

Social Market Economy

as Alternative Approach of Capitalism after the Financial and Economic Crisis

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Abstract

In 1989 socialism failed and scientists like Francis Fukuyama declared the end of history. Democracy and market economies were assumed to diffuse worldwide. Exact twenty years later the American financial crisis developed into a fundamental worldwide economic crisis. Therefore nowadays a critic of capitalism is on the increase. On the one hand, the Anglo-American laissez-faire-capitalism can be criticized with justification. Deregulation of financial markets combined with a lack in transparency of financial market instruments and the U.S. housing boom caused the crisis. On the other hand, Socialist as well as Keynesian concepts of economic policy have failed already decades before.

As result, a lot of economic policy deciders are searching for alternative approaches. As a special kind of regulated capitalism the author recommends the approved conception of Social Market Economy. The idea of Social Market Economy is basing on the principles of economic order by the German economist Walter Eucken and was introduced in West Germany after WW II by Minister of Economic Affairs, Ludwig Erhard. While the world was talking about an “Economic Miracle” we can state that the positive economic development in West Germany was in large part the result of this special economic approach. Therefore, it is the main issue of this paper to discuss the benefits and implementation restraints of this economic model in the current world, especially for transforming and emerging societies. The author will analyse the current financial and economic crisis in brief. Then he will describe the scientific framework of a Social Market Economy. In doing so, he will focus on the basic idea of an economic order in the Eucken sense, characterized by seven constitutive principles. Additionally, he will discuss if and how these principles can be transferred to other countries especially outside of the “West”. By this way he will work out how market economies can become able to avoid crises in the future.

Key Words

Social Market Economy, financial and economic crisis, formal and informal institutions, open access orders

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1. Introduction

In 1989 socialism failed and scientists like Francis Fukuyama (1992) declared the end of history. Democracy and market economies were assumed to diffuse worldwide. Exact twenty years later the American financial crisis developed into a fundamental worldwide economic crisis. Therefore nowadays a critic of capitalism is on the increase. On the one hand, the Anglo-American laissez-faire-capitalism can be criticized with justification. Deregulation of financial markets combined with a lack in transparency of financial market instruments and the U.S. housing boom caused the crisis. As it seems, not only the market economy itself is in crisis but also the ideas of liberalism and the dominance of the private sector in our economies. On the other hand, Socialist as well as Keynesian concepts of economic policy have failed already decades before. But nowadays, not only John Maynard Keynes seems to celebrate his resurrection, but even Karl Marx himself gains honour again. While large banks are nationalized and economic stimulus packages are implemented world wide the ideas of Keynesianism and even socialism resurrect.

As result of this confusion in the world a lot of economic policy deciders are searching for alternative approaches. As a special kind of regulated capitalism the author recommends the approved conception of Social Market Economy. The idea of Social Market Economy is basing on the principles of economic order by the German economist Walter Eucken and was introduced in West Germany after WW II by Minister of Economic Affairs Ludwig Erhard. While the world was talking about an “Economic Miracle” we can state that the positive economic development in West Germany was in large part the result of this special economic approach. It is the main issue of this paper to discuss the benefits and implementation restraints of this economic model in the current world, especially for transforming and emerging societies. Therefore, the author will analyse the current financial and economic crisis in brief. Then he will describe the scientific framework of a Social Market Economy. In doing so, he will focus on the basic idea of an economic order in the Eucken sense, characterized by seven constitutive principles. Additionally, he will discuss if and how these principles can be transferred to other countries especially outside of the “West”. By this way he will work out how market economies can become able to avoid crises in the future.

2. The Social Market Economic Perspective

2.1 The Financial and Economic Crisis

The reasons of the current economic crisis can be found in different fields of the international financial world. The US-American monetary policy, the globalization of the cash flows and the missing international regulatory framework of the same can be hold responsible for the bank and financial crisis. But speaking of pure market failure would be completely wrong. To begin with, the American Central Reserve Bank congested the market with cheap loans for years if an economic downturn was feared. Already after the burst of the New-Economy-Bubble the FED temporally lowered the interest rate to one percent. If one takes the inflation rate of that time into account, the interest rate was actually negative. This means that banks even received a bonus if they run into debts. Through such a policy of “cheap money” the money supply, especially within the U.S. but as well in the Euro zone, was extremely stretched over a long period of time. But wrong structures are created through distorted prices and concretely wrong interest rates. All those circumstances drove up the prices for real property and attracted speculators in real estate. American house owners calculated themselves rich and borrowed money on the appreciation of their real estate to finance their consumption. (Zweynert 2008: 2)

The banks earned a lot of money with such mortgage loans that they stopped taking care of the solvency of their debtors. At the same time, to give every American the opportunity of a home of their own not depending on their income and their productive efficiency, the granting of loans to deprived citizens in the USA was state-aided. For that reason governmentally secured banks were founded, which did not have to fear any risk. Subprime loans were created whose debtors were also named as Ninjas („No-Income-No-Job-No-Asset“). That the mortgage contracts were not secured through capital resources or consistent income did not bother. Instead those third range mortgages got bunched and were offered to international contributors of capital as capital marked instruments secured by mortgage. Credit Rating Agencies provided those instruments with their seal of approval without recognizing – or without wanting to recognize – that even the best mixture of bad risks cannot lead to a good overall risk. Within the scope of the ongoing globalization, such “instruments”, which included only minor value but a high risk, could be sold worldwide to investors – pension funds, investment funds and commercial credit institutions including all German Federal State Banks. (Wrobel, 2008: 4 - 5)

So, the financial crisis reached Europe. But also there, low interests have driven up the prices for houses and created bubbles. The cause of the current crisis therefore does not only derive from the U.S.. Those bubbles burst, when the western central banks had to ratchet the interests step by step, to control the boom of the economy and the inflation, because contrary to Germany in the U.S., Great Britain, Spain and other countries real estate loans are financed with short term fixed interest periods. Only then when the first mortgage debtors dropped out, because they could not pay the ratchet interests anymore and compulsory auction were cutting the prices, subprime credits were identified as what they really are, junk! (Zweynert 2008: 2) How was such an undesirable development actually possible? Especially the insufficient banking supervision has to be pointed out, which enabled the banks to high-risk transactions without any liability rules. Profits and liability were separated consequently in the international financial markets. In the USA as well as in other countries the failure of supervisory authorities and credit rating agencies had to be added. (Wrobel, 2008: 5)

Now the sector of the real economy is affected, because banks due to the uncertainty in the financial world are very precautious with the granting among each other and as well in giving only quit restricted loans to enterprises and private persons. But enterprises need loans to invest and to produce. On the other hand many private individuals - especially in the U.S. – could consume excessively on the basis of mortgage loans in the past; a demand which has now disappeared. Thus within the scope of the crisis the stock prices fell bottomless, many private means were extinguished and therewith also future consumption possibilities. That way, the world economy drifts deeper and deeper into a depression. The result is a rising number of bankruptcies and an exaltation of the unemployment rate.

Summarizing, an overstretched money supply, distorted prices and concretely wrong interest rates creating wrong structures on the financial markets as well as lacks in banking supervision and insufficient liability rules caused the current financial and economic crisis. But all these problems are main issues of the conception of Social Market Economy. Therefore, a re-consideration of this approach in economics is really necessary.

2.2 The Market Economic Order

2.2.1 Targets and Basic Conception

The Social Market Economy seeks a market economic system, rejecting both, on the one hand socialism and central planned economy as well as laissez-faire capitalism on the other hand. In contrast to these approaches, it is combining private enterprise with measures of the state to establish fair competition, low inflation, and social welfare. This is also called the “ordo-liberal” approach. Ordo-liberalism is a school of liberalism that emphasizes the need for the state to ensure that the free market produces results close to its theoretical potential. The theory was developed by different German economists and legal scholars such as Walter Eucken, Franz Böhm etc. from about 1930 - 1950. As basic theoretical approach the market economy order in the sense of Walter Eucken (1952/90) has to be emphasised. His ideals (with modifications) drove the creation of the post-World War II German Social Market Economy and its attendant economic miracle. In concrete, the Social Market Economy was created and implemented in West Germany by Ludwig Erhard, first director of economics of the western occupation zones, then Minister of Economics, and later in the 1960s chancellor of the Federal Republic of Germany – by development of the ordo-liberal approach. (Wünsche, 2001: 61)

As Erhard (1959) has pointed out economic actors in a market economy need some rules. He compares the economy with a football game: „In a good game of football it is to be noted that the game follows definite rules; these are decided in advance. (...) The spectators of a game of football would deeply resent the players coming on an agreement about the number of goals this or that side was to be credited with, and then not playing a fair and interesting game as expected and paid for with gate money. (...) What I am aiming at with a market economy policy is (...) to lay down the order and the rules of the game. (...) In the same manner I conceive it to be the basis of any market economy to retain freedom of competition. This can only exist where nothing is permitted to suppress freedom, but where freedom is guaranteed by statute.“

Therefore, the Social Market economy has to be understood as a privilege-free order, where neither feudal or party elites nor economic power groups like monopolies, cartels or trusts influence markets and society. All members of a society shall get in principle the same opportunity to develop individually beyond any barriers of class. The result will be prosperity

or “welfare for everyone” (Erhard, 1957) which means more than opportunities for consumption but a distribution of wealth within a society by the rule-based market order. Through the channels of mobility and redistribution of income over time by the forces of the market (without governmental intervention) a socialization of progress and profit will take place. Or as Erhard (1959 as well as 1992: 339) has pointed out: Determined to overcome the old conservative social structure once and for all, I planned for a broadly based mass-purchasing power. Along the road of competition, the socialization – in the best sense of the word – of progress and profit is best realized. In such an economic system personal incentives for higher productivity remain alive. But they are not primarily „pressure to perform“, but opening up opportunities for individual development. Everyone should get the chance to get involved in economic and societal processes according to his or her personal abilities.

The basic conception of Social Market Economy – as it has been developed by Walter Eucken - includes a regulatory framework of a functioning price system, monetary stability, freedom of contract and private property, open markets but also the principle of liability and the principle of constancy of economic policy. These constitutive principles are accompanied by so-called regulative principles like the necessity of a strict competition policy, internalizing of external effects and a few social measures. (Eucken 1952/90: 254 – 304)

2.2.2 The Constitutive Principles

The fundamental principle of a Social Market Economy is the functioning or flexible price system. The optimizing of allocation of scarce resources shall be done by flexible prices. Therefore Eucken (1952/90: 254-255) sees the necessity to implement an order for free competition. That includes a rejection or limitation of all subsidies, monopolies, price limits, or import restraints. Only prices reflecting scarcities of goods fulfil the functioning of a market system. To illustrate this problem the financial and economic crisis can be raised again. From the Social Market Economy perspective especially transparency in the opaque and complex developed international financial markets is of demand. The price mechanism can only function in that place, if investors can see through the risk-income-ratio, e.g. of modern financial products. Otherwise dangerous asymmetrical information is given. But in the current financial crisis that thought should lead under no circumstances to an intervention

into the concrete market process, but to an implementation of a worldwide regulatory framework for the globalized financial sector. Therefore it was absolutely right, that German and other continental European politicians already pushed for stricter rules for the financial markets in 2007 addressing their U.S.-American and British colleagues.

Because the free competitive systems react sensitively to unstable currencies Eucken (1952/90: 255) claimed monetary stability as most important for the market economic system. Only in an almost non-inflationary setting a functioning of the market economy is secured, because only then, prices can fulfil their informational and coordinating function. As we know nowadays, such monetary stability can be attained by different institutions like an independent central bank, a currency board or simple money supply rules. While the conception of an independent central bank has been established in Europe after the model of the Deutsche Bundesbank, a lot of smaller countries made good experiences with a Currency Board in the past. (e.g. Estonia, see Wrobel 2000: 196 - 205) Therefore, there is no single way to attain the goal of monetary stability. But as the current crisis has shown, if the monetary policy is misused as an economic policy plaything, it cannot fulfil that function any more. So far the conception of independence of the central bank has proved itself as very successful, but also the independent European Central Bank made itself guilty supporting the US-American policy of cheap money. (Zweynert 2008: 2) Here the occasion to search for stricter rules should arise, to prevent such undesirable developments in the future.

As is well known among economists private property means freedom and power of entrepreneurial disposition as well as the incapacity to limit freedom and power of disposition of all others in society. The existence of private property sets incentives to work, enables entrepreneurs to innovate, creates new jobs, and initiates economic growth and welfare. By this way, it is the basis for self-responsibility and initiative as well as a main reason for efficiency in use of economic resources like raw materials, goods and services, or the own potentials of the people. (Eucken, 1952/90: 270 – 275) But those who benefit from something must also be prepared to bear a loss! While the freedom to profit by the own performance is a very good incentive liability rules must enforce responsible decision making. They are limiting irresponsible high-risk behaviour (e.g. speculation on international financial markets). As Eucken has pointed out: “The one who benefits also has to carry the detriments (...) Investments are made the more carefully as the responsible is liable for those.” (Eucken 1952/90: 279) That means on the one hand, that enterprises, who mismanaged have to take the consequences in the crisis. It also might be necessary that they leave the market and make

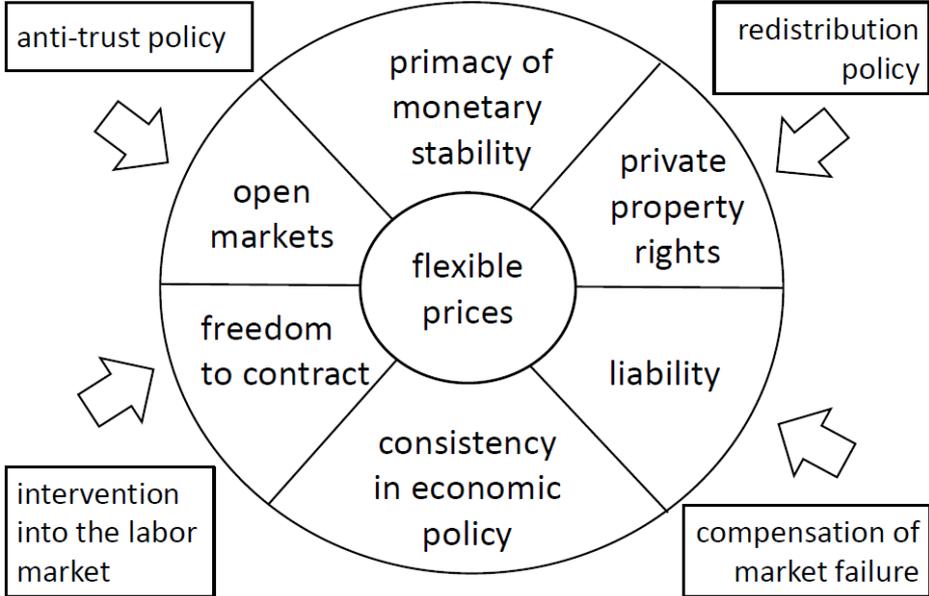
room for more efficient enterprises. Additionally rules for managers have to be implemented, which reach a level of responsible handling of the resources entrusted to them. Managers who according to the Shareholder-Value-Principle only see the current stock exchange price of their enterprise, because their quarterly bonus payment depends on that, as well as those who can just retire in a case of failure due to their guaranteed high pensions, will only act short-term-wise. A long-term, responsible business policy does not serve their needs, instead short-term high acquisitions promising risks are taken willingly.

While modern Keynesians as well as antiglobalists demand drastic restrictions of the mobility of capital, people and goods, theoreticians of the Social Market Economy like other neo-liberals advocate free markets, free investment and free migration. But while the promoters of the Anglo-American approach of a free market believe in the forces of the market alone, advocates of the Social Market Economy claim for free market access for everyone. By this way, they stand for free competition and performance-oriented behaviour as well as for restriction of national privileges and monopoly powers. This shall be attained by the reduction of market access barriers and a prohibition of cartels and monopolies domestically and by free trade, reduction of protectionist measures and membership in international organizations like the WTO, ASEAN, EU, etc. (Eucken, 1952/90: 264 – 270) Also regarding the freedom of individuals and corporations to form contracts without government restrictions differences between advocates of the free and the Social Market Economy have to be mentioned. Of course, everyone must be able to choose and examine the available opportunities and then to conclude agreements! But while promoters of the Free Market Economy are opposed to government restrictions like minimum wages, price fixing and sometimes competition laws, advocates of the Social Market Economy do not accept any kind of freedom which eliminates competition and establishes monopolistic positions. (Eucken, 1952/90: 275 – 279)

Last but not least, Eucken (1952/90: 285 - 289) points on the importance of a consistency in economic policy. A permanent trust of investors as well as consumers into a stable framework of economic policy and into macroeconomic stability (as it is reduction of business fluctuations by a long-term oriented monetary policy) will induce a permanent willingness of enterprises to invest and will improve the consumer's ability to make long-term consumption decisions. Additionally, it must be emphasized that all these constitutive principles of a Social Market economy must be enforced simultaneously. Some principles would fail in their purpose if they are applied in isolation. For instance, private property leads to excessive economic power if freedom of contract is not restricted and liability is only limited.

Additionally, Eucken (1952/90: 304 – 308) postulates an interdependency of each economic order with the neighbouring social, juridical and political order. As he mentions, all orders within a society effect each other. Therefore, the economic order cannot be understood without an analysis of all these other orders in a state.

Figure 1: Constitutive and regulative principles of a market order



2.2.3 The Regulative Principles

In contrast to a free market economy the idea of the Social Market Economy accepts the existence of weaknesses and deficits within the market order which require correction. Therefore, Eucken (1952/90: 291 - 299) demanded the prevention of monopolization and exploitation of consumers as well as workers by market-dominating enterprises. Especially, the experiences in Germany between First and Second World War led to such an insight. As he points out a stringent competition law, banning cartels and collusion, regulative supervision of monopolies or market-dominating enterprises and merger control are fundamentally for a functioning market economic order in course of time. An instrument to attain this goal seems to be an independent cartel authority. Unfortunately, Ludwig Erhard was not able to establish a Competition Law in Germany before 1958 including full independence of the German cartel authority because of political restraints. (Erhard, 1992:

267 - 275) But the German law became model for the European regulations by a large part. Additionally, Eucken demanded a correction of market failures like negative externalities (for instance environmental pollution) because they distort competition (by prices not containing costs of pollution) and harm society by suffering under “cleaning” costs. But while often an internalization of external effects by environmental taxes or charges is discussed, advocates of the Social Market Economy prefer internalization of externalities by the implementation of property rights.

In the social sphere, Eucken and the other fathers of the Social Market Economy saw an arising unequal distribution of income and wealth by the forces of the market. In their opinion this would violate the perceived “social justice” in a society (however, if such a justice can be measured or not). Therefore, re-distribution of income and wealth is necessary to generate or maintain „social peace“ in a society. (see e.g. Müller-Armack, 1947/82, Eucken, 1948/82, or Schmidt, 1957/82) This shall be done by market compliant social security systems (health, pension, etc.), regional distribution systems and a performance-oriented tax system. Of course, all these measures must be compatible with the structure of incentives in a market system, or in other words, if they “do not interfere with the price mechanism and with the automatism of the market derived from it.” (Röpke, 1950: 160) In contrast to these ideas, most West and North European societies developed into welfare states during the last decades. Also in Germany, the fatherland of the Social Market Economy, the social budget exploded. (Wünsche, 2001: 108 - 111) Thereby also Germany is marked by a too tight network of regulations (not regulatory framework conditions), equally to other welfare states in the world. But as Erhard (1957) has already postulated: The Social Market Economy cannot prosper if the underlying posture will be paralyzed by so-called social measures in neighbouring fields. A liberal economic order is only able to survive permanently while a high level of freedom, private initiative, and subsidiarity is guaranteed. Therefore, the current financial and economic crisis could also be used for a further regulatory reform, because a “purifying crisis” gives the option to implement an urgently necessary structural adjustment.

3. Implementation of a Social Market Economy

3.1 Benefits of a Social Market Economy

As has been shown above, a Social Market Economy is a very special model of market economy developed by ordo-liberal German economists and implemented in West Germany after the Second World War. In contrast to a socialist central planning system every kind of market economy is favourable. (see e.g. as classics in this sphere: von Mises, 1936; Hayek, 1982; etc.) Market economies are able to attain a higher GDP per capita by functioning market incentives and freedom of entrepreneurs and consumers. But in contrast to a free market approach the Social Market Economy takes also weaknesses and problems of the market system into consideration. Thereby, “welfare for everyone”, a more equal distribution of income and wealth can be attained. But the main policy instruments are not interventions into market processes, but a consequent implementation of the constitutive principles including strong liability rules or open markets as well as an implementation of a strict competition policy, supervision of strong market actors and a moderate social policy. In contrast to the current welfare states, such an economic system is not threatened by financial feasibility because most of the rules are qualitative ones. Last but not least, the Social Economy combines personal freedom with democracy and the rule of law. Concerning that, especially a difference to the hybrid system of Socialist Market Economy as is has evolved in China or Vietnam can be postulated.

Within the last 20 years especially transformation economies and emerging societies have been threatened by wrong reform programs neglecting the needs of market regulation. One was the failure of price liberalization and privatization in the Russian Federation due to a lack of market-oriented regulatory framework, a second dissatisfaction with economic reforms in South America following the “Washington Consensus” and neglecting the importance of safety nets and social insurance. Further the Asian banking crisis revealed that financial liberalization without prudent regulation can have disastrous consequences. (Ahrens, 2009: 114 – 115) These failures of the free market approach in developing societies have now been followed by the financial and economic crisis caused by a failing regulation of the international financial markets and an inflationary monetary policy in different Western states. But these disparate developments helped reinforce the efforts to put institutions on the reform agenda of policy makers. Today, it is widely recognised that privatization, price liberalisation and macroeconomic stabilization are necessary components of transformation but are insufficient without implementation of adequate economic rules and regulations.

Therefore, the conception of the Social Market Economy – founded on the constitutive and regulative principles by Walter Eucken – seems to be the right alternative approach of

capitalism in our times. Especially for transforming and emerging economies the approach is interesting because it allows societies to transform into direction of a market economy without neglecting regulative as well as social aspects. In less developed countries which have to do large efforts in poverty reduction the Social Market Economy may be a superior approach than the free market economy on the one side or the hybrid system of a Socialist Market Economy on the other.

But it has to be discussed, too, if a Social Market Economy can be established in different countries or societies worldwide. While implementation problems in Western societies are not to be expected as important, in transformation economies or even less developed countries in the Southern hemisphere cultural as well as political constraints can be estimated as more or less problematic. Especially, for the development in the poorest countries in the world economists like Jeffrey Sachs or Paul Collier have argued that free market development for the “Bottom Billion” will not work. (Collier, 2007: 175) Instead, they offer technocratic, administrative solutions to the poor. (e.g. Sachs, 2005; Collier, 2007) For the author this solution is wrong. Reality shows that the richest societies in the world are market economies. Here the standard of life as well as the human development is the highest in the world as e.g. the United Nations “Human Development Index” shows. Therefore it is not the question if a market system should be implemented in poor societies but only how and by which strategies.

3.2 Constraints of Implementation

3.2.1 Cultural Incompatibility and Adaptation

Economic institutions that fit in one country may not be the right ones in other societies. The specific culture of a society seems to play an important role. It must be recognised that people, characterised by cultural differences with respect to the values and norms, influence the performance of institutions. But the range of meanings given to the term “culture” is wide. It varies from culture as the realm of the arts to the sum of the man-made sphere. (Panther, 1997: 97) Maybe “culture” can be described as „all capabilities and habits acquired by a man as member of society” (Kaspar/Streit, 1998: 162). In economics culture is usually defined as the informal constraints on human interactions. As North (1990: 3-12) pointed out, rules, norms and strategies which shape individual and organizational behaviour can be identified as institutions, while beside formalized rules also habits and other informal rules of society must

be taken into account. Formal institutions like laws and regulations can be designed by politicians and enforced by the state administration. In contrast, informal Institutions like social conventions, ethical and religious convictions (“culture”) are evolving during time and are not enforceable by a state administration. Both may be contradictory.

Driven by the historical experience of institutional change in the Central and East European transformation countries the concept of culture has attracted attention by a growing number of economists in the recent two decades. For example authors like Huntington (1994 and 1996) or Panther (1997) introduced a “cultural division of Europe” as argument for success in transformation dividing Europe in a (catholic or protestant) “Latin Centre” and an “Orthodox Periphery”. These approaches may be declared as monocausal but they gain to the insight that culture matters. However, in the case of transformation to a market economy old traditions of trade and commerce, entrepreneurial activities in history and experiences with a civil society are helpful for such societies, while communist traditions like a lack of experiences with freedom and self-initiative, a passive behaviour e.g. characterized by permanent waiting for state activities, informal networks (e.g. the Chinese *guanxi*, see e.g. Wrobel, 2007: 179 - 180), or corruption are negative aspects. As the experience in Europe has shown, traditional “Western” oriented nations like Poland, Hungary, the Czech Republic or the Baltic States have been very successful in their transformations processes. (e.g. EBRD, 1999: 27, Wrobel, 2007) The German conception of Social Market Economy even has been a model for some of them in the transformation process. Less successful have been Eastern states like Russia, Belorussia or the Ukraine. As e.g. Panther (1997) has pointed out an obvious smaller tradition of civil society in these countries was the main reason.

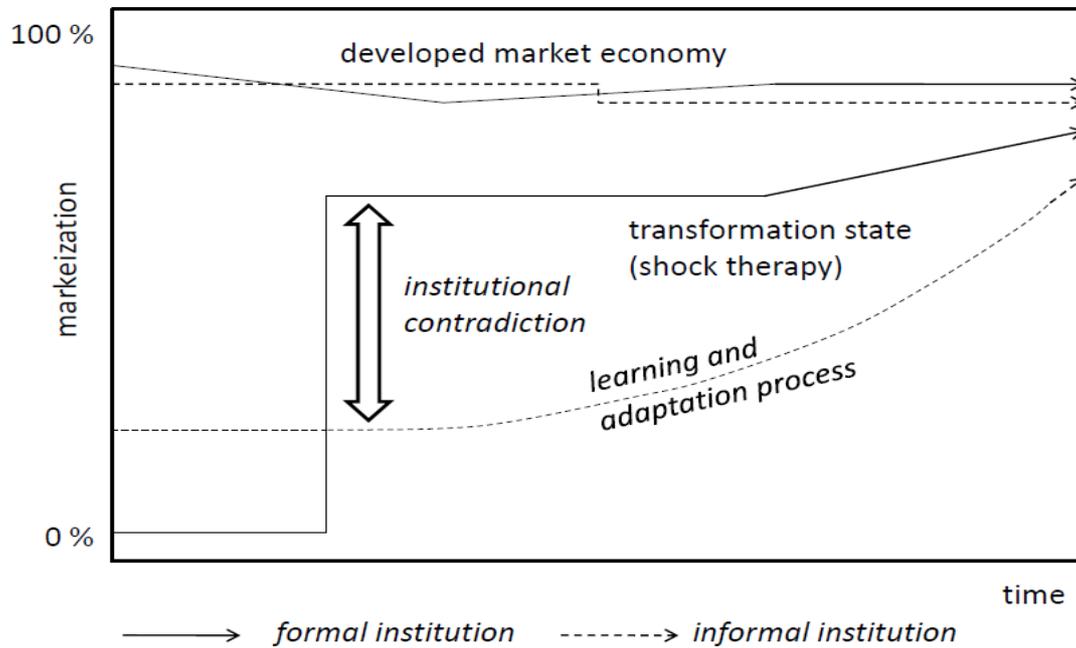
By this way, it is obvious that cultural patterns influence the success of reform or transformation processes. The implementation of a Social Market Economy in transformation as well as emerging markets can be interpreted as problem of transfer of institutions. (see e.g. de Jong and Mamadouh, 2002; Roland, 2004; Zweynert, 2009; etc.) As one can imagine the conception of a Social Market Economy is not so far away from the ideas of a free market or a welfare state in contrast to Socialism or other non-market models of economic coordination. Therefore, the author supposes that all institutions of a Social Market Economy can be introduced in the whole Western world without significant problems. In contrast, much more crucial seems to be the implementation of a Social Market Economy in less developed societies, especially if they have been socialist ruled in the past. Compared to European transformation countries a few obstacles have to be added: lacks in knowledge of the

functioning of a market system at all because of a historical subsistence economy, or a deep mistrust into the state, government or banking system, which will hamper the whole process of institutional development.

In the original analysis of North (1990: 188) informal institutions are described as changing only slowly. Thereby, sometimes “culture” became an exogenous variable. For instance, Eggertson (1996: 13) has pointed out: “... it is commonly believed that informal institutions, such as norms and customs, change relatively slowly, and therefore, in studies involving marginal changes in formal rules, informal institutions can often been taken for granted.” But he goes on to argue that this cannot hold in a long-term analysis or in cases where a fundamental change in formal institutions occurs. All institutions, formal as well as informal, are developing in time. Therefore, we can talk about an evolutionary process of mutually linked formal and informal institutions. From this point of view, there is no place for “cultural fatalism”.

A successful transfer of a Social Market Economy implies that special foreign formal institutions grow together with given informal domestic ones. Otherwise, the imported formal institutions will be rejected sooner or later. The success of such an institutional import depends on the right selection of imported rules, their adaptation to domestic conditions, and their familiarization in the host society. But especially the basic conception of the Social Market Economy seems to be a fitting set of formal institutions which may be successfully implemented also in other societies. Also in post-war Germany basic formal institutions were imported from the U.S. but were put into practice with significant tribute to domestic German traditions, combining market liberalism and a rather conservative vision of social life. By this way, the idea of the Social Market Economy was born. (Zweynert, 2009: 352-353) Therefore, the Social Market Economy approach may be of special interest for transforming and emerging societies searching for a pattern of development which combines the Western model of free markets, individualism and democracy with own more holistic traditions.

Figure 2: Marketization of different political-economic systems in time



Of course, a long learning and adaptation process must be supposed. (see figure 2) But this process can be accelerated by the politicians. It is one of the main tasks of the political entrepreneurs in developing countries, who implemented the foreign formal institutions, also to influence the informal institutions like cultural and political beliefs. They will be the more successful in doing so if they are able to ‘sell’ the imported institutions as compatible with the cultural heritage of the importing society. (Zweynert, 2009: 341-351) At all, a transformation of formal institutions implementing consistent learning and adaptation processes in the transforming society may be the only way of successful institutional transfer. The opening of markets, thereby induced FDI inflows and immigration can initiate such a learning process reducing inconsistencies between formal and informal institutions over time. Therefore the introduction of a Social Market Economy seems not to be impossible.

3.2.2 Political Conditions for a Successful Transfer of Institutions

But cultural contradictions are not the only constraints while implementing the set of rules of a Social Market Economic order. Also political restrictions must be recognised. According to this problem the new approach by North/Wallis/Weingast (2009) on violence and social order

can be drawn into consideration. They distinguish so-called limited access orders and open access orders. While the first are growing slowly and are vulnerable to shocks the latter enjoy a mainly positive political and economic development. Limited access orders, also called natural states, are characterized by polities without consent of the governed, a relatively small number of organizations and the predominance of social relationship organized along personal lines, including privileges and social hierarchies. As North/Wallis/Weingast (2009: 12) pointed out most of the societies in the world are such limited access orders. In their opinion those societies are characterized by a bigger, but more decentralized government, a rich civil society with lots of organizations and widespread impersonal social relationships including rule of law, secure property rights, fairness and equality.

These ideas were already formulated by other economists. For instance, already Eucken (1952/90: 304 - 308) has emphasised the problem of interdependency of orders. In his opinion, a functioning juridical system, control over the military, and the development of a civil society are important parts of the juridical respective political subsystem of a society. And as has been mentioned above, the Social Market Economy itself has to be understood as a privilege-free order, where neither feudal or party elites nor economic power groups like monopolies, cartels or trusts influence markets and society. By this way, already Eucken (1952/90) has brought these ideas into the scientific discussion. Also Panther (1997: 111) has to be mentioned, because he characterised the Latin West of Europe by a high degree of “civiness” what he defines as “a set of values and norms requiring actors to treat each other as equals, to be tolerant of each other and encouraging mutual solidarity.”

But North/Wallis/Weingast (2009) do not limit their analysis to the differentiation of new ideal types of social orders. They also make some detailed investigation into the transformation process from a limited access order to an open access order. This approach is of high interest for the analysis of the obstacles to implement a Social Market Economy in less developed countries or emerging societies outside the club of developed Western states.¹ Concrete, North/Wallis/Weingast (2009) define two steps for natural states to become an open access order. First, personal relations within the dominant coalition have to be transformed into impersonal ones. Then, three doorstep conditions have to be fulfilled. These conditions are first of all the implementation of the rule of law for the elites. This shall be enforced by the establishment of functioning juridical system as well as by successful anti-corruption

¹ Unfortunately, they do not present a historical case study of catch-up development and the transfer of institutions. But this gap is filled e.g. by Zweynert (2010) on the French Revolution and the transfer of the open access order to Germany.

measures. Second condition is the existence of continuously lived forms of public and private elite organizations. That means a civil society with lots of organizations which has to be implemented. And third, the military must be come under consolidated political control, for instance the Ministry of Defence. But this process will only occur if the members of the dominant coalition find it advantageous to transform their privileges into general, impersonal rights. (North/Wallis/Weingast, 2009: 150 - 166) But while the conditions for a development from a limited access order to an open access order is described in detail the emergence of the monopoly of power during the transition process is hardly dealt with at all. (Zweynert 2010: 5) Therefore, also the success of a political development is depending on the willingness and success of political entrepreneurs to implement the rules of an open access order. It can be supposed that the globalization – understood concrete as an institutional competition process (see e.g. the edited volumes by Hodgson, 2007, and Witt, 2008) – will enforce these processes in natural states. But further research has to be done into this issue.

4. Conclusion

As the analysis above has shown a Social Market Economic order has a lot of advantages, also for transformation states and less developed countries. These advantages became more obvious after the financial and economic crisis again. While American neo-liberals like Milton Friedman saw the answers to the failed Keynesianism in a total withdrawal of the state from the economy, German ordo-liberals tried to create a new connection between a strong state and free market economy. Therefore the conception of Social Market Economy is signed by its regulatory framework and the freedom of the players to act without restrictions within that frame. Thereby, the approach is not only interesting for developed market economies as alternative but also for transforming and emerging societies searching for a new target of institutional development after the crisis of free markets nowadays. But it is hard to implement a Social Market Economy worldwide because of cultural, political and other restraints. But this should not lead to the conviction that a Social Market Economy cannot be implemented in transforming or emerging countries. Restraints can be removed within a learning process over time. But on the other side, one should not be too enthusiastic like advocates of a free market approach have been after the fall of communism promising a large growth payoff to free market reforms. (Easterly, 2008: 13 - 15) Such a process will take time. Disappointments in the short-run are possible, too.

Until now, the German ordo-liberal conception did not gain acceptance throughout the world – between neo-liberal and Keynesian approaches. This is definitely not due to its quality but due to the inability especially of German economists, to internationally represent that conception and to communicate. A crisis like the current one should be the right time, to reflect those successful ideas of Social Market Economy à la Ludwig Erhard and the conception of a market economic order by Walter Eucken. By this way, this paper should be understood as attempt to bring the Social Market Economic approach again into the international discussion.

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