

# Social and Ecological Market Economy – The Future for China?

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## Introduction

This paper will compare the model of the social and ecological market economy in Germany with the Chinese vision of a market economy reflected in the laws and regulations governing the Chinese socio-economic system and in the relevant ongoing debates. It analyzes the differences in social values between Germany and China, assess the significance of the model for Chinese reforms, and, last but not least, makes some policy recommendations for the reforms. Thus, the author will analyze how Chinese social values are imbedded in the constitution, the changing role of the state in socio-economic planning, and reforms in the regulatory framework and state institutions in China in the context of globalization.

## Features, Achievements, and Problems of the Social Market Economy in Germany: A Chinese Perception

The social market economy in Germany is perceived by the government and the general public in China as a successful market economy, in contrast to the common view that a *laissez-faire* economy in its true and original sense is actually not acceptable anywhere in the world, including Germany and China.

According to a recent survey conducted by the author,<sup>1</sup> the general public in China appreciates highly the role of the European (including German) governments and enterprises in promoting environmental protection and admires the social welfare and high living standard in the EU-15, including Germany. Although very few Chinese have heard the term social and ecological market economy, labeling the German social market economy in this way is understandable and acceptable to the Chinese, given that many Chinese not only regard Germany and the Nordic countries as special types of market economies that emphasize the social dimension of their economies, but also take them as examples of best practice in environmental protection.

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<sup>1</sup>As part of an European Commission Project on “Perceptions of the EU in China and of China in the EU,” September 2007-March 2008.

Many Chinese take the real-world socio-economic system of Germany as the ideal and normative model of a social market economy and as the model for the Chinese economic system, as well. However, one must make clear exactly what one is referring to when speaking of a social market economy, as there are big differences between that real-world socio-economic system, on one hand, and the normative model of a social market economy as conceptualized in the early stages, in the 1950s and 1960s (hereafter model I), or as now conceptualized in Germany (hereafter model II), on the other hand.

The model of a social market economy in the early stages is best described in the famous book *Wohlstand für Alle* (Wealth for all) by Ludwig Erhard, the first Economics Minister of the Federal Republic of Germany, published in 1957 in German, and in English in 1958 as *Prosperity through Competition*. In his book, wealth or prosperity is generated through competition, not redistribution, and this wealth or prosperity is the foundation of welfare for those disadvantaged in the market economy, or redistribution. Erhard made a further distinction between wealth creation and redistribution. According to Erhard, social policy should not harm the productivity of the national economy in any way, and it should not counter market economy principles. For him, the welfare state was a modern illusion. The “Wirtschaftswunder” (economic wonder) of Germany in the 1950s and 1960s can be traced, to a great extent, back to the practice of social market economy in line with its model in this early stage.

The current model of a social market economy (model II) corresponds neither to the early one (model I), nor to status quo of the socio-economic system in Germany. This becomes clear when one examines the rigid labor market, the coercion by trade unions of non-members in the same sector or region, and the excess burden of the social safety net imposed upon the economy in contemporary Germany. In general, many people in Germany understand their problems well and wish for reform towards a more free market economy and less social burdens, although in concrete situations, they as individuals tend to protect their vested interests and are often not willing to draw back from their status quo. The expansion of social policy towards a welfare state in the 1970s and 1980s resulted in a ratchet effect, which has been detrimental to the incentives for entrepreneurs to innovate and increase productivity. However, no one is able to draw back easily.

Over time, many people in Germany have come to take their social benefits for granted and they have increasingly forgotten the market economy principles to which the founders of the social market economy in Germany, including Walter Eucken and Andreas Müller-Armarck, held. They also make little distinction between social entitlements and basic individual rights. Furthermore, since the

1970s, in contrast to the earlier period, the state and society in Germany have made significant efforts in the area of environmental protection, which have proven to be useful. So the present model of a social market economy (model II) lies somewhere between that of its early stage (model I) and the status quo of the socio-economic system in Germany today, with somewhat more emphasis on market economy principles, less rigid labor markets, and leaner social safety nets than in Germany today, and with a stress on environmental protection perhaps as strong as that at present. It seems that the Chinese people have no reason to refuse to adopt such a model in China, since it reflects an optimal combination of economic efficiency and social balance which would be highly valued by both the Chinese and German people, if a fair competition order is well preserved and property rights are well protected.

## **New Model of the Social and Ecological Market Economy in Germany**

In July 2007, the Federal Ministry for Economic Cooperation and Development (BMZ) announced that the guiding principles of social and ecological market economy would serve as the overall orientation for German development cooperation.<sup>2</sup> These principles for shaping the social and ecological market economy (hereafter “model III”) in Germany are:<sup>3</sup>

- 1) Promote the rule of law;
- 2) Strive for growth that benefits the broad population (involve the poor in the growth and wealth creation process);
- 3) Strengthen the private sector;
- 4) Improve the framework for the functioning of a market economy (promote competition);
- 5) Make the economy forward looking and viable (promote innovation);
- 6) Commit to social partnership (protect labor rights);
- 7) Align the economy with ecological protection;
- 8) Secure equal opportunity.

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<sup>2</sup>German Federal Ministry for Economic Cooperation and Development 2007.

<sup>3</sup>Author’s translation.

In comparison with model II, the only controversial principle for shaping the social and ecological market economy in model III might be the sixth principle: commit to social partnership. The shaping of real-world social policies based on this principle goes in two directions: On the one hand, the policies create an enabling environment for growth and employment, and therefore also for employment and redistribution. On the other hand, they produce a disabling environment for growth and employment, and are therefore also detrimental to employment and redistribution. A rigid labor market impedes many newcomers and unskilled workers from entering it. Thus, we need a set of principles or rules to concretize the principle of social partnership in order to ensure that an enabling environment is the result. In a modern society, factors such as rule of law, proper social security, a safe working environment, a dynamic labor market, and proper ecological and environmental protection (as referred to under the principle of “align the economy with ecological protection”) belong to the framework for sustainable economic and human development, and thus deserve special attention.

## The Chinese Transition towards a Market Economy

The Chinese economic transformation began in 1978. However, it was not until 1992, during its 14<sup>th</sup> Party Congress, that the Chinese Communist Party (CCP) set the “establishment of a socialist market economy” as the final goal of the Chinese economic system reform. It was then even written into the 1993 amendment of the Chinese constitution, article 15, that “the state enforces a socialist market economy.”<sup>4</sup> Both steps reflected the CCP’s commitment to fostering and furthering the economic reform course in China, after the stagnation of economic reform for several years following the 1989 Tiananmen Square turbulence. In 2003, the Third Plenary Session of the 16<sup>th</sup> Central Committee of the CCP passed a “Decision on Some Issues Relating to the Perfecting of the System of the Socialist Market Economy in China.” It declared that a rudimentary system of the socialist market economy had been established.

However, a market economy needs to have at least two basic properties: private ownership and competition order. Since there has been a system of private ownership from (and even before) the very beginning of the founding of the Federal Republic of Germany, the release of the Restraint of Competition Act in 1957 roughly marked the establishment of the system of the social market

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<sup>4</sup>In this paper, the English formulations of Chinese laws, regulations, and policy documents are in part the author’s own translations.

economy in Germany. Hong Kong is also a market economy: it enforces private ownership and a competition order without an explicit competition law, but with a set of common law rules and an open market which makes monopoly impossible in the long run.<sup>5</sup>

In comparison with Germany and Hong Kong, China obviously has not permitted sufficient private ownership, although great progress has been achieved up to now. It has not established a fair competition order either. China is still an economy in transformation.

In the above mentioned 2003 decision, the CCP announced its intention to “perfect the basic economic system, keeping public ownership as the mainstay of the economy and allowing diverse forms of ownership to develop side by side.” The constitution provides better protection for public ownership, that is, state and collective ownership, than for private ownership. For instance, article 6 affirms that “the state practices the basic economic system keeping public ownership as the mainstay of the economy and allowing diverse forms of ownership to develop side by side”; article 7 asserts that “the state economy is the sector of the socialist economy under ownership by the whole people; it is the leading force in the national economy. The state ensures the consolidation and growth of the state economy.”

The 2003 decision also announced the intention to “construct a unified, open, competitive, ordered, and modern market economy system” while at the same time to “perfect the macro-control system.” The exact formulation of the latter phrase can be found in article 15 of the constitution. Article 12 asserts that socialist public property is “sacred and inviolable” and that the state protects socialist public property, while according to article 13, private property is not protected as much as the public property: “The legal private property of the citizens is not to be violated. The state protects by law the citizens’ private property and the right of its inheritance” (article 13).

In 2007, China passed the Property Law. It provides that “the state protects the equal legal position and development rights of all market actors” (article 3), thus including state, collective, and private actors. This is a degree of progress in comparison to the constitution. But the rule of “protection of the equal legal position and development rights” is not strong enough since the state and

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<sup>5</sup>This insight is attributed to the Austrian economists. See especially von Mises 1927. The Hong Kong Special Administrative Region government has been considering passing a general competition law. This trend fits with the general trend of switching from a free-market port to an administration-dominated polity in Hong Kong, which has occurred gradually since its handover to mainland China. It also reflects the Hong Kong government’s distrust of the power of civil society in enforcing self-regulation in competition issues. In an economy of common law tradition, business society is indeed very creative in making and enforcing informal merchandise laws (internal rules).

collectively owned economy is backed by the state and collectives, and can easily constitute an anti-competition force and crowd out the private economy.

As is provided in the new Anti-monopoly Law released in 2007, the legal business activities in the state-controlled branches that have direct bearing on economic lifelines and national security or are subject to exclusive sale are protected. This is a clear signal that industrial policy has priority over competition policy. Also the so-called macro-control includes instruments such as planning, direct administration, monetary policy, fiscal policy, land use control, industrial policy, etc. This involves many more instruments than the classical instruments of modern market economies that in general include only monetary and fiscal policy. There has been a clear “spiral of intervention” in market processes since 2003.<sup>6</sup> The central bank and Ministry of Finance have opened and have been jointly running a giant state-owned controlling company, the Hui Jin Company. A fair competition order is absent in this regard.

## Recent Chinese Strategies Relating to Social Security and Environmental Protection

Although marketization in China has been set forth gradually, the social and ecological dimensions of the socio-economic system had been neglected by and large until several years ago. Consequently, while China has been admired for its high-speed economic growth since 1978, on the one hand, it has also been frequently accused of practicing “social dumping,” on the other hand. The move to greater emphasis on the establishment of a social safety network for all just started in recent years. At the same time, environmental protection has also been put on the policy agenda of the central government. In 2006, Premier Wen Jiabao admitted that the government had not fulfilled the target of reducing the energy consumption per unit of gross domestic product (GDP) by 4% and the emissions of main pollutants by 2% within that same year. In 2007, the government defined this reduction task as a main criterion for measuring the performance of local governments. Before that time, economic growth was the sole criterion for measuring their performance.

Several recent strategic developments related to the shaping of Chinese policies on social and environmental protection in China should be noted. First, China put forward a new development concept during the Third Plenary Session of the 16th Central Committee of the Chinese Communist Party in 2003, later dubbed the “scientific development concept.” The concept places high priority

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<sup>6</sup>Von Hayek points out how government action on an ad hoc basis will result in its being driven to further actions that were not contemplated nor desired. See Von Hayek 1960.

on the needs of human beings and pursues “comprehensive, coordinated, and sustainable development.”<sup>7</sup> The main elements and basic requirements include: 1) economic development as the central task; 2) coordinated economic and social development; 3) coordinated urban-rural development; 4) coordinated regional development; 5) sustainable development; 6) reform and opening up; and 7) high priority to the needs of human beings. The 17th Party Congress reemphasized the importance of the concept.

Second, China firmly endorsed the concept of a “socialist harmonious society” in the Fourth Plenary Session of the 16th Central Committee of the Chinese Communist Party in 2004 (Hu 2005). In February 2005, Hu Jintao, the Secretary-General of the CCP, enumerated the six basic requirements of the concept as follows: democracy;<sup>8</sup> the rule of law; equality and justice; dynamism; peacefulness and order; harmonious coexistence of human beings and nature. In October 2006, the party passed a resolution on building a socialist harmonious society which reemphasized these requirements.<sup>9</sup> Hu Jintao’s speech at the 17th Congress of the CCP on October 15, 2007 not only reemphasized the building of a socialist harmonious society, but also put forward the building of an “ecological civilization.” Such a civilization should have a basic sectoral structure and a growth and consumption pattern that saves energy and protects the ecological environment, a relatively large scale circular economy, a significantly increased share of renewable energy, effective control of emissions of the main polluters, and a significantly improved ecological environment. At that time, awareness of an ecological civilization should have been soundly anchored in the whole society.

Third, the CCP put forward the full-scale building of the “well-off society” at the 16th Party Congress in 2002 and set the goal of quadrupling 2000 GDP by the end of 2020. According to the party resolution of the 17th Party Congress, the party also called for a quadrupling of 2000 per capita GDP (RMB 7078) by the end of 2020 (to around US\$3,500. US\$1 = RMB 8.56 in 2000).

In line with all the above-mentioned strategic concepts, the party and the central government launched the “new socialist countryside construction” campaign at the end of 2005, addressing problems of rural socio-economic development. The

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<sup>7</sup>Communique of the 3rd Plenary Session of the 16th Central Committee of the CCP, October 14, 2003; and Hu 2007.

<sup>8</sup>However, in contrast to “democratic socialism” or “liberal democracy,” the full formulation is still “socialist democracy,” which is manifested in a so-called “system of democratic centralism.”

<sup>9</sup>The Resolution of the Central Committee of the Chinese Communist Party on Several Major Issues Relating to the Building of a Socialist Harmonious Society, passed at the 6th Plenary Session of the 16th Central Committee of the Chinese Communist Party, October 11, 2006.

basic requirements include: advanced production, improved livelihoods, civilized social mood, clean and tidy villages, and democratic management.

Furthermore, all these concepts are reflected in the outline of the 11th Five-Year Plan for National Economic and Social Development of the People's Republic of China, passed on March 16, 2006. In line with this outline, the 11th Five-Year Plan has specific outlines for the different areas at each administrative level, such as labor and social security, health care, education, environmental protection, energy, etc.

Up to now, the government departments in charge of these various areas have been responsible for designing specific reform concepts for their own areas, which can easily lead to protection of their vested interests. Consequently, such reform concepts tend to maximize the budget at their disposal. This is exactly the case predicted by Niskanen in his model of a budget-maximizing bureaucracy (Niskanen 1971). For example, the Ministry of Health intended to propose a reform concept similar to the British National Health Service System, based on a tax financing principle. In such an overall "reform strategy," government departments have no incentive to reduce their budgets; they tend to enlarge them instead, especially in the areas of social security and environmental protection.

## Significance of the Model of the Social and Ecological Market Economy for Chinese Reform

The principles for shaping the social and ecological market economy have great significance for Chinese reforms:

- 1) Promote the rule of law: Although China is striving to enforce the rule of law as a component of the "harmonious society" concept, a mixture of rule of law and rule of man prevails. In many fields, including social security, labor protection, environmental protection, and the internal market, there are a set of laws and regulations. However, there are severe problems with law enforcement, for instance, regarding the protection of intellectual property rights (IPRs).<sup>10</sup>
- 2) Strive for growth that benefits the broad population (Involve the poor in the growth and wealth creation process): China made great efforts to alleviate poverty. But, according to the China Poverty Alleviation and Development Association, there were still 23.65 million absolutely poor people in 2003 in the rural areas, and 28 million in urban areas, measured by a per capita

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<sup>10</sup>With regard to the protection of intellectual property rights, China tends to rely on special campaign to crack down on piracy. In March 2006, the Ministry of Public Security launched the campaign "Eagle II" (*shan ying dong er hao*). By the end of 2006, more than 3,700 cases of IPR violations were discovered, involving a total amount of RMB 2.6 billion. In these cases, over 5,600 suspects were detained. See Zhang and Yong 2007.



income of less than RMB 683, the 2003 poverty line, and around 50 million at the hunger fringe, measured by a per capita income between 683 and 882 yuan. If they are economically weak or disadvantaged, these poor people should be supported so that they can participate in the growth and wealth creation processes. If they are socially weak or disadvantaged, they should also be covered and empowered by a basic social safety network.

- 3) Strengthen the private sector: Chinese economic success can be largely attributed to development of the private sector. By the end of 2006, there were 498.1 million private enterprises (*siying qiye*) and 25.96 million individual industrial and commercial households (*geti gongshang hu*). There are 12.7 million investors and 53.1 million employees in private enterprises, and 46.4 million employers and employees within individual industrial and commercial households. The non-state sector comprises ca. 65% of total GDP in China.<sup>11</sup> Beside the urban unemployed and newcomers in the labor market, there will be around 150 million surplus workers from rural areas who need to find employment in the non-agricultural sector in urban areas. The private sector is almost the only sector that could absorb this labor force. It is thus very important to boost private sector development. However, many hindrances remain.
- 4) Improve the framework for the functioning of a market economy (promote competition): A competition order is essential in a market economy. But as mentioned above, China does yet not have a fair competition order. In China, the state-controlled branches are exempted from the new anti-monopoly law. Macro-control and industrial policy have priority over competition policy.
- 5) Make the economy forward looking and viable (promote innovation): In China, “dynamism” is one of the core components of the “harmonious society” concept; it means full of creativity and vitality. Although it does not directly refer to competition, such a status can only be attained through competition. Currently, there are still large hindrances to innovation, and innovation is lagging behind in China; thus an enabling environment should be created.
- 6) Commit to social partnership (protect labor rights): As above mentioned, China is often criticized by the international community for “social dumping.” Labor protection laws and regulations are not yet enforced. For instances, most of the employees in private enterprises and the individual

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<sup>11</sup>All-China Federation of Industry and Commerce 2007. Non-state enterprises (*minyong qiye*) refer to domestic enterprises, excluding state-owned or state-controlled enterprises.

economy are not insured, or not properly insured. There is still child labor. In 2007, the media publicized the fact that some coal mines in Shanxi province use slave labor. On the other hand, some clauses in some laws and regulations might constitute overregulation and need to be reviewed.

- 7) Align the economy with ecological protection: Environmental and ecological protection is an urgent and long-term issue in China. It also has a central position in the new “scientific development concept.” According to the World Bank, air pollution alone is costing China 3.8% of its GDP, causing much disease and claiming many lives.<sup>12</sup>
- 8) Secure equal opportunity: It is very important to empower economically and socially disadvantaged people in China through equal opportunity. Basic education and health for all and poverty alleviation, vocational training, etc. are all important for this purpose.

Although these principles are acceptable in the China context, one must first protect property rights. Only then can the property owner be also required to shoulder his social responsibilities, which should, however, be defined very carefully after considering the whole set of the above mentioned principles for shaping the social and ecological market economy. It would be one-sided to only stress the basic principle of model III, “Eigentum verpflichtet” (property entails obligations), which is detrimental to a free and open society with growth dynamics, equality of opportunity, and proper social and environmental protection. We need a basic principle which explicitly states that: “Eigentum ist geschützt, aber verpflichtet” (property is protected, but entails obligations). In a broad sense, this reflects a basic principle of human action: Freedom implies responsibility.

## Concluding Remarks

In summary, we can conclude that the new model of social and ecological market economy is very significant for Chinese reforms. But this doesn't mean simply copying the current German social, environmental, and economic system in China. Some relevant German laws constitute overregulation. In development cooperation, it is essential not only that knowledge of the Germany model and its real-world system is transferred, but also that the historical background of the German system, the relevant interest conflicts, their positive and negative consequences, etc. are made known and discussed in China.

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<sup>12</sup>See “World Bank Says Air Pollution Alone Costs 3.8% of China's GDP” 2007.

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