

plan his affairs spontaneously within the rules of law and morality free from subordinating compulsion by others and by state directions.

The free, competitive and co-ordinating *Ordo* is the standard against which to measure such interventions as may be justified on social grounds. They must be compatible with this interdependence and the co-ordinating principles, in conformity with the rules of the market, and must avoid discretionary and random authoritarian actions.

Thinking in terms of economic orders is for Eucken and his Freiburg associates the essence of their system. It refutes any historicist processes and presents the juxtaposition of actual orders in place of compelling evolutions over time. Economic orders are the totality of actual forms in which the daily economic process takes place. These forms change throughout history in manifold ways, and Eucken postulates that the task is to find the basic underlying principles and building bricks. Once the morphology is established, the interdependence between the economic order, the orders of society, law and state becomes transparent. It is one of the prime tenets of the *Ordo* liberals that only with the insight into these interdependencies can we establish the economic and social order best suited to modern industrial society.

Only the competitive order promises a system of conformity and consonance of all elements of society — economic, social, legal and moral. This was the underlying *Weltanschauung* of the first *Ordo* Liberals, though they were sufficiently pragmatic to realise the impossibility of *Ordo* ever being able to hold countervailing power and group interest structures completely in check.

Yet Böhm hopes that the acceptance of *Ordo* as a spiritual authority "may gradually immunise the great majority of men in Germany against the corruption by ideologies masquerading as scientific or prophetic." (*Ordo* Vol. III p. LXII). Böhm interprets *Ordo*: "The English classics assume a harmony and discovered the steering rules of this harmony. These rules must be obeyed, yet with the reward of freeing the individual from subordination under the arbitrary power of others. This is the meaning of *Ordo*. It is a spontaneous economic order, not a constructed and imposed one, giving economic freedom under the rules of private law. It is the opposite to command structures which subordinate man under manmade preconceived plans and directions." (*Ordo*, Vol. 3 1950 p. XLVIII).

This free exchange order is called by Hayek a catallaxy, a Greek noun meaning not only exchange, but also reconciliation and concord (Hayek, *Studies* 1967. p. 164), concepts at the centre of the new liberal thinking in Germany.

THE FREIBURG IMPERATIVE

Economic Orders

The outline of the principles of a market organisation by the Freiburg school was often presented under this heading in analogy to Kant's categorical imperative of a moral law which admits of no exceptions. The following presentation of the early ideas is largely based on papers by Eucken in *Ordo* in 1948 and 1949, on Eucken's book *Die Grundlagen der Nationalökonomie* (1939) and his *Grundsätze der Wirtschaftspolitik* published after his death in 1950 and of other contributors to the *Ordo* Annual.

Following his examination of the history of economic arrangements, Eucken reviewed the experiences of the last 300 years in an attempt to find a solution for the ordering policies appropriate to the modern industrial society in Germany. He distinguishes the period of *laissez-faire* of part of the 19th Century and the period of policy experiments and the collectivism of our own days.

Eucken's Competitive Order

He and his friends dismiss *laissez-faire* as leading — in the absence of a regulatory framework by the state — to the creation of power concentrations and eventually to the elimination of competition, to distortions of the price mechanism and to the misallocation of human and material resources. For this reason the Freiburg school never thought that the formation of an economic order could be left to itself. In their view *laissez-faire* turns into interventionism and makes the state an instrument for sectional interests and discretionary interference. Thus Germany on the basis of *laissez-faire* became the typical country of cartels during the last quarter of the 19th Century.

Böhm (*Ordo* 1948 Vol. I) analysed an important judgement by the Constitutional Court in 1897 which gave legal clearance to cartel agreements with far-reaching collectivist consequences over the next 50 years, until the Allies in 1948 decreed against business concentrations and cartels. Böhm sums up: "Through cartels the economy was deprived of its essential ordering tools — free prices and competition based on individual proficiency. It created much malaise in the population and led to increasing attacks on market principles and to ever-growing interventionism."

In 1913, an American observer, Elmer Roberts, called cartelised and dirigiste Imperial Germany "Monarchical Socialism". Gustav Stolper, the liberal editor of the *German Economist* during the Weimar period, wrote in 1940, while in exile in the U.S.A.: "Imperial Germany laid, through cartels and widely accepted anti-market policies, the foundations for the interventionist experiments of the Weimar Republic and of the dictatorship of National Socialism."

The era of Policy Experiments in contrast to *laissez-faire* embraces many varieties: command economies with or without private property; economies with controls of prices, wages, etc.; and economies of the middle way; delegating decisions from the state to semi-autonomous bodies, advocated in Germany by Rathenau before and during the 1914/18 War.

Eucken, Böhm and others strongly dismissed Policy Experiments as being unsuitable to solve the economic problem because of the inability of state or central planning bodies to replace individual decision making, choice and the appropriate correlation of resources through prices.

Eucken then asks: "What order — both functioning and humane — is adequate for today's society?"

"To answer this question the problem of the steering of the industrial society must be given pride of place: the great, daily, unboundedly interdependent economic process and the interlacing of the economic order with the orders of state, law and society is the point of departure. Order policies must be based on the knowledge of individual forms of economic order, coherence of economic processes and interdependencies of the orders. Ordering reasoning guides order-political acting."

Eucken concludes that perfect competition must be aimed at, though he acknowledges that this ideal – where marginal costs equal price - will be hard to achieve in reality. Yet he claims that, provided a number of interdependent conditions are met, an order of near-perfect competition can be realised. Two interlocked sets of principles must be applied: the principles which constitute the competitive order, and the principles which make it operational in face of malfunctions in certain markets including labour.

The Constituent Principles of the Competitive Order

(1) The maintenance of a properly working price system, free from controls, must be the prime objective. This principle is paramount and must be respected in all spheres of economic policy, hence there must be no control or subsidisation of prices and wages, interference with interest rates, import controls etc. Any economic policy is doomed which does not respect the price mechanism. It is the strategic centre which dominates the whole.

(2) A stable currency is indispensable for establishing the competitive order. Open or repressed inflation distorts the allocation function of prices and falsifies all economic calculus. Changes in relative prices steer the economy, but once inflation (or deflation) takes over, a disturbing element is introduced into price relationships and hence the amount and direction of production comes into conflict with the real objectives of the market. Money ought to be neutral relative to goods.

At this point the early Freiburg school's attitude to full employment policies falls into place: Eucken bases his opposition to Keynes largely on order-political grounds. Unemployment is for him a sign of faulty steering of the economic process and the typical result of the "middle way". The economy requires a serviceable calculating mechanism, but full employment policies tend to block this mechanism because they operate in global terms and are unable to find the correct relative proportions of the economic quantities. This inflationary bias of Keynes's theories was no doubt the principal reason why post-war Germany took such a different path from the U.K. and the U.S.A., giving micro-economics the principal place well into the sixties. There may though, be a different and perhaps emotionally deeper reason. In the preface to the German edition (7.9.1936) of his famous book, *The General Theory of Employment, Interest and Money*, Keynes speculates that "the theory of output as a whole is much more easily adapted to the conditions of a totalitarian state, than is the theory of the production and distribution of a given output produced under conditions of free competition." Such thoughts must have been anathema to the founders of the Social Market Economy quite apart from their distrust of thinking only in global terms. Ideas which Hayek had already expressed in 1930.

(3) Open markets are another precondition for Eucken's type of perfect competition. The modern state and private power concentrations have invented innumerable instruments for closing demand and supply and hindering competition, e.g. licensing of investment, state monopolies, misuse of patent rights etc. The C.A.P., which Eucken did not live to see, is probably one of the most crass examples of such closed markets.

Economic policies must be directed towards *opening* of markets, otherwise misuse of resources and permanent monopoly structures arise.

(4) Economic policies must have reasonable constancy and must indicate some long-term path. Instability of economic policies — "stop go" — affects the entrepreneur's decision making, confuses his expectations and so reduces his incentives to invest. Such inconstancies increase risk and are therefore a prime mover towards concentrations, fusions and conglomerates. Without constancy of policies, the competitive system cannot work properly, nor carry out its principal function to respond to the price signals of the market and avoid or correct disproportionalities in investment. Risks will be too high and calls for state help with all its arbitrariness are the result.

(5) Private property and private risk-bearing are essentials for the operation of a free market. Collective property of large sectors of the economy is bound to lead to uneconomic and low efficiency investment, misallocation of the means of production and the preservation of commercially obsolete units. If there is state ownership it must obey the rules of the market and not be run against the forces of the market through open or hidden subsidies, perpetuating inefficiency, over-manning and ignorance of changing demand environments etc.

Private property is the inalienable condition for the preservation of a widest area of personal freedom. Wilhelm von Humboldt, one of the last great liberal

philosophers before authoritarian thinking took over in Germany in the 19th Century, had written around 1792: "The idea of property grows only with the idea of freedom. The most energetic work, we owe to the institution of property." The collateral to private property is the private bearing of risk. Private liability is part of the steering mechanism of competition. Losses and bankruptcies are the unavoidable penalties. The consequences of wrong decisions must not be shifted to the state. Private liability is the precondition for a society where freedom and individual responsibility rule. In the words of Hayek "Freedom and risk are inseparable." (*Economic Freedom and Representative Government*, p.17, IEA 1973).

(6) Freedom of contract is another precondition for the working of competition, though it must be prevented from being misused towards monopolistic groupings. It is the basic principle of the rule of law that the freedom of the individual is secured in two directions: against the state and against menaces by other individuals. Bearers of private power, the unions for example, are in a position to abolish other peoples' rights of freedom. Hence freedom of contract must be built into labour legislation by preventing the closed shop, obstructions to enter trades through hidden or open restrictions on apprenticeships and so on. This applies equally to the analogous restrictive entry practices by enterprises and professions.

The Interdependence of the Principles

Following Eucken the six main constituent principles form an indivisible unity and are the basis of the liberal economic constitution. They are indispensable for creating the liberal order in reality and they yield "the best economic order... We must get used to the thought that fundamental questions of the spiritual existence of man are inextricably connected with the profane problems of the steering mechanism of the economy."

The application of the six principles in the particular situation, breaking with interventionism, constitutes an order willed by the people and yielding the conditions under which this order can unfold. The principles in their totality serve the one decision of using spontaneous forces and are the means to bring it to fruition.

All this may sound vague and strange to Anglo-American mathematical model builders, but it formed the foundations on which Erhard and his collaborators built up the Social Market Economy in Germany.

The Regulative Principles

Eucken proceeds; "Compliance with the constituent principles, however, cannot prevent the emergence of monopolistic and oligopolistic structures. Without monopoly legislation the competitive system and the rule of law can be endangered. The state is to provide the framework within which the market can operate and carry out its anonymous allocative and distributive functions. The aim of monopoly and competition legislation is to induce the bearers of economic

power to behave "as if" they operated as perfect competitors. Monopoly control or competition bills are designed to limit or dissolve anti-market concentrations and to act prophylactically, leading to business decisions analogous to the principles of perfect competition. In a competitive order monopoly structures are held in check by economic and legal policies, which promote the strong forces of competition and help the break-through of the six constituent principles. By following these principles the state liberates itself from the influence of power groups and at the same time gains the means to support competition against the greed of trusts, cartels and unions."

Leonard Miksch, another member of the original Freiburg school, sees this "as if prophylactic" effect rather as an heuristic principle in order to discover the precise points where the steering by the state has to start (*Ordo*, Vol. II 1949 p.327). Steering to make the market work, not steering the market itself.

Röpke summarises Eucken's maxims, which had such immense influence on German policies, as follows: "Eucken's problem was the creation of a functioning order or form of the economy and society, while its solution is seen as leaving the economic process to its own autonomy. Form and process are the categories in which his economic policy thinking moves. The emphasis is on the present form of the market, the protection of the price mechanism and on the freedom of the processes of markets, prices and competition. Only the combination of both — form and process — can yield order, freedom and spontaneous interaction on the markets, which are governed by competition and the scarcity signals of prices." (*Ordo*, Vol. XII 1960, p.14).

Perfect and Imperfect Competition

Eucken's views on monopoly, oligopoly and perfect competition were criticised on both theoretical and practical grounds. Hayek comments in 1953: "We do not insist on universal competition, but on the universal possibility of competition... I have no objection to a monopoly position and monopoly profits arising, for example, from the superior gifts of an entrepreneur, as long as nobody else is prevented to enter in competition. As long as such a monopolistic enterprise is under the pressure of potential competition, the rules of the competitive market are not put out of action." (From a lecture at Cologne 20th July 1953).

Friedrich Lutz, an early pupil of Eucken's, elaborates this (*Ordo*, Vol VIII, 1956, pp. 29/33) "Perfect competition in the language of the founders of the marginal school (e.g. Walras, Jevons, Menger, etc.) is a static concept of rest, the competition of the 'night cap', while practical men see in competition an innovating dynamism, which propels the economy forward. In this sense competition is operative in oligopolies or even in temporary monopolies. It works like a whip to induce producers to utmost exertions to lower costs, create new goods and services, introduce new technologies, etc. Such dynamic developments may lead to temporary monopolistic or oligopolistic situations, yet under the pressure of imitative competition they disappear after a time until new waves of innovations repeat this process. It seems a distortion of language to apply their concept of market domination to this pioneering role of the

entrepreneur, while in reality this is competition *par excellence*." Shades of Schumpeter's Theory of Economic Development (1911)!

The apparent contradiction between these interpretations of competition by Eucken and Lutz can be solved by allowing for their own deep personal experiences. Eucken witnessed the misallocation of resources under the Nazi dictatorship, the later days of Weimar and the interventionist economies of his time. Hence, his passionate striving for a system of optimum allocation which he saw ideally in perfect competition. Lutz on the other hand, with an American background, saw in monopolistic, imperfect competition a vehicle for innovation and technical progress. This was later repeated by others such as Haberler, who had a long background in America; "Monopolistic competition is essentially competition rather than monopoly."

The pragmatist Böhm (Professor of law, high civil servant, member of the Bundestag, legal adviser to the Government, adviser of the first monopoly legislation of 1957, negotiator with Israel on restitution, etc., etc.) is representative of *Ordo* thinking on competition: "Practical policies to establish competition and to check anti-market power positions are not pursuing the goal to mould the reality into the image of the theoretical model of perfect competition. Suffice it to create as much competition or rivalry as is just practical under given circumstances.... These compromises do not completely discard the ideal of perfect competition. Even an Ideal Type can give a lead as long as some approximation is feasible and desirable." It was argued that it would be wrong to base the new monopoly legislation on assumptions of total market transparency, perfect foresight, immediacy of reactions, prevention of differentiated demand preferences, or homogeneity of products and services — the basic elements of the perfect competition model.

INTERVENTIONIST LIBERALISM

General Principles

Though the early *Ordo* Liberals saw the prime function of the state as being to safeguard competition and to prevent degeneration into power structures and destruction by specific interest groups, market conforming adaptation interventions are not ruled out on dogmatic grounds. Helping and speeding up the process of adaptation to long term structural changes in the market environment may be justified.

Rüstow, in a famous address to the last session of the *Verein für Sozialpolitik* in 1932, shortly before Hitler came to power, sketched out this adaptation intervention parallel to market trends. Assuming that outside events irresistibly change some economic data, e.g. long-term worsening of the competitive environment of some industries (steel, shipbuilding etc.), three courses are open: ever-rising subsidisation by the state (the Weimar policy); *laissez-faire* by doing nothing, causing great hardships; or intervention to achieve a new position of equilibrium more speedily, abbreviating to almost zero the time towards the unavoidable change, thus shortening and ameliorating the social hardships. This form of intervention propagated in 1932 by Rüstow, an arch-liberal, was accepted in West Germany and is now supported both in theory and in practice. "While indiscriminate subsidisation of untenable structures or following blackmail by strong interest groups turns the state or government into booty, adaptation intervention, anticipating or recognising adverse market trends, restores the proper function of the state" and makes it a powerful instrument to uphold the principles of the Social Market Economy. From these considerations stems the general attitude towards market conforming interventions.

In 1943 Stackelberg gave a secret lecture to the Freiburg circle in which he expounded these principles on the strict basis of marginal utility theory. In particular he tried to distinguish between state regulations enhancing competition and regulations in direct conflict with the market, lacerating the marginal calculus. The former state regulations he called system-conforming and the latter system-obstructing. These thoughts — taboo in Hitler's Germany — were later given prominence in shaping economic policies.

Müller-Armack

This "Interventionist Liberalism" — intervening in conformity with the market — was elaborated after the war by Müller-Armack and others: "A market orientated social policy differs from discretionary interventions not by its goals, but by its instruments. Price controls, price and wages subsidies, etc., generally block and distort whole markets and are of little benefit to the community. The new economic policy attempts social progress through means in conformity with

the market. There may be doubtful limiting cases — the Social Market principles are never sacrosanct — but the meaning is clear. For example, non-market conformity is the attempt to control interest rates, mortgage rates etc. Market conformities are subsidies to certain borrowers, which do not interfere with the formation of interest rates. Or, non-market conformities are rent controls, but market conformities are cash subsidies to poorer people to enable them to compete on the housing market. The development of a negative income tax may be another market-conforming instrument of social policy, while fixing minimum wages is non-market conformity."

Aspects of the German Social Security System

The comprehensive and very sizeable German social security is the direct consequence of the rapid growth of the German economy since 1948 based on the Social Market principles. "Though Social Security is not directly generated by the market, a successful and growing market economy provides the conditions on which to build the complex system of market-conforming corrections and to counterbalance undesirable market effects." (Müller-Armack in 1952).

West Germany did not go the path of a universal welfare state, which was considered as state socialist and authoritarian. The main principles can be illustrated by the German old age (Renten) insurance and sickness insurance. Both are market conforming, the old age insurance trying to maintain the insurance principle of equivalence between contributions and benefits. Since 1957 pensions follow the rise in per capita G.N.P. The insured administer the scheme, 50% employees and 50% employers in an elected body. Due to the loss of capital during the war, pensions are now partly financed by the state and by current levies on employers and employees through transfers to a fund against the legal promise that the present contributors (15–65) will have the same rights when old (called the "generation contract"). But it is feared that this "generation contract" may not be maintainable in the long run due to the significantly changing age structure in the population of Germany. A great variety of reform plans are now being discussed in order to safeguard future levels of pensions. All plans are based primarily on decentralised market principles, combining levies with incentives towards self-help through cheap insurance schemes, assisted savings, transferable insurance at the place of work and incentives towards the acquisition of property, e.g. owning homes, savings accounts, shares in the employing firms, etc. (no final reforms have so far been introduced).

Public health provision has also not followed the welfare state. A decentralised, self-administered, partly competitive system of sick funds (*Krankenkassen*) including funds by employers, has developed. Though this system works well (no waiting lists) costs are escalating and contributions by employers and beneficiaries are rising. The state is not involved. It is now suggested by some reformers that in case of sickness extra premiums, financed from personal insurance, ought to be paid in addition to the general insurance. Also a greater role ought to be allocated to private health insurance schemes.

All reform plans aim at some restructuring of the existing social security system, not at the reduction of benefits. The reformers maintain that the mass of the population is now sufficiently well-off to shoulder part of the life risks themselves through cost-efficient private schemes within the Social Market Economy.

The present representatives of Social Market thinking are quite prepared to correct the distribution of incomes, but such redistribution and taxation must not destroy the market economy. Capital accumulation must not be hindered. Provision for the individual's future and social security must be rebuilt in such a way that one of the greatest incentives for savings, self-provision for old age, is not destroyed. They plead for all forms of property politics to create the widest possible dispersion of private ownership as the strongest pillar for social security.

A very comprehensive and interesting analysis and reform programme was propagated in numerous papers by the late Professor Schreiber of Cologne. As his ideas are of great influence on present thinking in Germany, yet controversial, a brief sketch is given in Appendix 1.

OPPONENTS: ECONOMIC DEMOCRACY

The new liberal ideas in Germany were first opposed by the left, demanding economic democracy in place of free enterprise, a slogan stemming from the 1920's. The Social Democratic Party (S.P.D.) and the Unions had broken with Communism after World War I and were much attracted by the ideas of Rathenau and of Mollendorf, a leading theoretician of the time. In 1928 a programme was published which demands supplementing political democracy by economic democracy. Though the details were kept rather loose, the principal claim was for the establishment of general councils or planning bodies giving directions to business. Thus, the totality of the economy was to be directed, though not the individual enterprises. These ideas were taken up again after 1945.

Böhm's critique of Economic Democracy

Böhm in a long paper in *Ordo* (Vol. IV 1951) rejecting workers co-determination, examined Economic Democracy, from which co-determination originated. His arguments shed some more light on the German interpretation of market economics.

Even the Left of the time made interesting modifications to the old ideas: no wholesale nationalisations, but only planning the framework of the economy and steering from certain key positions. The talk was of "planning with a light touch" or a "steered market economy", while accepting some of the virtues of the market and of competition. The opponents of Erhard and the Freiburg school saw in Economic Democracy, stripped of the more radical components of the 1920's, a regulative idea and a constructive solution of social and economic problems, which in their opinion the market could not solve.

Böhm's judgement conforming with *Ordo* principles proceeds on the following lines: "Economic Democracy of the post 1945 vintage rejects command economics on the ground of its authoritarianism, but it also rejects Market economics because of tendencies towards power and wealth concentrations in the hands of the few. Yet, there is no third alternative beside centrally directed and market directed economies. Economic Democracy therefore tries to combine and mix both systems. The means of central political and market steering are put side by side. This would open up many possibilities for different steering methods and intervention techniques into economic processes. Such a mixed system is not workable because the mixture would be random, giving a leading role neither to the one nor to the other. It is impossible to run an economy by way of two differently structured ordering forces. It is, as it were, an economic symphony with two scores. In the end Economic Democracy would lead to political steering from a centre and to discretionary (*punktueller*) interventions by government or special interest groups. Economic Democracy is comprehensive

planning, perhaps collusion between workers or unions and entrepreneurs at the cost of the consumer, a blocking of the market mechanism. In other words no longer does the steering of the economy work through the aggregate of free and spontaneous reactions of producers and consumers."

Böhm admits that the market leads to inequalities in incomes and wealth, but in his view this is the price which society pays for a system in which even the lowest income strata are better off than the totality of people would be in a politically enforced system of equality. Böhm rejects a philosophy which would curtail individual freedom for the sake of compulsory egalitarianism. The market is the unique system which equilibrates all interests according to consistent, rational and just rules.

ORDO IN THE 1960's AND AFTER

Paul Hensel, another of the first *Ordo* contributors, defined the tasks of economics as two-fold: "To analyse the economic process with the tool box of pure theory, but also to act like an architect drafting the economic order. It is therefore legitimate to assert the superiority of the architecture of a decentralised economy over a centralised command economy, once individual freedom and an open society are assumed as the basic foundations."

Constructivist Deviations in the 1960's

Eucken foremost, and the *Ordo* Liberals have acted in such capacity and have given through their leading ideas the greatest possible impetus to Erhard and his economic policies. Yet around 1960 more voices were raised to doubt whether the new Liberalism could survive in the face of power concentrations, increased state participation and discretionary interventions. Historicist theories once again emerged, prophesying the inevitability of a trend towards monopolies and the doom of a competitive order.

Böhm, Lutz and Meyer replied to these destructive visions in 1961: "Assuming the doomsters were correct and the economy became more and more the victim of power structures, interventionism and bureaucratic direction, the economy would still be co-ordinated by competition, because even such a haphazardly mixed economy would not be subjected to an overall plan. The results, however, would be different from a truly competitive system. A meaningful and plebiscitary order, in which private benefits tend to equal common utility, would be supplanted by an economy losing this plebiscitary qualification of the price mechanism, and the near identity of private and common utility would be lost. But even under the worst circumstances, the steering mechanics of the market would survive, though its dysfunctions would become more and more apparent. But well before the *Ordo* Liberals might capitulate, they would continue to insist that the proper market economy must be saved from dissolution and neglect." The prospect of a renewed "age of experiments" would suffice to awaken the spiritual and moral energies to prevent such a fate from perpetuating itself. The *Ordo* Liberals "will not capitulate because concentration and interventionism might overrun the free market system, but concentration and interventionism will win if the *Ordo* Liberals and other rational thinking people capitulate prematurely."

In 1970, with Galbraith seeing the technostructure replacing the market, Marcuse having become the new prophet, and some of the younger German economists teaching the evils of the market and advocating planning and controls, the *Ordo* Liberals once more stressed the importance of pursuing the early intellectual principles which brought about the German prosperity. In the face of constructivist and global economic policies which deviated from the paths which

Eucken, Erhard, Böhm and Müller–Armack prescribed, *Ordo Liberalism* in the persons of the younger generation e.g. Hoppmann, Tuchtfeldt, Hamm, Watrin and Willgerodt, once again took up the challenge and mapped out a way appropriate to the changing environment, yet in the tradition of the founding fathers.

Böhm: The New Problems of the Seventies

Böhm lists the new worries to which *Ordo* has to turn: inflation, largely imported from abroad but also arising from overstretched expectations of social wages; the problems of the physical environment and limits to growth; business concentration and manipulation of competition; co-determination by labour; structural unemployment; and the misguided critique of the Social Market Economy as an excess consumer society (a critique which Erhard had to counter since the early fifties).

Despite some deviations of reality from the original ideas, the intrinsic principles remain: a market economy steered by prices yet socially orientated; an independent Central Bank pursuing a money supply policy towards stabilisation; no controls of prices, profits and the direction of investment; free collective bargaining within the codified labour law; vigilance to protect as far as possible private competition; strict periodical reviews of subsidies, specific tax reliefs and other forms of discretionary assistance to persons, regions and enterprises (see Appendix 2). Hence also the caution by Government and the Central Bank in 1978/9 of allowing excessive monetary and fiscal stimulation to the economy.

Reaffirmation of the Basic Principles by the Government in 1979

The Economics Minister summarised the Government's attitude to the Social Market programme in a speech to the Bundestag on February 8th 1979: "We are all agreed on the basic premises:

(1) The economic superiority of the competitive order over any other order is undeniable. The market safeguards personal liberty.

(2) The market, though highly efficient, can not achieve everything. No government can therefore shrink from correcting certain results, if this is indicated on social grounds. Yet demands for social security must not exceed the capabilities of the market to finance them. This would reduce individual incentives and weaken the market. The Social Market Economy is not a political slogan, but the incredibly successful principle which guided economic policies for over 30 years, giving wide social security and providing the foundations for a free and open society.

(3) The fundamental freedom of the market order is anchored in the premise that entrepreneurs, workers and consumers are given numerous economic alternatives' thus avoiding the dictates of the powerful. Competition is not restricted to small business; very large enterprises also face competition. For this

reason we do not intervene directly into their policies, but we pursue and improve the appropriate competition legislation in support and not against the market.

(4) Excessive subsidies of long duration destroy the will to self-help and adaptation to new circumstances. Such subsidies may lead to further subsidies and interventions, eventually threatening the market economy and losing efficiency, flexibility and adaptability."

This was said by the Minister in 1979: the founding fathers would have disagreed with little!

THE SOCIAL ORIENTATION

The word "social" in its widest sense, of an obligation to create an environment of freedom from want, was introduced into the German language by Franz von Baader during the first half of the 19th Century. Baader, a medical man, philosopher and theologian, studied mining in England, observing both poverty and the remedial efforts of some members of the upper classes. Baader's writings based on Christian and not Marxist positions influenced other early social reformers in Germany and through them the *Kathedersozialisten* of the *Verein für Sozialpolitik* (Malchus, *Ordo* Vol. XVII 1966). The contradiction between market economics and solving the social question in Germany looked then unbridgeable.

Alfred Müller-Armack, Wilhelm Röpke and Alexander Rüstow have greatly contributed towards a solution, weaving social and humane concepts into the *Ordo* philosophy of the market order.

Müller-Armack's First Axioms; 1946–52

Although Müller-Armack did not belong to the Freiburg circle, he worked out the programme of a market economy appropriate to an industrial society. He saw in this liberal organisation the first attempt in history to enable a mass culture to exist without compulsion, in freedom and with human dignity. He examined in detail the basics of interventionism and of centrally directed economies in their various forms, and like the *Ordo* Liberals he proved their incongruities and the superiority of the market. Yet, due to his early historical and sociological studies he stressed the social desiderata to be built into a market economy as an inalienable part. The Social Market Economy is for him the attempt of a synthesis of a free, entrepreneurial organisation and the social exigencies of modern life. He hoped to achieve this by the appropriate setting of the desiderata and not by ever-growing expansion of the activities of the state as the *Kathedersozialisten* had preached.

Though a passionate advocate of the free market, he was equally insistent that market policies must be filled with a social content: "Without social protection no market order, and without market order no social protection."

His first programmatic ideas, which as the deputy to Erhard he was to put into practice during the 1950's, are spelt out in many books and papers.

Shortly before his death in 1978, he published a last, short programmatic paper "The Five Great Themes of Future Economic Policies" (1977). He reiterated his strong views in a speech in February 1978, which aptly summarises his beliefs: "The Social Market Economy is not a mixture of Capitalism and Socialism. It dared to achieve, on the foundation of a free competitive system, social and economic progress at the same time. On the one hand there is the freedom of

competition with the guarantee to acquire property, to act without compulsion and to participate in the growth of wealth. This economic efficiency is intertwined in the Social Market Economy with social progress, the sociological superstructure which yields for our society the spiritual and moral necessities."

Tracing the septuagenarian's final words from his beginnings after the war, his dilemma was clear: how to devise a free, yet socially geared economic system, without the state being the all-embracing interventionist, the chief provider of the social benefits. In Eucken's words "to prevent the crushing dependence on the state and the metamorphosis of man into part of a large machine with economic and social insecurity flowing from this dependence." Müller-Armack (and also the *Ordo* Liberals) saw their task in re-shaping the economic order and establishing the rules of the game in such a way "that one intervention was not causing a further intervention in order to cure the prior intervention" (Christian Watrin), thoughts which haunted Mises after 1918 until his death in 1973.

A few quotations from Müller-Armack's earlier writing are essential in this context: "It is our task to examine the compatibility of the market order with those economic and social goals which are now the basic requirements of the industrial state. The economic order is in indissoluble cohesion with the lifestyle to which we aspire. The ideals of human freedom and a dignified life cannot be realised if the economic order contradicts them.

"The goal must be a free market economy surrounded with social protections conforming with the rules of the market.

"The free market order is likely to achieve a much higher rate of productivity than any interventionist economy. This growing wealth will enable society to carry out its social and moral duties. By safeguarding the apparatus of exchange and commercial freedom, the market economy remains within the limits of the possible and it eschews the tragicomic situation of interventionism which combines ever growing promises with a deteriorating standard of living."

He also concedes that the state must provide social goods, but must also submit to the rules of the market. "The instrumental character of the market economy needs supplementing by a framework of a market-conforming social policy. We must develop an all-embracing system of policies which is compatible with the rules of the market. It is however, essential to abandon social arrangements which lead away from market co-ordination and culminate in direct interventions and controls."

Following the principles of "Interventionist Liberalism", Müller-Armack is not averse to high taxation in favour of social consumption provided the choice of taxation techniques is correct (e.g. a proper blend of direct and indirect taxation). Although this may change the demand data, it does not damage the rules of the market and yet it provides the essential means towards achieving the required social goals.

The Social Market Economy underlines the principle that wherever the individual requires conjoint help, the safety of his freedom is of eminent importance. In other words, the free order of the market must be complemented by a free social order. Both taken together constitute the Social Market Economy. It is based on the search for solutions which meet the criteria of freedom, social justice and productivity.

The Second Phase of Müller-Armack's Principles

The great material success of Germany's Social Market Economy during the first decade of its life necessarily led its protagonists to a critical examination of achievements and of the outlook for the future. Already in 1948 Erhard had stressed the requirements of adaptability and adjustment of ideas to new tasks.

Müller-Armack gave much thought to the future and the widening of the tasks beyond the efficient equilibration of supply and demand. He was convinced that in the second phase of the Social Market Economy, socio-political problems will have precedence over pure economic concerns. New forms of property must be devised, spreading capital ownership over the widest sections of the population, through subsidies on personal saving, distributing state-owned property, increasing concern for education, cultural values and the environment. Concentration of anonymous big business must be corrected, encouraging individualism in small and medium sized enterprises. He sees the principal task for the future as being to determine the style and humanity of social policies to come.

He lists a catalogue of requisites, all with the overriding aim to free men from being engulfed and mechanised by mass structures. "While the Social Market Economy was so far largely propelled by the insight into the proper functioning of the free market, a turn must now be made, using the same economic basis towards the furtherance and development of social and more objectives. " The Social Market Economy therefore is not an exclusive theory of competition. It aims at the co-ordination of the life compass of the market, of the state and social groups. It reaches beyond supply and demand and represents values which have their source in ever-valid cultural and religious traditions of Western Civilisation.

Röpke: Beyond Supply and Demand: Civitas Humana

Müller-Armack also echoes thoughts which Röpke, while in exile in Switzerland, had developed during the war, his main theme being the social crisis of our time. Röpke was probably one of the few who at that time, clearly dismissed the visions of inevitability from Spengler to Toynbee and saw signs of a regeneration of Liberalism, both as a superior form of social organisation and a spiritual power with its roots in the English Classics of the 18th and 19th Century. In a memorandum commissioned in 1950 by Adenauer, Röpke once again develops his thoughts with great emphasis on the necessity to prevent ever increasing loss of individuality and proletarianisation of a mass society. He sees in the Social

Market Economy and its decentralising tendencies the best means towards the goal of achieving a full life for all, no longer in conflict with the industrial society.

Müller-Armack supplements the three basic economic aims — price stability, growth and maintainable high employment — with three spiritual aims: personal freedom, security and social harmony. It is an "irenic" order. Significantly, he borrows from the young Marx the concept of alienation at work and sees in the solution to this evil, which Adam Smith had already recognised, one of the most important tasks for the Social Market Economy. In his view, interventionism only aggravates it. Improvement in the quality of life is the summons to Social Market principles; "We must proceed on a double path; humanising the environment, the firm, the income and wealth structure, and yet giving individuals the chance to develop and apply their full potentialities within the dynamics of technology, science and business. " Pursuing these objectives with determination and conviction, the Social Market Economy may eventually be transformed from a highly efficient economic instrument into a *Civitas Humana* — Röpke — not regressing once again to an all-powerful Leviathan.

FURTHER DEVELOPMENTS

Though the main purpose of this paper is the presentation of the leading ideas of the Social Market Economy which guided policies in Germany since 1948, two developments during the Sixties and Seventies are of great importance for the evolution and understanding of the early principles: (1) The introduction by Karl Schiller, the Economics Minister, of macro-economic concepts through the Stabilisation and Growth Law of 1967 and (2) The acceptance of some monetarism in 1973, already touched upon by Eucken 25 years earlier.

Schiller Turns to Macro-economics

From the beginning of the 1960's many changes began to take place in Germany. World-wide inflation was imported into Germany, largely due to her inability to neutralise the inflow of Dollars and other weaker currencies, a rising internal price level partly generated by government expenditure, a reluctance to upvalue the DM, militancy of the unions, and rising demands by the public for better welfare services in response to the 100% growth in G.N.P. between 1951 and 1960. The recurrence of the trade cycle was also a new facet in the German economy during the Sixties, previous recessions after the currency reform having been overlaid by the rapid growth of the economy. Also, economic thinking of those days was that inflation and instabilities were caused mainly by the power of the unions to achieve unsustainable wage increases and by business to raise prices wilfully in consequence, while the Bundesbank had difficulties in controlling the money supply due to the Bretton Woods agreements. It was then thought that the microeconomics which served the country so well since 1948, needed to be supplemented by some global arrangements. In a famous address to the Eucken Institute in 1966, Schiller introduced the idea of Concerted Action, a periodic meeting between governments, employers, unions, the central bank and economic experts.

After reviewing some of the new problems of the Sixties, Schiller proceeds: "The combination of global steering and market economics is not only the pre-condition for stability, but under present circumstances is the only means to preserve the market economy. Concerted Action is its most essential tool... For the steering of competition in individual economic relationships remains an adequate means to safeguard the optimal application of resources to the demands of the consumer. But this is not enough to achieve certain overall goals. This requires macro-economic influencing of the economic aggregates.

"The optimal arrangements of global steering consists of a combination of the principle of self-steering of the micro-relations and global steering via the Concerted Action of the macro-relations."

In Schiller's view only Concerted Action can save the market economy from increasing interventionism. Though primarily conceived as a tool for the stabilisation of wages and prices at high employment levels, Schiller was convinced that this would lead to a new style in the relations between government and the autonomous groups, and between these groups themselves. By such conversations at a round table it was hoped that a social integration process of aggregate goals would be initiated and a specific contribution towards price stability, full employment and growth be made. This was later known as the "magic triangle".

Schiller's ideas had their antecedents: as early as 1956, the Economics Ministry suggested the drafting of periodic economic reports to all social partners in aggregate terms in order to illuminate the path of the economy.

This was followed on the initiative of Adenauer by a Bundesbank report in 1960 about the connections between wages and price trends, giving all partners quantitative data as a help for individual, market-orientated, free and autonomous decision-making. The next important step in "strengthening" the Social Market Economy was the setting up in 1963 (under Erhard's chancellorship) of the five-member Council of Economic experts (*Sachverständigenrat* or S.V.R.) whose main task was to analyse each year the state of the economy and advise the government, always bearing in mind that a competitive but socially orientated market economy is the unalterable base of West German society.

Amongst its many tasks the S.V.R. had to examine in its annual reports how to achieve simultaneously price stability, a high degree of employment, foreign trade equilibrium and sustainable growth within the framework of a free economy, now the "magic quadrilateral". To this end, the S.V.R. advised in its 1965 report: "the provision of orientation data to the social partners and a Concerted Action which can solve social conflicts by eliminating misunderstandings among the partners, or at least minimising them. This can bring about monetary stability if only the partners so desire."

The Stabilisation and Growth Law of 1967

These macro-economic requirements were codified under Schiller in 1967 in the controversial Stabilisation and Growth Law.

The salient provisions of this law are:

Para. 1: Federation (Bund) and Regions (Länder) have to base all their economic and financial measures on the requirements of the aggregate economic equilibrium and its interdependencies. The measures are to be such that they lead to stability of the price level, to a high rate of employment, to external equilibrium and to continuous and adequate growth within the competitive market order.

Para. 2: Asks the Federal government to submit each January an economic report dealing with the report of the S.V.R., specifying for the current year the government's economic and financial targets and policies.

Para. 3: (1) In case of danger to any one goal of para. 1., the Federal government provides orientation data for a simultaneously co-ordinated behaviour (*Konzertierte Aktion*) of public authorities, trade unions and employers' organisations in order to achieve those goals. The orientation data supply a picture of the aggregate economic relationships in the given situation. (2) The Minister of Economics has to explain the orientation data at the demand of any member of the Concerted Action group.

Concerted Action: The Government's Orientation Data

The aims of Concerted Action are defined by Otto Schlecht (a State Secretary in the Ministry of Economics) in a lecture given at the Walter Eucken Institute in 1969: "Concerted Action is a short cut between the principal institutions of the economy in their autonomous wage and price decisions, and the government, which must co-ordinate the aggregate economic elements. In the present situation economic goals in our free, non-authoritarian society can be preserved only if the economic power groups have more understanding for the economic interdependencies. Yet these voluntary co-ordination efforts will not work against the market, but are most likely to strengthen the market. Concerted Action provides only global quantitative orientation data with no reference to individual branches... In relation to wages policies this strategy implies not simply general appeals (moral suasion) or meaningless coffee parties, but neither restrictions on wages autonomy nor direct commands to the social partners. Specific branch decisions on investment, prices, profits, wages etc., have to be left to the steering by the market... The aim of Concerted Action is restricted to enlighten the partaking groups about the economic inter-relationships and to obtain understanding for the necessary decisions of the state — after mutual consultations — for its global steering, order and structure policies."

Schiller eventually sharpened the aim of Concerted Action in a speech in July 1969: "It serves to achieve central economic and social targets." This would appear to be a considerable deviation from the original ideas of the Social Market Economy, though Schiller never wavered from being one of its strong supporters among the younger generation.

Watrin describes this dilemma as "a break away from the market economy as an order based not on collective aims but on common spontaneous rules, and its substitution by the idea that some pre-set objectives ought to be pursued by all groups, totally in conflict with liberalism and the steering of the economy by anonymous price and market forces. The enlightened market economy of Schiller in its programme thus becomes socialistic."

This theme of the incompatibility between the growth law and Concerted Action and the liberal order is pursued in a paper by Hoppmann, leaning on F. A. Hayek's teachings.

Hopppmann in this paper of 1972 contrasts a spontaneous economic order with no concrete purposes (in the tradition of the English classics and revived since the 1930's by Eucken and his associates) with the constructivism of the 1967 Stabilisation and Growth law and Concerted Action.

The spontaneous non-directed market order steered by the invisible hand was described by Adam Smith: "Man is led to promote an end which is no part of his intentions."

The Social Market Economy was conceived as an order under the rule of law, but not as an instrument to achieve specific and quantitatively defined collective targets. "The new enlightened Social Market Economy," says Hopppmann, "contradicts these principles and is based on constructivist models with the aim (though no doubt unconscious to its protagonists of the Sixties) to steer the economy from above into *ex ante* preset directions."

Hayek had formulated this in 1964 in more general terms: "Rationalist constructivism (largely based on French thinking of the 17th Century) postulates that we have it in our power so to shape our institutions that the results which we prefer to all others will be realised... when conscious consideration of all factors would make preferable an outcome different from that of the spontaneous process. It is from this kind of social rationalism or constructivism that all modern socialism, planning and totalitarianism derives."

Professor Hopppmann concludes his essay of 1972: "The new economic policy attempts to formulate an economic programme for the transformation of the spontaneous market order into an organisation of the state. If this new concept was to succeed it would replace the liberal economic system under the rule of law by a constructivist interventionism." Hopppmann interprets Concerted Action in its final analysis as requiring direction of economic activities through instructions by the state (in whatever guise) and the erosion of the free market economy and the open society.

Hopppmann's and Watrin's critiques and the laying bare of the consequences of Schiller's Concerted Action can no doubt be taken as typical of the great neo-liberal critical literature around this subject. As the interventionist aspects became clearer they may have contributed to the gradual watering down of the original ideas, Concerted Action now being in Germany simply a useful forum for the periodic exchange of views and discussions of the major economic problems. (The Concerted Action group has not met since 1977 due to the objections by the unions to the appeal by the employers to the Constitutional Court upon the Codetermination Law of 1977.)

Monetarism since 1973

While Concerted Action lost its original primary purpose of integrating individual decision taking with global economic goals, the application of monetarist concepts and the fixing of the growth of the monetary base helped Germany to overcome the world recession of 1973 much faster than other

industrial countries. Friedman had published papers in *Ordo* during the 1960's and the Freiburg Imperative was now flanked by the Chicago Imperative.

The monetary theme was taken up e.g. by Woll in 1971: "An incomes policy stands and falls with the analytical consistency and empirical relevance of a non-monetary theory of inflation. Should the monetary quantities be the most important and at the same time independent operational variables, then an incomes policy is redundant nor promising of success... a lasting wage push is inconceivable without alimentation by monetary expansion."

And Watrin wrote in 1972: "Should the hypothesis of Milton Friedman and the monetarists be correct, that trade instabilities are the consequence of discretionary and inflationary money supply policies (or just passive acceptance of inflationary actions by foreign financial institutions) then one ought to consider increasing the money supply at a constant rate, in order to promote growth monetarily and to guard the economy from unpredictable and partly politically determined fluctuations."

At last, early in 1973, the E.E.C. currencies started to float against the Dollar, which gave the Bundesbank the desired control over the money supply via the monetary base. The independent Bundesbank strictly refused to underwrite cost increases and unsustainable wage increases by over-expanding the money supply. (Though deviations occurred, this is still the Bundesbank's fundamental policy). The "five wise men" (S.V.R.) commented in their 1974 report: "By restricting the money supply in conformity with stabilisation aims, the competitive market system regains its ability to function properly. The Bundesbank actions since 1973 transcend widely in general significance the stabilisation effects alone. They are of equal importance and fundamental consequence as the original Social Market Order principles, and the basic economic decisions taken after the war, and ought to be regarded as lessons to other countries, especially to those which still pin their faith upon large-scale interventionism and widespread controls by the state."

APPENDIX I

Prof. W. Schreiber's analysis of the German Social Security System

The following interpretations and suggestions for reform are largely the ideas of the late W. Schreiber, probably the sharpest analyst of the German system and protagonist for its market conforming restructuring.

The German social security system as it developed during the 30 years after the war can no longer be regarded as dispensing relief from above (the employers) or from outside (the state). Today some 85% of earners are both contributors and beneficiaries at the same time, thus paying in one form or another for their own benefits. While the reforms introduced by Bismarck during the 1880's were true income transfers to the needy, in today's prosperous mass society such transfers from employers and the state (through taxation) are largely illusions. Employers' contributions are part of wages — long absorbed by rising productivity — and state subsidies are taxes paid by the beneficiaries themselves. In fact the beneficiaries pay for their benefits largely among themselves. A real net income redistribution is becoming less and less operative. Schreiber writes in one of his papers: "Since the employee has become the prototype of industrial society, it is he who determines the standard of living. It is essential to understand that no group — in numbers and total incomes — stands above him which would be able to provide him with real, net subsidies. This group has ceased to exist. The employed person is today dependent on himself in the economic formulation of his existence. The employee in the present prosperous mass society must pay for his own social security. There is nobody to relieve him from this, however much the existing mechanics of sickness benefits, provision for old age etc., are hiding this truth. The social security system must be rebuilt in order to make this self-financing transparent to all wage and salary earners."

A very comprehensive enquiry into the principles of German social security was published in 1968, dealing with these changed social circumstances and projecting into the future. Though radical changes in the structure of the system have not yet materialised, the insight is gaining ground, that a system of social security could today function well without the present highly sophisticated methods of income transfers, subsidies etc.

Schreiber continues: "Compulsory insurance leads to income redistribution only if the insured person with average characteristics over his lifetime receives benefits which are smaller or higher than his lifelong contributions. In the interval over his whole life, however, full equivalence may be attained between contributions and receipts. This is today practically achieved in the vast majority of cases. What then is the sense of the present social security system, with its manifold contributions, premiums, taxes, transfers etc?" Schreiber argues that under today's conditions of rising mass incomes the chief virtue of social security

no longer rests in redistribution from rich to poor (certain exceptions admitted), but in bridging income gaps over limited periods of a lifetime: childhood, unemployment, illness, old age etc. Not correction of the market, but temporary transfers of parts of market-generated incomes from periods of full earnings into periods of no income or increased needs. Our present industrial organisation necessitates this filling of income gaps by redistributing the incomes of the full earnings phase over all periods of life.

Following Schreiber: "There is no denying that social security systems do in essence serve the wellbeing of the employee, the dominant type of worker today. His wish for security is justified and it is not a sign of lack of responsibility and the destruction of personal values. But today this security is no longer a gift from above or from outside. It is and can be earned over the lifespan of the earners." Hence the present highly complicated system of social security, a relic of the past, "can be transformed into a system of solidarity contracts financed by varying percentages of gross income (according to life risks). Social security would thus be taken away from the state and the employers and be based on personal responsibility and self-reliance. This would provide an intertemporal earnings rearrangement without any involvement of state subsidies through taxes and employers contributions retained from wages."

Self-help and charity welfare would be divorced, and the market processes through the solidarity insurance principles would be the sole basis of social security. Taken over the whole lifespan, giving and receiving would broadly equalise. It is only the short term view — the healthy pay for the sick, the earners for the old — which characterises the present system in Germany.

This is admittedly a very cursory description of Schreiber's reform proposals in the direction of mutual self-help. A detailed review of these German ideas would far transgress the principal aim of this paper. Yet his ideas point into directions which might increasingly apply as long as Social Market principles continue to operate as the integral elements of a free and open society. In today's terminology: Social Security would cease to be part of the PSBR.

(Note. I am indebted to Professors Watrin and Willgerodt, both of Cologne, to have pointed out the importance of Wilfred Schreiber's ideas.)

APPENDIX 2

Aspects of German Labour Law

This essay is not the appropriate place to describe and to discuss the voluminous labour legislation in Germany and its important implications for the long periods of industrial peace and the low numbers of strikes in Germany. But a few principles must be mentioned as part of the Social Market philosophy: The overriding principle of the labour legislation is the promotion of peace (*Friedenspflicht*) between employers' organisations and unions. (There are only 16 unions in Germany representing the main sectors of industry, e.g. metals, chemicals, etc. Inter-union conflicts and demarcation strikes are unknown.) Periods of *Friedenspflicht* are written into the collective agreements.

Strikes can only be called by the unions after exhaustive efforts towards peaceful solutions, e.g. secret ballots (75% must agree to strike), arbitration and other means towards avoiding a strike at the *ultima ratio*. Wildcat strikes, though they happen, are illegal. Strikes must not be called against existing collective agreements nor against provisions outside the scope of such agreements.

Most of the negotiations are confined by law to the workplace itself through the works council. The unions agree with the employers' associations a binding framework of terms and conditions. This framework is then filled out by negotiations at enterprise or plant level.

Strikes must not affect the vital interests of the community as a whole nor must they pursue quite unreasonable demands. Labour Courts and a supreme Labour Court can be appealed to on all matters in dispute. Individual employees have access to the Labour Courts.

The legality of strikes is undoubted if the union aims, through the strike, at improved wages and better general working conditions. The unions are responsible for strike pay; and only the unions, and not the shop stewards, can legally initiate the strike procedures. After the end of a strike all efforts must be made to restore peace at work.

The Supreme Labour Court summarised the overall tasks of the unions: "They ought to be order-political factors safeguarding the existing order, and even in times of crisis encouraging the loyalty of the workforce."

It may not be without significance that within the constraints of the German labour law, average real gross wages per industrial worker have nearly quadrupled since 1950 (by 32% since 1970). Productivity increased by 3.5% p.a since 1970. (3.1% during 1979).

The unions are thus an integral part of the Social Market Economy. In Chancellor Schmidt's words (11th October 1979): "The internal peace during the last 30 years is largely the merit of the unions and their acceptance of the economic framework. The unions managed, during the last 30 years, to remain independent from employers, politicians, the government and from political parties." The enlightened and moderate labour laws were essential factors towards this peaceful evolution, and they met with broad consensus over this long period, even in periods of stress.

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