

## “Social and Ecological Market Economy. A General Overview” Dieter W. Benecke

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### I. Introduction – From Political to Economic Competition

The *social* market economy is one in which social concerns are accorded the same importance as economic concerns. Faced with contemporary environmental challenges, the social market economy must of necessity become an *ecologically* oriented economy.<sup>1</sup> But the ecological orientation should not dilute the traditional social market economy “brand.” The ecological ingredients of the social and ecological market economy (SEME) are as important as its market elements and social characteristics. However, if the market does not work and if economic policy is not combined with preventive and compensatory social policy, the ecological dimension cannot be effectively incorporated into a social market economy. So, the terms *market*, *social*, and *ecological* should chime with each other as equally essential elements in a melodious triad.

Until the 1980s, the world was divided into competing political and ideological systems. The main question was: Is society better off and more just if the economy is centrally planned – as in the former Soviet Union or in China until 1979 – than is the case in a capitalist market economy? Or could there be a third way<sup>2</sup> in which the state is as important an economic player as the market? Since the collapse of the Soviet Union, the market-oriented model has asserted itself, albeit with different political shades from country to country: greater or less state interference, more or less influence of civil society organizations. The main question today is: which type of market economy is most effective in terms of economic success, social justice, and ecological sustainability?<sup>3</sup> Thus, the debate has moved on from the political to the economic.

Globalization has opened up and accelerated worldwide communication processes. Information about what is going on in different countries has increased enormously. This enables competitors to adapt or imitate successful techniques and products much more quickly than before. Before the 1990s, it

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<sup>1</sup> *Market* here means as much competition as possible and suitable for society. *Social* means caring for the weaker members of society and keeping in mind the interests of society. *Ecological* means caring for the environment in terms of greenhouse gas emissions, recycling, alternative energies, traditional energy savings, etc. in the respective country and worldwide. These elements are explained in more detail later.

<sup>2</sup> The “third way” was launched as a programmatic approach by the British Labor Prime Minister Tony Blair in 2000. In English-speaking countries, the question is often raised as to the difference between the social market economy and the third way. The term *third way* could mean anything between communism and capitalism, between centrally planned and free market economies. The term *social market economy*, however, contains the clear message that the market elements are at the same level as social care. In terms of content, the third way model, which was above all a political concept for the reform process in Great Britain, is close to the neo-liberal approach (see Fig. 1), because the state increasingly relinquishes the production of public goods like transport, infrastructure, health care, education, and other services, privatizing them. Social subsidies to the weaker members of society are reduced, in an attempt to give them more incentives to care for themselves and release the state from high social costs. Alfred Schueller discusses several third ways to show how ambiguous this concept is. See Alfred Schueller, “Soziale Marktwirtschaft und Dritte Wege” (Social market economy and third ways), *ORDO: Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft*, Band 51 (2000):169-202.

<sup>3</sup> In economic terms, the world is far from the thesis of Francis Fukuyama’s *The End of History and the Last Man* (New York: Free Press, 1992). Its validity is doubtful even in political terms, given the Chinese approach or that of the “neo-socialist” Venezuelan President Chávez and his followers Morales (Bolivia), Correa (Ecuador), and Ortega (Nicaragua).

was relatively easy to insulate a country from outside influences, to exclude the majority of the population from access to relevant information, and to protect national enterprises from foreign competitors through custom barriers and other means of discrimination. There was scarcely any public discussion at that time about the damaging ecological effects of some types of economic activity.<sup>4</sup>

Today, democratic governments, which by definition are committed to plurality of opinion and freedom of information, neither wish nor would be able to cut the population off from foreign influences. Even authoritarian and totalitarian governments can impede global information flow into their country only by means of strong repression. The internet and international trade agreements, especially the World Trade Organization, and various regional groupings have strengthened international interaction.

In this world of free information, economic competition between countries has become tougher. This has brought about a more intense search for the most effective *economic* system. For about a decade, this competition has been dominated by three issues:

1. How can the wealth and educational level of the population be increased and, if achieved, how can it be sustained?
2. How can economic growth and improved knowledge be distributed in a way that allows as many people as possible to participate?
3. How can an acceptable level of social security for all be guaranteed?

In this contest for the most effective social market economy model, ecological sustainability has gained more and more ground. Possibly – and in my view, ideally – the environmental dimension will come to be recognized worldwide as the third criterion for measuring the effectiveness of any economic system.

So, current discussion no longer gravitates between the extreme positions of a centrally planned economy linked to authoritarian government and a free market economy associated with liberal government. In most countries today, the discussion revolves around a more neo-liberal or neo-conservative model and a more socialist or social-democratic market economy (see Figure 1). Between those two alternatives lies the social and ecological market economy (SEME), an open and flexible system that may be adjusted according to the time and situation in different countries. That is why SEME is not a fixed point on the scale of economic systems, but rather a range which may move to the left or to the right according to particular needs and circumstances (see Figure 1).<sup>5</sup>

In the European Union (EU), which has expanded from an economic community of six founding countries in 1958<sup>6</sup> to 27 countries<sup>7</sup> with about 500 million people, the member states have opted for a

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<sup>4</sup> The statement of a former Brazilian minister of economy – “The darker the clouds, the better for our economic growth” – expresses the viewpoint of many developing countries and some industrialized countries, too.

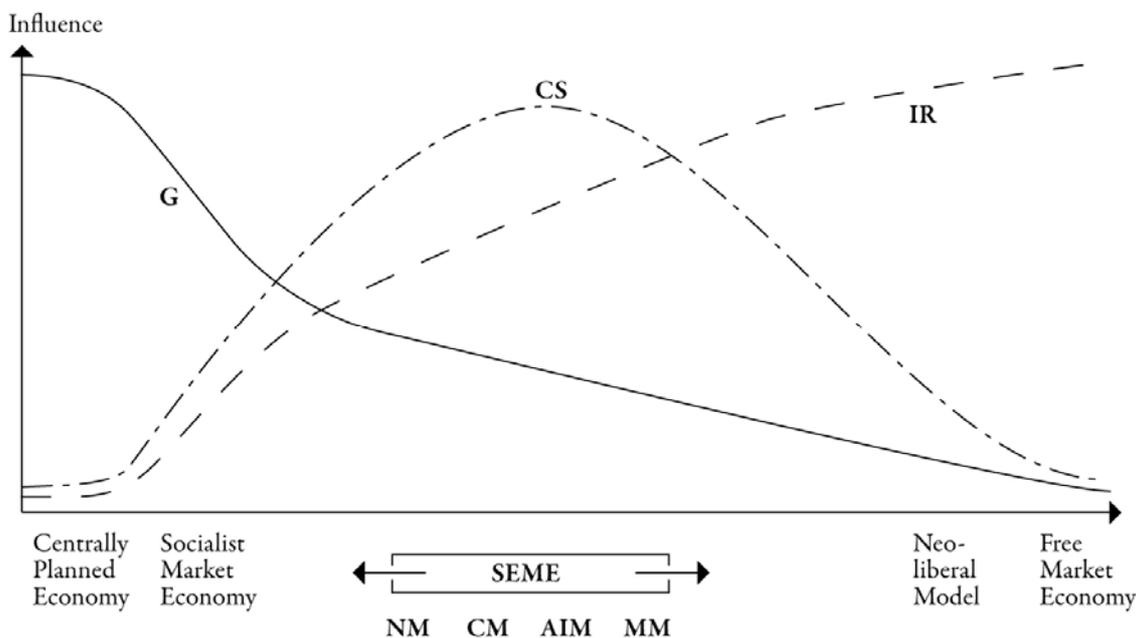
<sup>5</sup> For example, if unemployment increases, the state or its employment agency must become more active (the model moves to the left) than would be the case in times of full employment (the model is situated more to the right). The fluctuation of the SEME model showing the necessary adjustments can be illustrated through many more examples: the effects of a more or less severe economic crisis; higher or lower inflation; needs for greater environmental protection; problems of energy supply; insufficient health care; demographic changes; adjustments of the foreign exchange rate and foreign trade; etc.

<sup>6</sup> Belgium, France, Germany, Italy, Luxembourg, and the Netherlands.

market economy molded by more or less important social and ecological elements. In search of the most effective system, one which offers economic efficiency, social justice, and ecological protection, the EU distinguishes four models<sup>8</sup>:

- the Mediterranean model (MM), as found in Greece, Southern Italy, and Portugal;
- the Continental model (CM), as found in France, Germany, Northern Italy, and Austria;
- the Nordic model (NM), as found in Sweden, Finland, and Denmark;
- the Anglo-Irish model (AIM), as found in Great Britain and Ireland.

Figure 1: Range of Economic Systems and Influence of the Economic Actors



NM – Nordic Model; CM – Continental Model; AIM – Anglo-Irish Model; MM – Mediterranean Model

These models show variations in relation to state influence, tax systems, flexibility of labor markets, pension systems, redistribution instruments, open market competition, environmental protection, etc. The ten states which joined the EU in 2004, as well as Romania and Bulgaria, which joined in 2007, are still experimenting with different elements of the four models. As Figure 1 shows, the SEME model differs from the socialist and the free market economy models by virtue of such factors as the relative influence of government (G), the role of civil society (CS), and individual responsibility (IR) in society and in the economy.

<sup>7</sup> The six countries named above plus Austria, Bulgaria, the Czech Republic, Cyprus, Denmark, Estonia, Finland, Great Britain, Greece, Hungary, Ireland, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden.

<sup>8</sup> The economic and social situations of the EU member states was analyzed in the Sapir Report. See André Sapir et al., *An Agenda for a Growing Europe – Making the EU Economic System Deliver* (Brussels: the EU Commission, July 2003).

## II. Aims of the Social and Ecological Market Economy

As already mentioned, SEME incorporates economic, social, and ecological aims.

### 1. “Welfare for all” as Economic Target

The call for “welfare to all,” which provided the title to the book by Ludwig Erhard,<sup>9</sup> the pragmatic pioneer of the social market economy and the first minister of economy in Germany after World War II, does not suggest that all citizens are at the same level of welfare. Every country naturally has more and less well-off people, and their condition is not always related to individual effort or merit. However, the social market economy should enable the vast majority of people to participate in the wealth of the nation, either through their own endeavors or with the help of society, thus allowing for a significant level of individual dignity. It should deliver a decent standard of living and open access to education and professional training. Nobody should live in poverty.

Several factors combine to achieve this aim of welfare for all. The creation of wealth, normally measured by *economic growth*, depends greatly on *investment*. This presupposes an adequate *savings rate*, possibly promoted or supported by the state. Savings, however, make sense only if there is *price stability*. Inflation is poison to the enterprise of creating welfare for all. Certainly, investments can be financed temporarily through credit; however, credit must be repaid one day. Individuals normally respect this obligation, while governments often go into debt at the expense of their citizens, sometimes even at the expense of future generations.<sup>10</sup> Therefore a *balanced government budget* is equally essential to the creation of welfare for all. Ideally, all current expenses of the state should be covered by tax revenues.

Economic growth can also be driven by foreign investment. This implies a higher risk of volatility because of speculative capital transfers or withdrawal of profits and/or capital. Thus, solid economic growth leading to welfare for all requires a sound *internal savings rate*.

*Innovation* is also decisive for economic growth. No country achieves real growth of 5% or more through increased production of traditional goods and services alone. There must also be a qualitative approach. This is apparent from the experience of Germany and Japan after World War II, later on from that of some Asian countries like South Korea, Singapore, and Taiwan, and more recently from India and Chile. Other fast growing countries like China, Vietnam, Brazil, Mexico, and Venezuela, having started with the quantitative approach, are now being forced to pay more attention to innovation if they are to continue playing an important role in the global economy. In Europe, Ireland and Finland have opted very successfully in the last decade for the qualitative approach to economic growth, and Germany, a bit too comfortable in the 1980s and 1990s, now seems to have left its

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<sup>9</sup> Ludwig Erhard, *Wohlstand für Alle* (Welfare for all) (Düsseldorf: Econ-Verlag, 1957). Erhard became the first minister of economy of the Federal Republic of Germany in 1949. His approach was, at that time, vigorously opposed by the Social Democratic Party, which was in favor of more state planning. Only after the model proved successful did the different democratic parties generally accept it, while frequently debating its different elements.

<sup>10</sup> Public debt crises of the last 30 years, like those of Latin America, Asia, and Russia, show how quickly countries can be thrown back. In Germany, the constitution limits the debt that the state can incur. It states that the government should borrow only for investment purposes, not to cover current administrative costs. The EU has established that member states should not contract debts higher than 3% of their GDP.

sleeping-beauty period. New products and new technologies are vital to the opening of new markets. This in turn allows for a reduction of costs and a concomitant increase in competitiveness.<sup>11</sup>

The more productively employed the population, the greater the chance to achieve welfare for all. *Full employment*<sup>12</sup> in the strict sense of the word can hardly be achieved in a dynamic economy, because of the fluctuations within the different economic sectors. This phenomenon is reinforced by globalization.<sup>13</sup> Therefore, workers and managers need to be highly flexible and mobile. The effort to create welfare for all is not confined to the national economy alone. Foreign markets must be considered as well, in terms of both *exports* and *imports*, if countries are to benefit from their comparative advantages. The economic development of China after 1980 shows this clearly. Opening its market to foreign investments and goods, China learned from foreign experience. It imported the raw materials and technology necessary for industrial modernization and became increasingly able to export, to the extent that it is expected to overtake Germany as world export leader in 2008.

Exports increase welfare by creating more employment. Imports increase welfare by bringing new, better, or cheaper products into a country, as well as putting competitive pressure on internal prices and thus raising real income. However, large export or import surpluses that are not accompanied by high capital imports or exports, respectively, disturb the macroeconomic balance and could endanger general welfare. *Foreign trade equilibrium* is therefore another important factor which facilitates welfare for all.

The art of politics is called upon to give effect to the above-mentioned aims and to enable countries to react quickly in the case of imbalance. The achievement of an acceptable level of welfare for all does not justify sitting back or resting on one's laurels. Internal or external influences can disrupt this dynamic equilibrium very easily, if attention is focused mainly on creating wealth and insufficiently on its distribution. Sooner or later, the concentration of wealth in certain echelons of society or in certain regions will engender social conflicts. The social market economy model obliges the state to pay attention to fair *income redistribution*<sup>14</sup> and balanced *regional policy*. If economic growth is concentrated on a certain region, a "backwash effect"<sup>15</sup> may be expected. This can be observed in China, as dynamic people migrate from backward regions into more prosperous ones, thus hobbling any chance of improvement in the backward regions.

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<sup>11</sup> Some countries try to innovate through attracting foreign investment, offering tax advantages, low labor costs, less regulations, and lower environment protection standards. But growth created in this way is rather artificial and brings only transitional benefits, especially if the process is not based on well-trained workers, a high level of engineering and managerial skills, the ability to innovate, and the protection of intellectual property rights.

<sup>12</sup> Generally, when the unemployment rate is less than 4%, a country may be said to have *full employment*.

<sup>13</sup> For example, the textile industry, once an important production sector in industrial countries, has been reduced as Asian countries have taken up production of everyday textiles. So workers from this sector have had to look for jobs in other areas.

<sup>14</sup> In many countries which benefited from globalization, a stronger concentration of wealth on fewer persons can be observed. Therefore, a political debate arises as to whether the state should redistribute not only income but wealth, too, for example, by taxation of inheritance.

<sup>15</sup> This effect has been analyzed by Gunnar Myrdal, *Economic Theory and Underdeveloped Regions* (London: Duckworth, 1957), contradicting Albert O. Hirschman's plea in *The Strategy of Economic Development* (New Haven: Yale University Press, 1958) for creating development poles and expecting a "trickle-down effect" from these. See Dieter W. Benecke, *Kooperation und Wachstum in Entwicklungsländern* (Cooperation and economic growth in developing countries) (Tübingen: Mohr-Siebeck, 1972, p 33 ss.).

## 2. Social Justice as Political and Economic Aim

*Social* has a double meaning. On the one hand, the term relates to society and on the other, to the concept of welfare services as in social security. Social justice is achieved through social security measures, like health services, pension systems, etc. and the redistribution of income in favor of those who cannot help themselves. This is not the place to discuss the philosophy of justice. In economic terms, social justice means equal opportunities, facilitated by a sufficiently open educational system. It means as well that those who make a greater effort should obtain more benefits. However, the satisfaction of basic needs like food, housing, and healthcare may be taken as a minimum standard. Social justice, in economic terms, cannot be measured exactly.<sup>16</sup> In the end, it has to be judged politically by the majority of the population through the process of democratic elections. The notion of social justice for all is somewhat idealistic because, while human beings are of course all equal under the law, they are unequal in terms of potential, ambition, and expectations.<sup>17</sup>

In spite of this fact, a stable and successful society can be achieved only if it is organized as justly as possible. The best way to realize this aim is through open access to education. Also in this field not everybody has the same ability or willingness to learn and one cannot force people to engage with a lifelong learning process. But it is highly important that the door to education and professional training is open to everybody and not restricted by economic or social background.<sup>18</sup>

## 3. Environmental Compatibility of Economic Policy as Ecological Aim

Since the 1970s, the economic and social aims of the social market economy model have been complemented by ecological goals. Although efficient waste disposal or recycling was important even before, the discussion about energy shortages, the expansion of the ozone hole, and climate change have increased ecological awareness of the population and has pushed the state to include environmental elements in the social market economy. Thus, states have passed laws and regulations which limit emissions, require the installation of filters, and enforce recycling and have established tax incentives or subsidies for alternative energies, energy saving, and the development of new environmentally friendly technologies.

In the beginning, industry and households took a defensive approach to ecological needs. This cost factor, however, soon turned into profitable activity, with the production of filter systems and waste recycling and incineration plants, the development of alternative energy sources like solar cells, geothermal warming, wind farms, and biofuels,<sup>19</sup> and the promotion of energy-saving techniques. In this way, a huge new market was created with enormous potential for growth.

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<sup>16</sup> In 2007, the 17<sup>th</sup> Congress of China's Communist Party, obviously aware of the current concentration of wealth, set a harmonious society as a central goal. Such an aim cannot be achieved without social justice, but might be a step towards the SEME.

<sup>17</sup> The British writer George Orwell, known for his critical view of the almighty state (1984, "Big Brother is watching you") satirizes former communist ideology in his novel *Animal Farm*. While starting the "revolution" of the animals against their farmer with the slogan "All animals are equal," after a short while the pigs in power complement the slogan with the addendum that "some are more equal than others."

<sup>18</sup> The Pisa Study, which regularly analyzes the knowledge level in different countries, shows that the efficiency of the educational system corresponds with the economic and social performance of a country.

<sup>19</sup> Meanwhile, biofuel has become a contested international issue. Brazil and the USA have brought their common interest in biofuel production almost in line. Venezuela's President Chávez, together with Cuban President Fidel Castro and the Movement of Landless People in Brazil (MST), started a campaign against biofuel, arguing that the production of biofuel

International pressure has driven the ecological agenda in some countries. The Kyoto Conference<sup>20</sup> in 1997 and subsequent agreements have played an important role in this. In Europe, politicians have recognized that the Kyoto target is insufficient to reduce global warming. At the initiative of the German government, EU member states agreed in 2007 to reduce carbon dioxide and greenhouse gas emissions by 20% and to increase the production of renewable energy by 20% by 2020 (“20-20-2020”). At the Bali Conference on Climate Change in 2007, the 190 participant states also recognized that the Kyoto aims were insufficient, but could not commit themselves to quantitative aims. However, they agreed to draw up a new international protocol by 2009, which will commit the industrialized country to greater reduction of greenhouse gas emissions, but will also demand more pollution control from the developing countries.

Great political skill and intense dialogue between the state, enterprises, trade unions, and consumer organizations are required to harmonize economic, social, and ecological aims. Once more, it should be emphasized that ecological aims can only be achieved effectively in a dynamic economy that places importance on the future of society. In spite of a certain resistance by some governments, awareness of the need for greater environmental protection has increased.<sup>21</sup> The development of a system allowing firms or countries to buy and sell so-called pollution rights or carbon credits is also welcome.

### III. Sources of the Social Market Economy

As the SEME was developed on the basis of the social market economy, the latter must be explained first. A social market economy is an economic order based on clear principles and therefore offering a reliable orientation for economic actors. Such an economic and social order does not fall from heaven. It is rather the result of scientific research and reflection on ethical principles and the outcome of entrepreneurial and political activities. In addition to its theoretical framework and philosophical underpinnings, positive and negative experiences and trial-and-error processes have helped build up this system.

The social market economy, named as such in Germany from 1949 onwards,<sup>22</sup> is based on a long tradition of socio-economic debate. “Manchester Capitalism,” the 19<sup>th</sup> century process of

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raw material prevents small farmers from producing food. In the EU currently, the policy of bonuses for agricultural land not used for the production of food has changed. In recent years, farmers used their land, at least partially, for the production of biofuel raw material. Now, as prices for milk products, meat, and flour have increased sharply (in part because of the great demand in China), European farmers once again get bonuses for using their land for food production.

<sup>20</sup> In this conference, the 55 countries which produced over half the worldwide emissions of carbon dioxide agreed a protocol to reduce the 1990 level of emissions by 5.2% by 2012. By 2007, 169 countries had signed this protocol but the USA, the greatest offender, has not yet done so, and China, the second greatest offender, is reluctant to fix quantitative goals for emissions. The Bali Conference on Climate Change in 2007 again demonstrated the confrontation between more progressive countries, for example the EU states, and more reluctant states like the USA, China, India, Russia, and several developing countries. The latter argue – and this is correct – that the industrialized countries have caused a large part of the current ecological damage and that their priority is to reduce poverty and pursue more dynamic development.

<sup>21</sup> Here we can cite the popularity of the Nobel Peace Prize winner Al Gore and his film *An Inconvenient Truth*. It is notable as well that at the Chinese People’s Congress in 2006 and the 17<sup>th</sup> Congress of China’s Communist Party in 2007, different motions proposed more attention to environmental aspects than in the past.

<sup>22</sup> The term is attributed to Erhard’s State Minister Alfred Mueller-Armack, *Wirtschaftslenkung und Marktwirtschaft* (Steering of the economy and market economy)(Duesseldorf: Verlag für Wirtschaft und Sozialpolitik, 1947). In many later

industrialization in England and Germany, generated enormous technical innovations and wealth for some entrepreneurs, but also caused significant worker pauperization. This pushed economists and politicians to think about alternative designs for the economy and society.

Karl Marx correctly described these social problems, but his call for the “expropriation of the expropriators” was not a viable option.<sup>23</sup> Conservative politicians, obviously afraid of a revolution, tried to take the wind out of socialist sails by introducing social relief schemes. The then German Prime Minister Otto von Bismarck pushed very progressive social legislation through parliament in the latter part of the 19<sup>th</sup> century, creating an insurance system for workers that provided health protection, pensions, and unemployment payments. The Catholic and Protestant churches introduced charity activities, but also developed alternative economic concepts: the Catholic Social Doctrine<sup>24</sup> and the Protestant work ethic,<sup>25</sup> respectively.

These political and church activities were important in a pragmatic sense. However, the conclusive model of the social market economy was developed in academic circles, by people who were aware of the positive aspects of a liberal economy, but at the same time conscious of its social downsides. The challenge was to find a system that assured technical progress and dynamic entrepreneurship, while avoiding concentration of wealth and hegemony by few rich persons. Based on the analysis of the economists of the Vienna School (notably Boehm-Bawerk and Schumpeter), the social scientists of the Freiburg School (von Hayek, Roepke, Eucken) developed Ordoliberalism: a regime that combined individual freedom of economic activity (“liberal”) with an economic “order” acceptable to society. So, this theoretical approach advocated:

- for open markets and free competition, individual property rights, and contractual liberty;
- against economic concentration, excessive individual liberty, and uncontrolled business cycles.

This ordoliberal concept does not argue in favor of equality for all citizens, but rather for equal opportunity. Everybody should have access to resources which permit a decent standard of living; markets should not be monopolized nor interfered with by the state and should be open for newcomers to allow for effective competition. These requirements which involve government decisions, at least in part, and the scientific, ethical, and political roots demonstrate that the social market economy is not an economic order alone. It is at the same time a political system, the success of which must be verified periodically. Majority decisions are required to establish if citizens feel that their society is properly organized. This is manifest in the right of the population to re-elect or to change the government that is responsible for shaping the general framework of the economy and society.

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publications, different aspects of the social market economy were analyzed, for example. Dieter Cassel (ed.), *50 Jahre Soziale Marktwirtschaft* (50 Years of social market economy) (Bonn: Lucius und Lucius, 1998).

<sup>23</sup> Karl Marx recognized the positive role of capitalism, too. Asked by Russian and Indian socialists how to establish socialism in their countries, he stated that capital accumulation and industrialization are preconditions of socialism, because in agricultural societies like Russia and India at that time, there was neither a proletariat ready to fight for the revolution nor sufficient wealth to be redistributed and spent on social services.

<sup>24</sup> See for example Anton Rauscher, “Katholische Soziallehre und liberale Wirtschaftsauffassung” (Catholic Social Doctrine and Liberal Economic Concepts), in *Selbstinteresse und Gemeinwohl. Beiträge zur Ordnung der Wirtschaftsgesellschaft* (Berlin: Duncker & Humblot GmbH, 1985), 279-318.

<sup>25</sup> See for example Helmut Thielicke, *Theologische Ethik* (Theological Ethics) (Tuebingen: Mohr/Siebeck, 1958).

The concept of a social market economy was put into practice by Ludwig Erhard. He had learned from the worldwide economic crisis of the 1920s, the experiences of the German war economy (between 1939 and 1945), and the theoretical approaches of the Vienna and Freiburg Schools. Obviously, nothing is more convincing than success, evident in Germany between 1952 and 1990, when the country experienced unprecedented prosperity and social justice.

Several countries bear witness to similar economic success.<sup>26</sup> Although their jump forward deserves great acknowledgement, the real challenge is to improve the standard continuously.<sup>27</sup> One of the great advantages of the social market economy model is that it provides a roadmap for *sustained* wealth creation. Its application makes it possible to overcome economic underdevelopment and to stabilize a level of wealth, combined with a satisfactory component of social justice. This model is not unique to Germany; it may operate in countries with different characteristics. Indeed mere imitation of the German experience cannot promise the same success, given the structural differences. The instruments of the social market economy might be roughly the same, but their application will differ according to the situation in which the country in question finds itself.

#### IV. Definition of the Social Market Economy

The social market economy, although based on strict principles, constitutes at the same time a very flexible system. This presents a great challenge in terms of entrepreneurial dynamics, consumer vigilance, and attentive governmental policy. The successful application of the model demands rather prompt reactions to internal societal changes as well as to external influences. The fundamental institutional requirements are the rule of law and a democratic order in which the interests of the different social groups are respected. Social partnership between trade unions and entrepreneurial associations is an essential component of labor market design, to allow for entrepreneurial dynamics, investment, high employment rates, and social justice. Through this system of countervailing powers, a dynamic equilibrium is created.

Implementation of the social market economy is based on three general principles:

- **Individual spirit of achievement and self-responsibility** of citizens. Obviously the range of individual performances varies: it depends on financial, educational, and physical capacity. Therefore, while everybody does not share the same spirit of achievement and sense of responsibility, people must – to a degree that corresponds with their ability and capability – make the same effort to obtain a good education and adequate welfare and to provide for their pension and their health insurance. A great spirit of achievement is likely only if citizens can acquire *private property* and if they can *compete* with one another.
- **Solidarity** within society. This means that the more capable and wealthier members of society have to contribute more to improve the opportunities and quality of life for people who cannot manage to achieve a proper standard of living. Solidarity is shown for example in the tax system, where people with higher incomes are charged more, or in the social insurance system, where those

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<sup>26</sup> Examples worth studying are Ireland, Finland, Estonia, and Slovenia in Europe; Chile in Latin America; South Korea, Taiwan, Singapore and, more recently, India, China, and Vietnam in Asia.

<sup>27</sup> Many Latin American countries, for example, have experienced a quick boom based mostly on the export of raw materials, but they have also suffered deep crises, because they did not succeed in facilitating the participation of the broader population in the newly created wealth.

with higher incomes pay higher contributions, enabling the weaker to avail of a decent level of security. Solidarity expresses itself also in the freedom to form trade unions, associations, cooperatives, and other civil society organizations, which assist those who by individual effort alone cannot participate actively in the economy and society.

- **Subsidiarity**<sup>28</sup> of the state. This comes into play in the case of natural catastrophes, but also in times of economic depression with high rates of unemployment and business collapse. Government subsidiary support may be necessary too if the contributions of tax payers are insufficient to maintain the system of social security, in the case of an aging society, for instance. Government subsidiary support however is not just a *defensive* measure. It can also stimulate innovation. In general, ecological protection needed state intervention at the outset. High-tech areas may also sometimes require state subsidies. It is important to clarify that subsidiary activities should always be considered *transitional* and concentrated on *public goods*: they should not be designed for individual advantage.

It is self evident that the social market economy is an open system which requires a high degree of in-built flexibility. Otherwise, citizens, social groups, entrepreneurs, and government will not succeed in achieving an optimal combination of the three principles. If there are too many subsidiary activities, solidarity and self-responsibility will be reduced or even suffocated. If solidarity is too generous, this may be exploited by persons who do not exert effort according to their capability (“social parasites”). If citizens cannot count on solidarity or subsidiary activities, society will be divided into a dominant coterie of the very rich few and a poor and dependent majority.<sup>29</sup>

This can be shown by a recent example of world-wide relevance: the opening of the Chinese economy in 1979. By giving more flexibility and freedom to entrepreneurs, amazing economic growth has been achieved in the last decade.<sup>30</sup> However, the government neglected to dedicate high priority to the social solidarity that is needed in such times of drastic change in the economic structure. Now, special social policy is urgently required to compensate for the loss of social security caused by the demolition of the technologically and economically inefficient big industrial conglomerates, which in former times took care of all the social needs of the workers and their families.<sup>31</sup>

Summing up these remarks, the social market economy can be defined as an economic order based on open market competition with in-built social security factors. This model cannot ever be perfect. But, as it is a flexible system, open to new ideas and developments, it aspires to improve continually by checking its effectiveness and its outcomes through international comparison and citizen satisfaction.

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<sup>28</sup> Subsidiarity means in general that the higher level entity only becomes active when the lower level entity cannot solve a problem. In the social market economy, it means that the state only gets involved if individual efforts and community solidarity cannot solve an individual or social problem.

<sup>29</sup> A sad example of a bad mix of the three principles may be observed in many Latin American countries, where 10% of the population have 50 to 60% of the wealth at their disposal, and half the population has only 10% of the wealth. In China, too, this problem of wealth distribution has become a considerable problem, not only in regional terms but also in interpersonal terms. The poverty of small farmers and migrant workers may lead to greater social conflict if more attention is not paid to redistribution issues.

<sup>30</sup> The Chinese government, at the 17<sup>th</sup> Congress of the Communist Party, recognized that this growth had been achieved, at least partly, at the expense of ecological needs, which must be taken into account if the declared goal of quadrupling the level of wealth by 2020 is to be reached.

<sup>31</sup> Clearly, part of the economic inefficiency of those conglomerates was caused by the high costs of their social functions: organizing health services and childcare, educational facilities, and the pension system for their workers.

Politicians must be ever vigilant as to the balance of the three general principles, and analysis, carried out by independent experts, should advise the government how to react to changes and how to improve the system, especially since politicians habitually are inclined to maintain a more or less satisfactory system, often eschewing timely adaptations.

The social market economy, established in 1949 and further developed since then in Germany and other countries, has been challenged by two important phenomena in the last 20 years: globalization and the issue of environmental protection, both inseparable from the energy crisis and climate change. An adequate response to these challenges demands a shift in individual and social behavior as well as a new thrust towards lifelong learning. It also entails a readjustment of the instruments of solidarity and subsidiary measures.

## **V. Conditions for Success of the Social and Ecological Market Economy**

The SEME has been able to deliver good results in every country. Obviously, as in all economic models, the educational level and the population's access to and willingness to engage in lifelong learning are of decisive importance. Rich natural resources can help but are not a necessary condition for success, as can be seen by the examples of Switzerland or Singapore. In addition, the following four functional requirements are fundamental to achieving welfare for all, social security, and better environmental protection.

### **1. Reliable Framework Conditions**

Adequate laws and an independent judicial system, respect for individual and social human rights, the possibility of participating in the political decision-making process, and a certain continuity of government policy or at least of the public service, are all indispensable to offering long-term orientation to the different economic actors. If rules are not clearly established and socially accepted, some will try to gain advantages at the expense of others or at the expense of society. Without a clear and reliable framework, the economic actors will strive to maximize short-run profits, placing their savings abroad rather than investing them in the country in which they were generated. If the framework conditions change very quickly, citizens' willingness to participate responsibly in the design of society can hardly be expected.

The maintenance of stable framework conditions, however, does not mean eternal devotion to the status quo.<sup>32</sup> The potential for flexibility and change must also be an in-built feature of the framework. Part of the art of politics is to combine stability and flexibility, continuity and innovation. Tardy reactions to internal or external change – as has been the case in different countries' response to globalization – have led to deficits in competitiveness or lack of social security.

This may be observed in Germany, where between 1990 and 2002 economic policy and the social security system were not adjusted to take account of higher unemployment, an aging society, and the problems encountered in incorporating the eastern German population into the western social security system. The measures to reform the system, which began in 2003, caused considerable political difficulties. In this case, the framework conditions of the social market economy were still in place,

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<sup>32</sup> In the extreme case, this happens in dictatorially governed countries where the wrong framework is maintained to the disadvantage of welfare for all, human rights, and social justice.

but politicians did not exercise the flexibility of the model. In fairness to the democratic process, adjustments are more difficult in a multi-party democracy than in an authoritarian system, because interest groups defend their positions and thus render dialogue more time-consuming. However, such dialogue offers greater stability for the future. A strongly structured and institutionalized economy<sup>33</sup> is like a big tanker, changing course much more slowly than a sailing boat.

The specific ecological framework conditions are defined through scientific research and political movements. It has taken some time to recognize them as such and to introduce them in a legally binding way. Nowadays, in Germany and many other countries, environmental protection and energy savings are accorded the same importance as economic and social aims.

## 2. State Behavior

The government must clearly espouse the SEME model, expressing its commitment to prosperity, social justice, and ecological protection, while recognizing its own intervention limits. The state's active *economic* role refers, above all, to the production of public goods like health service, education, public transport, infrastructure. The state can privatize these sectors, but then has the obligation to monitor the performance and to regulate the service conditions.<sup>34</sup>

As the citizens must behave in accordance with the system, the state, too, in the form of government organizations and the public service at the national and regional levels, must respect the SEME rules established and sanctioned by majority decision. State-owned firms have to be competitive; the public service has to work effectively. The state must protect structural plurality and foster the take-off potential of enterprises and individuals. It should offer incentives rather than intervene in the economic process. A preventive social security policy – for example a professional training system – should take priority over subsidies. Indirect transfer measures (taxes, interest rates, etc.) should be favored over direct redistribution. The state should be willing to bolster the self-responsibility of citizens and, as far as possible, to delegate control and decision-making to autonomous organizations.

Typical features of positive state behavior according to the SEME model include: central bank independence; the autonomy of trade unions and employers' organizations to arrange labor market conditions; transfer of control and professional career design to chambers of commerce and industry; delegation of control functions in the banking and insurance sector to autonomous bodies; delegation of the control of economic concentration to an anti-trust organization. All these institutions, financed partly or entirely by the state, should perform their public functions independent of state intervention.

The state has a special function in the area of environment. Communication campaigns inform citizens about their obligations and advise them how they can adjust their behavior to meet ecological requirements. In the past people regarded their behavior as rather irrelevant to the world climate. Therefore, to convert the social market economy into a social *and ecological* market economy, the state has had to issue new laws and regulations and determine and implement duties and behavior codes, incentives, and punishments for producers and consumers.

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<sup>33</sup> This inflexibility of different highly institutionalized countries has been analyzed by Mancur Olson Jr. in *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities* (New Haven: Yale University Press, 1982).

<sup>34</sup> Examples include the railway system or the energy sector, where the state can intervene if the tariffs exceed a rational limit and where the state can maintain the property of the physical infrastructure.

As environmentally oriented activities constitute a relatively new element of the model, the temporary subsidy of activities which are ecologically more effective is compatible with the SEME model. Traditional energy resources like coal, gas, or petrol are still less expensive than energy produced by wind farms, bio-material, thermal heating, and solar cells. The more alternative and renewable energies gain credibility, the closer they get to the break-even point and so become competitive. For the present, environmental protection is of higher priority in the SEME than free competition in the energy sector. However, state support will apply only until companies reach their break-even point.

### **3. Independent and Responsible Media**

The SEME is a multi-faceted model. It is hard for the average citizen to fully grasp the economic, social, and ecological processes. Therefore, effective information and communication is imperative. In the SEME, this is made possible for consumers by consumer protection associations and state regulations obliging producers to indicate clearly the content of products. Just as for consumers, adequate information is essential for firms. Producers affiliate themselves with chambers of commerce and industry, branch associations, and lobbying institutions in order to get access to relevant, timely information.

In this process of communication, independent and pluralist media – newspapers, radio and television programs, and the internet – play a vital role in monitoring and motivating people. Additionally, independent expert committees must find weak points and failures in the system and inform institutions that are affected by these.

An effective communication process also depends on the educational level of the population and their interest in being well informed. If the schooling structure is inadequate or if possibilities for ongoing professional training and adult education<sup>35</sup> are lacking, people can hardly be expected to understand or interpret media messages. According to the SEME model, not only must the state facilitate, but it must actively support freedom of information in its own interest. Independent reporting and journalism can assist the government to recognize and respond faster to system deficits.

### **4. Relative Independence and Willingness of the Participants to Compromise**

The economic and social actors, meaning the state, entrepreneurs, trade unions, autonomous public institutions, and interest groups of civil society are, in principle, independent in their decision making, while being mutually dependent (Figure 2). No single actor can fully achieve its interests without impacting in some way on the interests of the others. Sometimes there are conflicts of interest, producing winners and losers. The SEME requires, however, that the actors do not regard others as their enemies, but recognize (albeit at times only silently) that the interests of the other actors are equally legitimate. In the end, this obliges the SEME actors to compromise.

The most frequent example of this struggle for advantages is played out in the controversy between employers' associations and trade unions. While recognizing their mutual legitimacy, both institutions

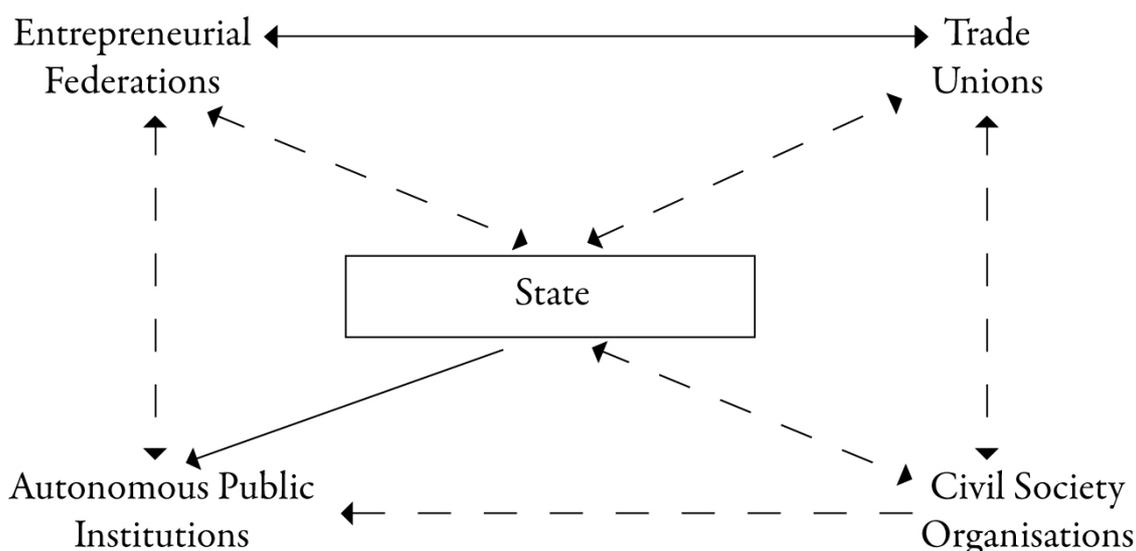
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<sup>35</sup> In addition to public and private education in Germany, there is a dual professional education system: apprentices learn the practical requirements of the firm while attending professional schools, where they are given the theoretical background of their activity. Polytechnic schools (Fachhochschulen) offer students a more practical third level education. Adult education schools (Volkshochschulen) offer a great variety of courses for adults, while political foundations, financed mainly by the state, offer courses on political, economic, and ecological matters.

may employ instruments of threat in the form of a lockout or strike. Both sides know that such measures have high costs. Even in the case of widely differing opening positions, a strike would not usually go so far as to destroy the enterprise, since that would not only fail to improve working conditions or salaries, but would destroy the employment itself. Similarly, in the case of lockout, the firm stands to lose its experienced workers, possibly entailing much more serious costs than a higher salary agreement. Social partnership is an important feature of the SEME model. This does not always imply peaceful understanding and harmony between the actors, but rather the willingness to compromise if negotiation possibilities are exhausted.<sup>36</sup> When both sides have reached a compromise, a truce arrangement applies, meaning that while the negotiated agreement is still in operation, strikes or lockouts are legally forbidden.

Government must also be willing to compromise. Before introducing laws which affect economic, social, or ecological interests, hearings and consultations take place that may lead to modifications of the original plan.

Figure 2 – Interest Conflicts, Cooperation, and Compromises



Autonomous institutions like the central bank, the anti-trust office, the chambers of commerce and industry, the institutions that regulate banks and insurance companies, the office for environment protection, the central employment agency, the national pension office, etc. are essential elements of the SEME. The state delegates sovereign functions to those institutions, which in turn are bound to show willingness to compromise. So, in its effort to combat inflation, the central bank cannot raise the interest rate to the extent that the cost of credit inhibits investment. The anti-trust office has to compromise in terms of concentration issues, given the bigger market in the EU and globalization. But that does not mean that it abandons its general skepticism vis-à-vis the concentration of economic power.

<sup>36</sup> In Germany, an independent expert is often called in as mediator in the case of a very difficult conflict. In other countries, the government intervenes.

There are many more examples to show how the freedom to build associations and the management of their diverging interests can complicate the process of negotiating and reaching agreements. But this is all part of the dynamic of the SEME model. If the economic, social, and ecological actors demonstrate flexibility and open-minded behavior, if they know that compromise is necessary, then the dynamic and innovative process of the SEME is guaranteed as is the continuity of an effective, partnership-oriented decision-making process.

## **VI. Shaping the Social and Ecological Market Economy**

It is the art of politics to take the right measures at the right time and to the right extent. The same challenge applies to shaping the SEME. In this context, local and national governments have the leading role, since the election process gives them the responsibility for the welfare of society. However, these government institutions can be successful only if they are in dialogue with the other above-mentioned economic actors, such as employers' federations, trade unions, and autonomous institutions. Civil society associations like conservation groups, nuclear power or other protestors can play an important role in this dialogue as well, especially at the local level. Intensive dialogue is also necessary within the political parties to involve the members in the decision-making process. In the case of far-reaching decisions, governments may also benefit from dialogue with the opposition.<sup>37</sup>

The SEME principles are relevant for almost all areas of the economy and society, but there are seven policy fields, where SEME principles particularly influence decision making. Each of these policy fields, which must be carefully analyzed, can be illustrated here only very briefly.<sup>38</sup>

### **1. Planning and Coordination**

The macroeconomic and macro-social framework is at issue here. Planning and coordination of economic, social, and ecological activities refers to the legislative competence of the government on the local, national, and international levels. The state has to clarify what constitutes a public good and consequently set its priorities for action or participation.

In order to establish a reliable reference system, the state also has to declare which of its sovereign control functions are delegated, for example, to the central bank or the anti-trust office. It guarantees the freedom to create associations which represent members' interests in the planning and coordination process. It gives autonomy to trade unions and employers' associations in their negotiations on labor market conditions, and to chambers of commerce and industry, but obliges all firms to associate themselves with one of the chambers. Banks and insurance companies are free to regulate their own operations, but have to affiliate themselves with the respective regulatory institutions and solidarity funds. Subsidy priorities are fixed and made public, for example, for firms engaged in environmentally friendly activities and for research and development. Transparency is the necessary condition for clear orientation of the economic, social, and ecological actors.

### **2. Property Regime**

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<sup>37</sup> This political dialogue will not always bring about the intended consensus. However, decisions must be taken. Those groups who feel disadvantaged by a decision have the possibility to seek affirmation or redress through the courts. In Germany, one can also take proceedings against the state to administrative courts (Verwaltungsgerichte).

<sup>38</sup> Several of the following articles in this book will deal with these areas in detail.

Private property is one of the pillars of the SEME and is protected in Germany by the constitution. Property rights, both material and intellectual, constitute the basis for planning private activity. In general, private property can be used freely, except where it affects the interests of society or could damage other persons. In the SEME, limitations on the free use of property have to be established very clearly. This can be controversial where there is a social interest. Private owners can go to court if they feel that the social interests are less important than their right to private property.

In the SEME, state property is possible as well. In general, it must serve the public interest, as in the case of land for infrastructure or educational purposes.

The workers' right to codetermination in big firms, allowing representatives of the employees to participate in the board of directors, is a special feature of private property in the SEME. Although they are not the owners, workers participate in entrepreneurial decision making. In medium-sized firms and public institutions, freely elected workers' committees must be informed about the activity of the firm and participate in key decisions, such as, for example, the employment or dismissal of staff. The higher-level aim of social peace and welfare demands this limitation of private property and its free use.

### **3. Monetary Order**

In general, the state decides on the type of national currency and its convertibility, while the value of the currency is determined in international markets. In the SEME, monetary decisions, originally regarded as proper to the government, have been delegated to the central bank.<sup>39</sup> The central bank's fundamental task is to procure the stability of the currency by using the generally acknowledged money market instruments (interest rates, rediscount rates, deposits of the private banks, etc.).

The capital market, which also serves as a source for government borrowing, is self-regulated. Because of the recent problems created by hedge funds, government circles are considering more state regulation so as to reduce the – often merely speculative – purchase of firms by hedge funds.

A new national and international “capital market” could arise with the trade of carbon certificates between those enterprises or countries whose greenhouse gas emissions are below the nationally or internationally fixed limits and those who have to buy certificates because their production is not yet within the limits. Here a new facet of the ecological enrichment of the social market economy is emerging.

It is important for the SEME shaping of the monetary order that there are alternative bank types. Germany's bank system is based on three pillars; the commercial banks, owned by families or shareholders; the savings banks, backed by a municipal liquidity guarantee; and credit cooperatives, in operation since the 19<sup>th</sup> century when they started to attract small savings and to borrow low cost credits. In order to prevent bank crashes, a bank regulatory institution monitors bank activities. Banks themselves have created a guarantee fund, through which they help member banks which find themselves in difficulties, in order to maintain the credibility of the banking system as a whole.

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<sup>39</sup> Since the introduction of the common European currency, the euro, in 1999, decisions formerly taken by the national central banks, are now taken by the European Central Bank.

#### 4. Enterprise Order

The plurality of approaches in the SEME is also expressed by the diversity of legal forms of enterprises, including shareholder companies, individually owned firms, state enterprises, and cooperatives. For each of these, the legal regulations in terms of minimal capital contribution, liability, publication duties, workers committees, tax burden, etc. are clearly defined.

The treatment and at times the support of small and medium-sized enterprises (SMEs), mostly family-owned, constitute a special case in the SEME. These firms play an important role in the area of innovation as they reach the break-even point quicker than big companies and therefore can pass innovations more quickly to the market.<sup>40</sup> In psychological terms, SMEs offer the advantage that workers can identify with the firm more easily than with big companies. This is because production is often more labor oriented than capital intensive and workers can see, for the most part, the final result of their work. Such identification has proved to be a stabilizing factor in times of recession. So, in general, SMEs are more flexible and often more dynamic than big companies. This societal advantage, according to the SEME model, justifies state support of these enterprises through tax reduction, technological and managerial consulting and credit facilities.

#### 5. Competitive Order

The intensity of competition is the result of market processes, but the rules of the competitive system are established by government. State interventions can be used in special situations like concentration of market power, patent protection, or public interest. In general, however, competition should be as free as possible to strengthen the spirit of achievement and as regulated as necessary in order to avoid social and ecological problems. This combination of freedom and regulation leads to a *functional* competition in SEME terms: resources should be allocated in an optimal way, but not at the expense of society or the environment. Such a situation can be achieved only if markets are open to newcomers and if an official entity – in Germany, the Federal Anti-Trust Office – monitors the markets. In addition, the media, along with producer and consumer organizations, should strive to ensure transparency. Attempts to agree on market conditions and to control or to fix prices are banned and can attract heavy fines. Market power<sup>41</sup> can be achieved by higher efficiency and lower costs for a certain time, but this will be reduced if the market is open to newcomers.

This open market policy is also valid for foreign investors and their products.<sup>42</sup> Imports, however, are subject to the same hygienic, ethical,<sup>43</sup> and other regulations as national products.

Although free competition is a priority, it is not a contradiction of SEME principles to subsidize certain products for a time and in exceptional cases. This “promotional subsidy” can be observed in

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<sup>40</sup> While SMEs always played an important role in the field of technological progress in Germany, in the last 20 years they have also often become pioneers in the production of ecology-linked goods and services.

<sup>41</sup> The question of whether a firm may be allowed to control a market and the circumstances and length of time in and for which this may apply requires intensive discussion. Market power achieved by buying out one’s competitors is clearly banned if one already has a considerable share of the market. In that case, there must be good reasons to allow a merger. Obviously, the dimensions of markets have changed with regional integration, as in the case of the EU market, and with globalization, which have widened many markets and forced some firms to merge.

<sup>42</sup> The WTO, strives for maximum freedom of international commerce. In the case of agricultural products and textiles, it has been particularly difficult to overcome national egoism.

<sup>43</sup> In the SEME, obviously exploitation of workers, child labor, lack of work accident insurance, etc. are banned.

innovative areas such as technology or environment protection. In particular, the latter needs subsidy, since the production of renewable energy and climate protection measures still entails higher costs than traditional production. Here, the interest of society justifies interference in the competition process, which is usually self-regulated.

The cooperation of firms on a lower level enabling them to compete on a higher level is also compatible with the SEME oriented competition order. This is typically the case of cooperatives, where, for example, smaller dairy farmers eliminate their potential competition by establishing a commonly owned dairy, which allows them to compete with bigger farmers. Another case of cooperation that eliminates competition is the existence of the trade unions where workers, actually competing with their own labor force, collaborate to form a countervailing power against employers, thus achieving better work conditions. These and other cases of cooperation have a social justification which prevails, too, over the objective of competition.

Increasingly, the national competition system is influenced by international rules. The UN Conference on Trade and Development and, even more, the World Trade Organization (WTO) try to establish rules that facilitate the world-wide commerce of goods and services and reduce the disadvantages of developing countries.<sup>44</sup> The International Labor Organization has influenced social standards for workers and therefore the costs of competitors. International competition is also affected by multinational initiatives like the EU, the Southern Common Market (MERCOSUR), the Association of Southeast Asian Nations (ASEAN); international groupings like the Cairns-Group, oriented to agriculture; the Group of 20, which was formed to reach better conditions in the WTO Conference in Cancun; and the politically more influential Group of Five (Brazil, China, India, Mexico, South Africa). These and other groupings show that globalization not only widens the possibilities for international competition, but also provokes countervailing trends. The same may be said about free trade agreements which the USA and EU have concluded with several countries.

In spite of these international agreements, there are plenty of opportunities for functional competition on the national level where, according to SEME principles, the individual spirit of achievement, solidarity, and subsidiary activities must be brought together in a harmonious balance.

## 6. Fiscal Order

Fiscal policy is important in procuring for the state the necessary financial means to produce public goods and pay for public administration.<sup>45</sup> In times of globalization and environmental protection, fiscal policy has an additional international dimension. Corporation and profit tax, as well as the ecological regime in different countries, have influenced, at least in part, the decision of firms about where to locate. That can be seen in the new EU member states, in India, China, Vietnam, and other

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<sup>44</sup> Numerous multinational agreements have been presented and partly approved: the General Agreement on Tariffs and Trade, the General Agreement on Trade in Services, Multilateral Environmental Agreements, the Convention on Biological Diversity, Agreement on Trade-Related Investment Measures, the Agreement on Trade-Related Aspects of Intellectual Property Rights.

<sup>45</sup> In some countries, the central bank is still one of the finance sources of government, not so in the SEME. Here only (part of the) profits of the central bank is transferred to the state budget.

countries, as they attract investors from Europe and the USA. In Western Europe, Ireland presents a relatively recent example of this.<sup>46</sup>

The state fixes the type and rate of tax for firms and individuals. The distinction between direct taxation like income tax or profit tax and indirect taxation such as value added tax (VAT) is very important to the SEME discussion. On the one hand, direct taxes are politically more problematic because the tax payer feels directly affected and is therefore more likely to sanction those politicians responsible for this tax burden. And indeed, politicians must be careful not to seek too high direct taxation, for fear of suffocating the spirit of achievement and consequently the dynamics of economic development. On the other hand, direct taxes furnish the government with an instrument of redistribution, allowing it to charge the wealthy more than the less well off and thus to subsidize services for the whole society. Therefore the rate of direct taxation is indicative of government willingness to finance social justice.<sup>47</sup>

In the case of indirect taxation, the tax payer can reduce his/her burden by spending less money on the taxed service, as for example in the case of VAT, by buying less. The social problem caused by high VAT is that the less well off are more affected because their consumption quota – the percentage of income spent on consumption – is higher than that of the wealthier population. Indirect taxation can become an instrument of social policy if luxury articles attract higher taxes than basic goods. The same is true for ecological policy: pollution-causing, high-energy-consuming goods (like big cars) could be taxed at a higher rate than more environmentally friendly products.

The distribution of tax revenue between the central government and regional or local authorities is also problematic. In Germany, a federal republic, the VAT, which generates the highest single tax revenue, is divided half and half between the federal government and the regional state governments, leaving just 2.2% for the municipal level. In the case of income tax, 15% of the revenue remains at the municipal level and 85% is divided equally between the national and the regional levels. In order to fulfill the constitutional requirement to establish a more or less equal level of development in the entire republic, a redistribution of tax revenues is undertaken: the richer federal states of Germany have to pass part of their revenue to the poorer states.<sup>48</sup>

Therefore, the design and application of tax policy is a highly sensitive political issue and requires intensive dialogue between economic and social actors. The ultimate decision about tariffs and tax rates resides with the government, which has to consider the revenue aspect, macroeconomic consequences, and social and ecological implications.

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<sup>46</sup> Since 1973, Ireland, one of the poorest countries in the EU, has attracted investors from the USA and the European continent, thanks to lower tax rates, well-trained workers, and less regulation, converting it into the second richest EU country today.

<sup>47</sup> Discussions about flat rate, progressive, or linear tariffs are never ending, as well as the discussion about the top marginal rate and the level of tax-free income. An income tax of 75% (applied previously in Scandinavian countries) seems indicative of a highly socially-oriented approach. However, it also provokes tax avoidance and capital flight. This can mean that the overall tax revenue collected by the state may be lower than if a maximum rate of 42% were applied.

<sup>48</sup> This redistribution process is a very political topic. Of course, the general rule that the richer must help the poorer is accepted. The question, however, is the amount that should be transferred to less developed regions. And the richer states question why the poorer ones are not able to better organize their development.

## 7. Social Order

In the SEME, appropriate behavior of the economic actors should diminish the incidence of social problems. The state fixes the rates and the quota to be paid by employers and employees for pensions, health insurance, and unemployment insurance. Contributions to the social security system are shared by employers and workers according to salary level. These payments, often supplemented by private insurance, contribute to *preventive* social policy. *Curative* social policy constitutes the other element of the social order. By this is meant the pensions, health and unemployment benefits, and contributions to those who cannot maintain a decent standard of living on their income alone.

The social order demonstrates the interlinking of the three general SEME principles: responsibility of citizens to care for their own welfare; solidarity through the higher contributions of those who have higher incomes; and subsidiary activities by employers and the state.

Here education and professional training deserve special mention. Every citizen should do his/ her utmost to be sufficiently well prepared for professional life and for adequate opportunities in the labor market.<sup>49</sup> As education is an expensive commodity, the state must guarantee access to educational institutions. Investment in scientific research, in the different levels of education, and in lifelong learning, whether by the state, private institutions, or citizens themselves, enables countries to respond more effectively to globalization and an aging society.

In a broader sense, the ecological aspects of society are also part of the social order, being indispensable to the living conditions of present and, even more, of future generations.

## VII. Current Challenges for the Social and Ecological Market Economy

At present, the design of the SEME at the national level encounters three major challenges, globalization, environmental requirements, and changes in the social structure.

Globalization is not a new phenomenon,<sup>50</sup> but nowadays it presents an even more important challenge for politicians in designing the *national* economic, social, and ecological policy in dialogue with the different groups of the society. While globalization offers wider opportunities for commerce and investment, it also reduces the scope of national politicians to shape proper SEME conditions. However, this does not mean that the economic actors, and above all the state, are relieved of their responsibility to cooperate in the design and tailoring of the economic, social, and ecological order.

The second great challenge lies in the domain of the environment and climate change. Germany has taken a leading role in this field. It had introduced and continues to introduce new laws and regulations,<sup>51</sup> partly because of EU obligations. Germany's ecological orientation has led to high-tech innovations in the production of filters, solar cells, and geo-thermal heating and insulation systems.

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<sup>49</sup> In times of crisis, usually those who have invested less in their professional qualification are the first to lose their employment. The same can be observed in industrialized countries whose firms lose market share in the less sophisticated production areas taken over by developing countries at lower costs.

<sup>50</sup> In a certain way, although in a "smaller world," former empires had also created a globalization effect, enriching minorities while impoverishing majority segments of the populations.

<sup>51</sup> Some of the regulations, for example, the separation of litter or deposits for cans, once caused smiles in other countries, but were later introduced there as well.

Far exceeding the already mentioned Kyoto aim of 5.2% reduction of emission between 2008 and 2012, Germany, according to the Ministry of Environment, has already reduced emissions by 19% in comparison with 1990 level. This challenge will remain important for the next 10 years as well.<sup>52</sup>

Demographic change constitutes the third big challenge for the future design of the SEME:

- People are now living longer, a factor that has implications for social security and health systems: either older people must get smaller pensions and reduced services or younger people will have to contribute higher amounts to the social system, or the state must fill the gap.
- Women are as well-educated and professionally prepared as men; therefore, in their wish to exercise their profession, many postpone pregnancy. That means that fewer children will be born unless the government makes provision for stronger support for young families.
- The increased migration from poorer countries makes greater demands on social services and calls for more cultural integration efforts with corresponding additional social costs.<sup>53</sup> Aid to developing countries could reduce migration, especially from Africa to Europe, if it is invested in productive activities that create more employment. This international solidarity is another cost factor which may reduce the ability of national governments to tackle social problems at home.

Such challenges, to which some of the EU countries and certainly Germany are exposed, can be managed within an adjusted SEME system, which is, as already pointed out, a flexible and open model, not bound to a rigid ideology. International competition might accelerate adjustments, but even the “tiger” states like China, Vietnam, South Korea, and others will reach a certain saturation point and experience higher costs for employment, social services, and ecological protection.<sup>54</sup>

## VIII. Conclusion

The interaction of the state, entrepreneurial federations, trade unions, and civil society associations is the cement that holds together the different blocks of the SEME edifice. The state influences the other economic, social, and ecological actors as they influence the state. Both the state and the social partners challenge social scientists to analyze their activity and to enable them to look into the mirror that reflects the level of welfare of the society. As the different actors are autonomous and play their role according to their own interests, the shifting balance of their actions can lead on occasion to frictions. Sometimes, considerable conflicts arise between the different interests, and the adjustment may be slow, but the solutions will be found in dialogue between the actors within the framework of the SEME model.

To summarize the functions of the SEME actors:

### The **state** and the public institutions

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<sup>52</sup> During her term as President of the EU, the German Chancellor Angela Merkel decreed the mentioned “2020” goals.

<sup>53</sup> Migration problems exist in several countries on the national level as well. In quantitative terms, the inner migration in China, from the hinterland to the more prosperous coastal areas, is probably the most problematic. Migrant workers are often employed in very poor conditions and we have already cited the backwash effect. India presents another case of considerable inner migration by better educated persons towards the new centers of high-tech industry like Bangalore. Similarly in Germany, after unification in 1990, there was a notable migration of young people from east to west.

<sup>54</sup> David Ricardo’s principle of comparative cost advantages is also valid in a globalized world, although it is no longer as simple as Ricardo’s account of the exchange of wine and textiles between Portugal and England in the 19<sup>th</sup> century.

- establish SEME-relevant laws and the framework conditions as well as a monitoring system that ensures that the actors obey the rules;
- fix the priorities of the different economic, social, and ecological action fields;
- protect and promote functional competition;
- are vigilant with respect to the social balance in order to avoid or ease social problems;
- offer incentives and support innovations;
- produce public goods;
- set rules for environmentally friendly behavior;
- control and sanction the rules which define the SEME system;
- promote and support educational activities, professional training, and research;
- intervene in a subsidiary way when private initiatives or solidarity cannot solve problems.

#### The **entrepreneurs** and their institutions

- focus on productivity and competitiveness;
- search for and undertake profitable activities and reinvest – at least part of – the profits;
- monitor national and international markets and search for innovations;
- observe ecological requirements in their production;
- ensure socially acceptable conditions for their workers;
- promote and support professional training of workers;
- facilitate workers codetermination by channeling transparent flows of information;
- participate in social partnership, negotiating labor market conditions with the trade unions;
- invest in research-and-development activities;
- establish federations and pressure groups to present their interests and exchange information.

#### **Trade unions**

- strive for socially acceptable conditions in the labor market;
- negotiate salaries through social partnership with employers' associations, respecting market conditions and the profit interests of firms;
- engage in professional training of their members;
- support worker committees in the firms in the codetermination process;
- seek international contacts as a countervailing power to multinational companies.

#### The organizations of **civil society**

- engage politically to influence – at least indirectly – the other SEME actors;
- search for information in order to increase transparency in society;
- demand and support consumer protection;
- promote environmentally friendly behavior;
- support incentives for lifelong learning;
- act on the local level to improve the economic, social, and ecological welfare of individuals.

#### **Social science** institutions

- analyze the effectiveness of different economic models in general and check the operational efficiency of the SEME in terms of its economic dynamism, social justice, and ecological protection;
- monitor developments inside and outside the country and their influence on the SEME (globalization, demographic changes, environment, cultural changes, psychological factors of economic and social behavior, business cycles);

- analyze the different instruments of the SEME in terms of their effectiveness and dimension;
- offer consulting services<sup>55</sup> to the economic, social, and ecological actors.

In synthesis: the SEME, as seen in the experiences of different countries, especially Germany, has proven to be the best of all imperfect economic, social, and ecological systems. It creates prosperity, thanks to entrepreneurial freedom; it allows for interventions to redistribute this wealth and achieve social justice; it has effective in-built instruments of environmental protection. The SEME instruments have to be applied in a manner that corresponds to the conditions of the country in question, incorporating the exigencies of international development. Though aiming at optimal results, the SEME will be never perfect. However, it is flexible enough to allow continuous improvements and to offer solutions to economic, social, and ecological problems which come up unavoidably from time to time.

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<sup>55</sup> In Germany, a group of economists prepares an annual report for the government. In its public presentation, the government representative does not always look very pleased. Additionally, different scientific institutes regularly publish their short- and long-term outlooks.