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Social Market Economy – a contemporary institutional framework

*Prosperity for all and prosperity through competition
belong together inseparably; the first postulate is the
goal, the second is the path that leads to this goal.*

Ludwig Erhard

Abstract. *The present study highlights the need for research on and the reform of the topic of Social Market Economy (SME). Even though this socio-economic order lifted Germany onto a path of, until then, unknown prosperity after WWII, surveys show that a considerable part of Germany's population does not rally behind this concept anymore. The study uses an institution-based approach to propose a contemporary framework of the SME. Relevant literature is analyzed to identify those institutions that on one hand fall in line with Walter Eucken's classic principles and, on the other hand, that have empirically proven to be prosperity enhancing, since prosperity is assumed to be one of the primary objectives of the SME. The resulting framework of institutions will most likely not serve as a blueprint when establishing an economic order; but can be used as a benchmark of a contemporary SME in theoretical and empirical analyses.*

Keywords: *Social Market Economy, SME, reform, institutions*

Introduction

While the term Social Market Economy (SME) is commonly associated with the reigning economic order in Germany, this understanding of the underlying concept is far too limited in scope. Taking its historical development into account, the concept of SME was created as a plan that set itself apart from the predomi-

nant social order during WWII and from the planned economic and social order in the eastern world. It therefore needs to be recognized in a broader sense as a task for economic and social policy aimed at combining social security and market efficiency while respecting certain core values such as the recognition of freedom or social justice. One of the results of implementing this approach in Germany following WWII was the creation of an economic order that respects the aforementioned values. Thus, broadly defined, SME is a social order, and narrowly defined, an economic order.

But in post-war Germany, Social Market Economy used to be more than the economic order of the country. It used to be the attitude of a generation that experienced economic growth and prosperity after years of suffering through wars and ensuing economic and political upheaval. Following the liberation from the Nazi Regime, the collective German spirit was no less than broken and the satisfaction of the basic necessities of human existence became the top priority for large portions of the population. When the implementation of SME brought an economic upswing, it is no surprise that the majority of the German people rallied behind this concept. Recently though, it appears that SME has become nothing but an empty phrase in German discourse. While it officially remains Germany's economic order, in recent years an increasing amount of legal bills has been passed that overturn the basic principles of SME. In addition to that, representative polls show that large portions of the German population do not rally behind SME anymore and express dissatisfaction with it. Also, it is part of scholarly and public debate whether SME was ever fully implemented in Germany. Researchers like Von Weizsäcker believe that the SME has never been implemented the way it was meant to be, that it remains an ordoliberal utopia to this day and that we need to fundamentally rethink the German economic order [Von Weizsäcker 2006: 158-159]. Building on these observations, the purpose of this article is twofold: On the one hand, it assesses the current state of SME in Germany, on the other hand, it proposes a modern definition of SME in terms of an institutional framework that respects historic principles and comprises modern institutions alike.

1. Intellectual origin of SME

The first traces of SME date back to 1881. In November of that year, Imperial Chancellor Bismarck read a message in parliament on behalf of Emperor Wilhelm I. announcing the introduction of social security measures [Reichstagsprotokolle 1882]. Even though the Emperors agenda was most likely not entirely focused on creating social justice, but mainly on ending the protests of the working class and on weakening the influence of the Social Democrats, it was nevertheless the

beginning of German social legislation [Osterhammel 2009: 893]. Despite the fact that this occurred roughly 70 years prior to the introduction of SME, it introduced a social environment aimed at social balance and thus created a German society that would be receptive to the concept of SME seven decades later.

Even though many economic schools of thought influenced the concept of SME, Ordoliberalism stands out in particular as its theoretical foundation. Ordoliberals, mainly represented by scholars of the German Freiburg School and most notably Walter Eucken, consider the economy a subsystem of the social system. In their opinion, the state should create a proper constitutional framework in order to maintain a healthy level of competition, but should not interfere with the process of competition within the framework. The concept of Ordoliberalism was hence created as a market economy, in which the state provides only the legal and economic framework, thus enabling market competition free of political interference [Goldschmidt, Wohlgemuth 2008: 267-268]. A second school of thought that provided considerable theoretical influence to the concept of SME is Sociological Neoliberalism, mainly represented by scholars like Wilhelm Röpke and Alexander Rüstow. They asked for consideration of the life situation beyond supply and demand [Röpke 1956/2009: 303-314]. They called for social policies and equal opportunities and thus envisioned a positive and more extensive role for the state, as rule-maker, enforcer of competition, and also provider of basic social security. Rüstow in particular was aware that a market economy would likely lead to a satisfaction of quantitative societal necessities, but that it would fail to satisfy non-economic needs of all societal groups at all times. Therefore, he called for vital politics, aimed at the general living conditions beyond pure material needs [Rüstow 1957: 520]. This is especially noteworthy because it is an example of the introduction of the “social” dimension to the market economy that the ordoliberals envisioned in their scholarly discourse. This does not mean in turn that Ordoliberals did not have empathy for social matters – Walter Eucken for instance was in favor of a minimum wage in case of an abnormal behavior of the labor supply [Eucken 1952: 304] – but their main focus remained on guaranteeing the market competition while the Sociological Neoliberals expressed a broader societal focus in their works.

The implementation of SME in Germany is largely credited to Ludwig Erhard, post-war Germany’s first Minister of Economic Affairs, and to Alfred Müller-Armack, professor of economics at the University of Cologne and senior official in the Ministry of Economic Affairs under Erhard. These SME-practitioners shaped the concept just as much as the scholars, who provided the theoretical foundation. Economist Alfred Müller-Armack coined the term Social Market Economy in 1947 as the headline for the second chapter of his publication “Wirtschaftslenkung und Marktwirtschaft” [Müller-Armack 1947/1990: 78]. He drew from both Ordoliberalism and Sociological Neoliberalism and created a concept based on

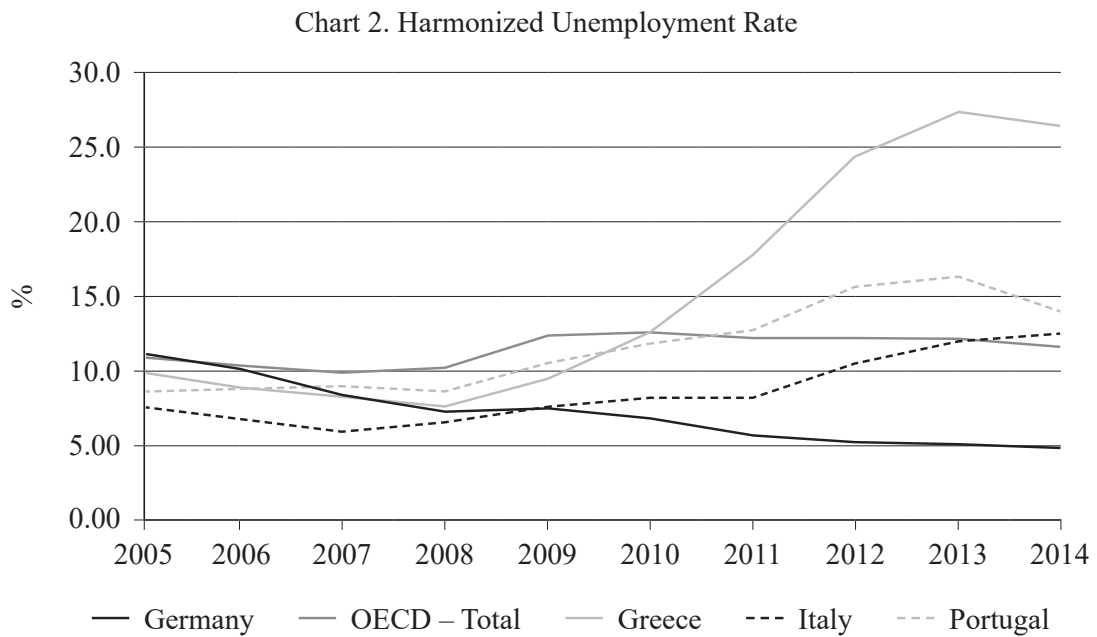
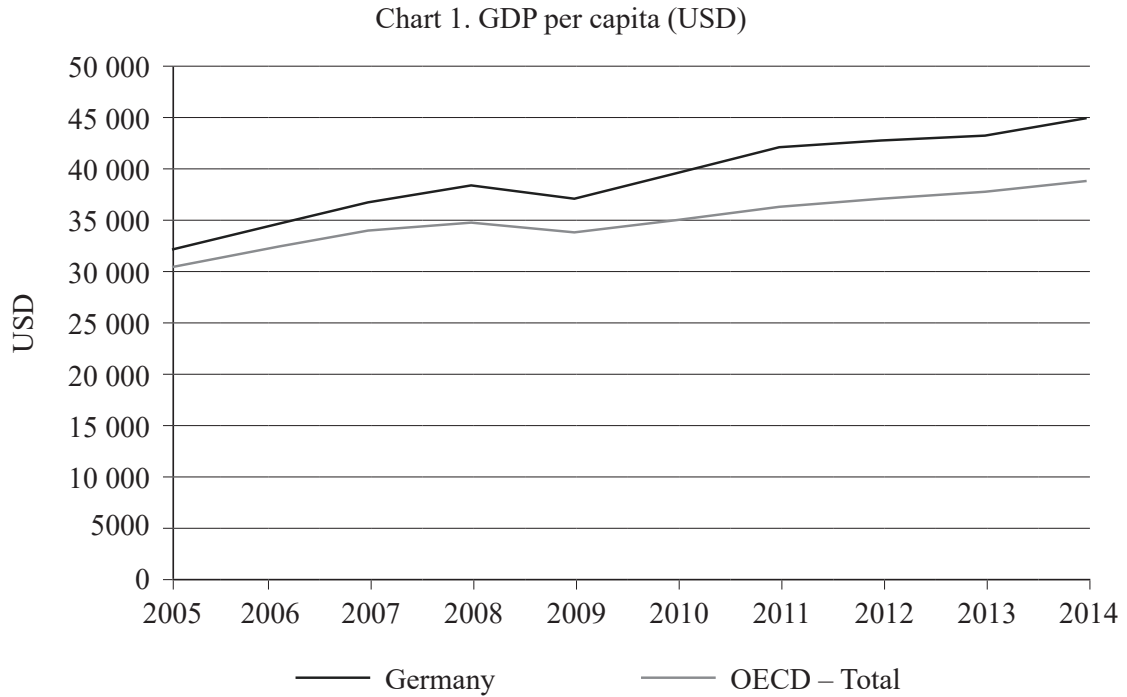
two equally important aspects – the “social” and the “market.” Even though the SME evolved from Ordoliberalism, it is by far not identical to the latter. In contrast to Eucken, who favored a strictly rule-oriented liberalism in which the state solely sets the institutional environment and abstains from interference in the market, Müller-Armack emphasized the state’s responsibility to improve market conditions and simultaneously to pursue a social balance. Müller-Armack assumed that regular market conditions would not necessarily lead to a state of equilibrium, but that the market mechanism was merely semi-automatic, and thus needed support through government-induced measures. His concept is often described as ‘third way’, reconciling the seemingly conflicting objectives of market efficiency and social security [Müller-Armack 1947/1967: 67]. Starting in 1948, Ludwig Erhard shaped German economic and currency related reforms and therewith successfully applied the concept of SME to political reality. He continued to monitor the implementation of the concept first as Minister of Economic Affairs and later as chancellor.

There is a discussion in relevant literature as to the emergence of the term Social Market Economy, since some believe that it was Ludwig Erhard who first used it in an informal discussion in 1945 [Weiss 1996: 571]. Notwithstanding this discussion, the notion of a ‘guided’ or ‘controlled’ market economy was on the general scholarly agenda at the time [Goldschmidt, Wohlgemuth 2008: 263] and SME was the term that asserted itself in the end.

2. Current state of SME in Germany

In the aftermath of the worldwide economic and financial crisis beginning in the fall of 2007 with the failure of subprime credits and taking off after the bankruptcy of the Lehman Bank and the subsequent collapse of the interbank market in the fall of 2008, Germany’s economy performed relatively well compared to other industrialized countries in the western world. Despite suffering stronger negative GDP growth rates than the rest of the OECD countries in 2009, Germany outperformed the OECD average in the years from 2005 to 2014 as seen in Chart 1.

A second typically-cited indicator for the economic performance is the unemployment rate of a country. Also when considering this indicator, Germany outperforms the OECD average, which shows a rising unemployment rate between 2007 and 2012, fueled especially by southern European countries like Italy, Portugal or Greece. In contrast, Germany managed to lower its unemployment rate during that time and it dropped even further in 2013 and 2014. Chart 2 displays the unemployment for the OECD total, Italy, Portugal and Greece compared to Germany.



Surprising to some, no macroeconomic growth programs, e.g. of a Keynesian kind in terms of deficit spending, had been put into place during the crisis years in Germany. Consequently, Germany only saw a moderate increase in its public debt rate during the crisis years. Since there are no miracles in economics, Germany's

performance was credited to the supposedly well-functioning economic order of the Social Market Economy [Van Suntum et al. 2012: 9]. The IMF credits Germany's labor market performance during the crisis, among other factors, to collective agreements, which include flexible workweeks and work-time accounts, to subsidies for reduced work-time and to the redesigned welfare and unemployment benefits as part of the German Hartz IV reforms [IMF 2011: 6].

Paradoxically, German citizens show a considerable amount of discontent with their economic order in recent representative polls. According to a poll by the Bertelsmann foundation in 2011, 30% of the respondents express that we "do not" or "do rather not" live in a SME. 67% are of the opinion that Germany is rather likely a SME while only 14% are of the conviction that we do indeed have a SME as an economic order [Bertelsmann 2011: 7]. A study by the Allensbach institute for public opinion research found in 2010, that only 38% of the German population has a positive opinion regarding SME. This is a rise by 7% compared to a similar poll in 2008, but still a much lower rate of approval than in 2000, when Allensbach found that 50% of the German population had a positive opinion regarding the SME. In 2010, 28% of the respondents said to have a negative opinion of SME [Allensbach 2010: 2]. A poll by Infratest dimap conducted in 2012 demonstrated an almost equal division within the German population regarding its level of satisfaction with the SME: 49% of the respondents were satisfied or very satisfied with the economic order and 50% of the respondents were dissatisfied or very dissatisfied with the SME [Infratest dimap 2012: 9-10]. 49% of the respondents to the Allensbach institute poll expressed doubts as to the social element of the SME in Germany in 2010 [Allensbach 2010: 5], but at the same time, when asked for a relatively better economic order, 48% of the respondents denied the existence of an alternative, while only 14% believed that there would be an alternative economic order [Allensbach 2010: 7]. The poll by Infratest dimap yields similar results: 65% of the respondents believe the SME to be the best economic order for Germany, but 51% think that fundamental reforms to the concept are in order [Infratest dimap 2012: 9-10]. When it comes to reforms to the SME, 58% of the respondents propose an emphasis on social security while only 23% speak out in favor of a more market oriented approach [Bankenverband 2010: 9].

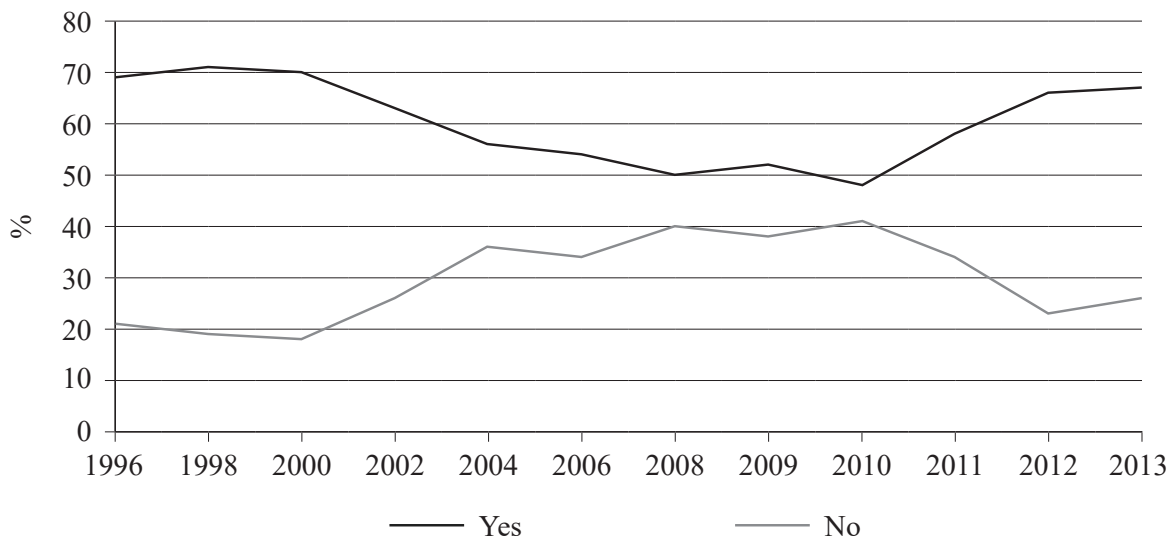
The Allensbach institute poll also established a relationship between approval of SME and the socio-economic status¹ of a respondent: 57% of the respondents with a high socio-economic status express a positive opinion about SME, while only 36% of the respondents with a medium socio-economic status and only 25% of those with a low socio-economic status express a positive opinion about SME

¹ The socio-economic status is determined by education, income and occupation of the principal earner as well as by the subjective assessment of the interviewer.

[Allensbach 2010: 3-4]. Assuming that the approval of SME does indeed decrease with the socio-economic status, this could serve as an explanation why the Infratest dimap poll found that 77% of their respondents believe that SME makes the poor even poorer and the rich even richer, and that 52% blame the presumed injustice in Germany on the SME [Infratest dimap 2012: 10].

The most recent poll regarding attitudes towards SME in Germany was published by the German Banking Association in 2013. Their report indicates a change in public opinion for the better. When asked if they thought that SME had proven itself as a good economic order, only 48% of the respondents gave a positive answer in 2010, thus making this a low in yearly comparisons, while 67% responded positively in 2013 [Bankenverband 2013: 13-15]. Chart 3 displays the results of the polls conducted by the German Banking Association since 1996.

Chart 3. Did SME prove itself?



Source: German Banking Association.

It is obvious from the various poll results that a large fraction of the German population is dissatisfied with its own presumed economic order, despite the most recent poll, which still displayed only an approval rate of roughly two thirds of the German population. As to the “why,” most likely, the answer to that question is twofold: on the one hand, it is feasible that the population simply lost touch with the sixty-plus-years-old concept, and on the other hand it is intuitive that Germans do not believe in an existing SME anymore because they increasingly observe policies that violate core ideas of the concept. Supporting these hypotheses, the Infratest dimap poll found that 73% of the respondents believe that the SME does not function as well as it did in the past [Infratest dimap 2012: 10].

No matter what causes the dissatisfaction, the concept is in need of a translation into the 21st century based on a sound theoretical foundation. This theoretical foundation should be of dual nature. Firstly, it should reflect the intellectual origin of the concept and thus draw on the ideas and theories of the Ordoliberalists that shaped SME. Secondly, it should reflect current economic theory, namely New Institutional Economics (NIE), in order to make it compatible with the research community. A simple example of anecdotal evidence describes the importance of institutions for the economic performance: Similar to Germany, Sweden fared well during the crisis years. Despite being hit by a sharp drop in GDP growth, the Swedish unemployment rate and the Swedish public debt remained virtually unaffected [OECD 2014]. Through three waves of fundamental institutional reforms between the 1970's and the 1990's, the Swedish "Folkhemmet" welfare state had been replaced by market oriented policies, as visible e.g. in the early 1990's when low and stable inflation was awarded priority over full employment. Nonetheless, Sweden maintains a high level of income taxation and emphasizes on social security [Lindvall 2006: 268-269; Lindvall, Rothstein 2006: 57-58]. It appears that both Germany and Sweden have grown an economic order, in other terms a bundle of institutions, and accompanying policies that helped them survive the crisis with limited damage to their respective economies. In the article at hand, the theoretical foundation of the proposed model of SME will link the normative demands of Ordoliberalism with a positive analysis based on NIE, thus combining the very origin of the concept with current economic theory.

3. A contemporary institutional framework of SME

When studying the concept of SME, one has a multitude of original texts by the ordoliberal scholars from the past to consider. Since this article wants to establish a contemporary definition of classic SME, the frame of reference for definition will foremost be the constitutive and regulatory principles by Walter Eucken, since these often serve as a normative frame of reference in the discourse around SME [Van Suntum et al. 2012: 12]. The existence of a functioning pricing system is the focal constitutive principles. Eucken also demands the primacy of monetary policy, open markets with free market access, a guarantee of property rights, freedom of contract, rules of liability and consistency of the economic policy. Eucken furthermore believed that these constitutive principles were insufficient to keep up competition processes at all times and thus proposed competition policy, income policy and business accounting in the sense of consideration of externalities as well as the consideration of abnormal labor supply as additional regulatory principles [Eucken 1952/1990: 254-304]. The following briefly describes his principles.

Considering the laissez-faire liberalism and the period of economic policy experiments following the laissez-faire period, Eucken believes a *functioning price system* to be fundamental to economic stability. He writes that lawmakers have to refrain from interventions like subsidies and government-supported monopolies, but he also stresses the importance of a positive economic policy, hinting at developing the perfect competition on markets. For him, a decentralized market structure is key to entrepreneurial success. According to Eucken, the *primacy of the monetary policy* leads to a stable currency. He envisioned a commodity bundle-based standard instead of a gold standard and believed in a 100% reserve requirement for banks. With supporting *open markets*, Eucken adheres to the principles of perfect competition, which does not know market entry or exit barriers. *Private property* and especially private ownership of the means of production is a prerequisite for competitive markets, but at the same time they are bound by competition to avoid social concerns. As long as it does not hinder competition, as is the case with contracts creating cartels or monopolies, *freedom of contract* is indispensable for perfect competition. According to Eucken's radical view, *liability*, which he primarily analyzed in the context of corporate law, should apply fully to majority stakeholders. An undermining of the principle of liability would lead to tendencies favoring a centrally planned economy, something Eucken is fundamentally opposed to. The principle of *consistency of economic policy* implies that it should be reliable and predictable for market participants, not only because this is a value per se, but also because in the absence of consistency, insecurity would arise, which could lead to the increased formation of company groups, which could impair competition. The best possible economic order can only emerge, if these constitutive principles are met at the same time, making this a principle on its own, the principle of interdependence. These constitutive principles are accompanied by four regulatory principles. Eucken asks for a *competition policy* in the specific context of monopolies, which should be executed by a single government agency, ideally dissolving monopolies or at least controlling their behavior. The principle of *income policy* is aimed at promoting progressive income taxes, both on efficiency and social-distributional grounds. The call for *business accounting* refers to the need of the correction of externalities. Eucken specifically addresses ecological concerns, employing the example of the destruction of North American forests. Lastly, Eucken speaks out in favor of the *correction of abnormal labor supply*, which aims especially at protective measures for workers, especially for female and child workers.

In the following, drawing on empirical literature, institutions will be identified, which have proven to be prosperity enhancing.² For the most part, these

² The choice of prosperity as an objective of SME was made deliberately, since SME has contributed to great prosperity in Germany and since it was explicitly voiced by Ludwig Erhard as an objective of SME. In a recent study, Mertins empirically displays the positive relationship between

institutions will reflect Eucken's principles, but there will be conscious additions to Eucken's ideas in order to provide a rather contemporary definition of SME. These institutions, that both reflect Eucken's principles and in some cases a more modern take on SME, are categorized into three dimensions. In some cases, empirical literature yields conflicting results as to the prosperity enhancing properties of the institutions. In these cases, a well-founded decision will be made as to whether or not the respective institution will be a positive argument in the contemporary definition of SME or not. For brevity reasons, only one or two studies will be presented for each institution to underline the relevance for the dimension. A consistent definition of the term institutions remains elusive in economics research as of yet, but many scholars agree on Douglass North's definition of institutions as "the rules of the game in a society or, more formally, [as] humanly devised constraints that shape human interaction. In consequence they structure incentives in human exchange, whether political, social, or economic" [North 1990: 3]. Referencing the North's definition of institutions, the three dimensions of the institutional framework refer to the areas of politics, economy and society. Unlike a dimension like nature, these three are well within the range of possible empirical research based on an institutional economics approach and are thus susceptible to policy reforms, hinting at the possible practical application. It is furthermore assumed that it is not only the mere existence of an institution that is a determinant for economic prosperity, but its quality. Thus, the three dimensions of SME are named Political Institutional Quality, Economic Institutional Quality and Societal Institutional Quality.

4. Political Institutional Quality

Generally speaking, the existence of political and civil rights, freedom from corruption and reasonable government spending are indicators of a well-functioning and balanced political system, in which political power is not only exercised by the political elite but in which the population can voice its opinion and be heard. Categorizing Eucken's constitutive and regulatory principles within this dimension, the existence of property rights, freedom of contract, liability and income policy are related to the political quality of his vision of an economic order. Property rights, freedom of contract and liability refer to a stable rule of law, which is covered by political and civil rights institutions. Eucken wants income policy to also serve distributive purposes, thus giving the government a budget to work with for society. Therefore this principle is absorbed in the reasonable government spending institution in the institutional framework. For a contemporary

the values of SME and prosperity in terms of GDP per capita, emphasizing economic freedom as a central value of SME [Cf. Mertins 2013: 142-145].

vision of SME, the aspect of control of corruption is introduced as an institution as well. The theoretical and empirical relevance of these institutions in the context of prosperity will be proven as follows. As literature is vast, this paper only presents highlights.

Weingast analyzed the role of political institutions in the context of prosperity in general and he argues that the results are best if political and economic institutions develop at the same time [Weingast 1995: 25]. Zywicki stresses the importance of a stable rule of law³ for economic prosperity. In his theoretical essay, he concludes that the institutional link between the rule of law and economic growth stems from the prevention of arbitrary government behavior through a rule of law, thus attracting investment, entrepreneurship and long-term capital development [Zywicki 2003: 22]. Haggard et al. stand out for their analysis of the development of the literature on the subject, ranging from initial enthusiasm to recent skepticism. They also give an overview of the most important rule of law indicators [Haggard et al. 2008: 206]. Mahoney takes an interesting approach when he compares common law and civil law systems and their respective impact on economic development. He states, referencing Hayek, that these systems reflect different philosophies of government. He finds that common law countries, which offer better property rights protection, grow faster [Mahoney 2001: 523]. Besides the rule of law, property rights are a subject of much scholarly discussion in terms of political and civil laws. Early groundbreaking examples include Coase [1960], Alchain [1965], Demsetz [1967], Williamson [1971] or Alchain, Demsetz [1973]. In this context, systematic overviews by Furubotn, Pejovic [1972] and Asoni [2008] provide a solid basis for research. Empirical results on property rights and prosperity are not controversial. Keefer, Knack show for example that polarization tendencies in a society, be it through income inequalities or ethnic conflict, impair the guarantee of property rights and thus hinder economic growth [Keefer, Knack 2002: 147-148].

In economic literature on corruption the results on the relationship with economic prosperity are ambiguous. Aidt accurately describes the two opposing sides as sanders and greasers,⁴ sanders being those who believe that corruption impairs the economy like sand in a wheel by making political economic transactions more difficult, while the greasers believe corruption to be the grease of the economies' wheels by facilitating beneficial trades that would not have taken place otherwise. Aidt finds himself on the sanders-side since he finds that corruption impairs growth [Aidt 2009: 272, 285]. De Vaal, Ebben develop a theoretical model to show that if institutions are considered, corruption will adversely affect growth when political stability and property rights are guaranteed above a certain threshold [De Vaal,

³ For classic definitions of the rule of law, cf. Shklar 1987.

⁴ Cf. Andvig, Moene 1990 or Blackburn et al. 2006 and 2008 for the "sanders" and cf. Leff, 1964 and Huntington, 1986 for the "greasers."

Ebben 2011: 120]. Mauro asks why corruption persists in countries in which it is widespread when it is obvious that everybody would be better off without it. He argues that if other people steal from the government, the individual will base its decision on the lower marginal product from legal activities and the higher marginal product from corruption, since his chances of getting caught are lower. Thus, it will pursue rent seeking instead of a productive activity [Mauro 2004: 16]. Bentzen summarizes econometric shortcomings of past corruption analyses and finds a negative impact of corruption on economic productivity [Bentzen 2011]. From a normative point of view corruption is morally highly questionable. Also, it is declared as illegal around the world and thus its continuing existence hints at a weak rule of law. This is a quality that is harmful to growth. Despite the greaser's opinion, it is obvious that control of corruption will be a positive argument in the contemporary institutional framework of SME.

Just like with corruption literature, also the literature on the relationship between government spending and prosperity also yields conflicting results. One of the scholars most immersed in the subject is Barro, who found that government consumption is inversely related with economic growth, while public investment has little effect. The reason for the inverse relationship is that public consumption does not have an effect on private productivity, but reduces savings and growth through government expenditure and taxes [Barro 1989: 15-16]. Plümper and Martin set out to explain the "Barro-effect." They find an inverse u-shaped curve in the relationship between levels of democracy and prosperity, and analyze different regime types. They argue that democratic regimes tend to over-invest in public goods to attract political support. Also, they believe that the higher the level of democracy, the better the quality of government spending will be [Plümper, Martin 2008: 44]. Barro's finding that a large public sector tends to impair economic growth, has been attested in subsequent studies by Engen, Skinner [1992], Grier [1997], Hansson, Henrekson [1994] or De la Fuente [1997]. Fölster, Henrekson limit their study to rich countries and find that an increase of expenditure ration by 10% leads to a decrease in the economic growth rate by 0.7-0.8 percentage points [Fölster, Henrekson 2001: 1516]. Even so, the negative relationship between government spending and economic growth is all but established, since studies e.g. by Easterly, Rebelo, 1993 do not observe this relationship at all. Fölster, Henrekson review the literature on the relation between government expenditure and economic growth. They state that the relationship turns negative in countries, in which government size reaches a certain threshold. Also, they find evidence for Wagner's law which describes the interrelation between an increase in the level of income and an increase in government scope [Fölster, Henrekson 2001: 1502]. In general, OECD statistics show that less than 20% of the GNI is spent on public goods in developed countries, while in developing countries more than half of the GNI is spent on public goods. In developing countries, the provi-

sion of public goods might boost the economy, but above a certain threshold, government expenditure could result in the contrary [Fölster, Henrekson 2001: 1503]. Since SME relies on an ideology that promotes limited government, reasonable government spending will be a positive argument in the institutional framework representing contemporary SME.

5. Economic Institutional Quality

A functioning and prosperous economy is determined by competition and independence of businesses from government control, by an entrepreneurial environment, by reasonable monetary policy and by a sustainable government debt in the institutional framework of SME. Categorizing Eucken's constitutive and regulatory principles again, the existence of an effective price system, the primacy of monetary policy, open markets, consistency of economic policy and most importantly competition policy are related to the core economic quality of his vision of an economic order. In the institutional framework of SME, the effective price system and the primacy of monetary policy are absorbed by the reasonable monetary policy institution. Competition policy and open markets go into the competition and independence of businesses from government control institutions, while consistency of economic policy will be absorbed by the entrepreneurial environment institution. The institution of sustainable government debt is an additional argument in the SME that is not part of Eucken's original design.

The institution of reasonable monetary policy comprises a multitude of aspects, from price stability to central bank independence. A study by Alesina, Summers explores the relationship of the aforementioned institutions to economic growth. In their empirical study they find that central bank independence reduces the level and variability of inflation but does not have a considerable effect on long-term macroeconomic development [Alesina, Summers 1993: 159]. Berger et al. extensively review previous research on central bank independence and establish their own model, concluding that the negative relationship between central bank independence and inflation is robust [Berger et al. 2001: 38]. Hayo, Hefker also work on central bank independence and find it neither necessary nor useful for reducing inflation. They argue that the reason why countries choose their central banks to be independent is rooted in the legal, political and economic system. They propose a two-step model, the first step being the decision on price stability, the second being the institutional implementation via e.g. an independent central bank. Thus, the latter cannot be the cause for the former [Hayo, Hefker 2002: 669-670]. Since there is no evidence that central bank independence is harmful, and again, the SME builds on limited government and on the promotion of price stability, this institution will be a positive argument in the institutional framework.

Thurik summarizes the rather young and hence limited literature on entrepreneurship and its consequences for national economies. He states that economic growth rates depend on the speed with which national economies embrace entrepreneurial energy [Thurik 2007: 16]. Van Steel et al. analyze a panel of 44 countries and discover evidence that the relationship between entrepreneurial activity and GDP growth is negative for less developed countries and positive for developed countries. The fact that an individual would be more productive in a bigger firm than in its own little shop is offered as an explanation that is supposed to be true for less developed countries [Van Steel et al. 2005: 17-18]. Despite these findings, the entrepreneurial environment will be a positive argument in the institutional framework of SME, because it is not only limited to actual entrepreneurial activity, but also to the regulations that surround company foundations. If the regulations are entrepreneur-friendly, this means that the government has found the correct balance between regulation and the free market. The institution of competition and independence of businesses, especially in the financial sector, from government control is closely linked to the institution of entrepreneurial environment. Beck et al. analyze data for banks and conclude that financial intermediaries exert a positive influence on GDP growth [Beck et al. 2000: 295-296].

As for the institution of sustainable government debt, considerable amounts of recent scholarly discussion evolves around the relationship between debt and growth, where results are conflicting. Reinhart, Rogoff find that below a threshold of external debt of 90% of the GDP, there is only a weak relationship between debt and GDP growth, above 90%, the relationship is considerably stronger, but still negative. In developing countries, the threshold is even lower at 60% [Reinhart, Rogoff 2010: 22-23]. Their research has been the subject of a lot of criticism. Égert puts the aforementioned results to a test and shows that they are highly sensitive to modeling choices. When non-linearity is detected, he shows that the negative effects begin at much lower GDP-levels between 20% and 60% [Égert 2013: 23]. Herndon et al. refute Reinhart, Rogoffs claim for methodological reasons and employ the same dataset to find GDP growth rates of 2% above the threshold of public debt of 90% of the GDP, where Reinhart, Rogoff found -0.1% [Herndon et al. 2014: 277-278]. Kuma, Woo focus on long-run growth and high public debt. They show that a 10 percentage point increase in the debt-to-GDP ratio is linked to a slowdown in growth of 0.2 percentage points in developing countries in the long run, and they detect a smaller impact of 0.15 percentage points for developed economies [Kuma, Woo 2010: 21]. Since the institutional framework of SME is based on a philosophy of limited government interference and since high debt ratios could be considered an interference as it limits the sustainability of the economy without its own doing, high government debt will enter the definition of SME as a negative argument, thus making sustainable government debt a positive argument.

6. Societal Institutional Quality

The levels of societal participation, freedom of the press, health care and environmental sustainability determine the dimension of Social Institutional Quality in the institutional framework of SME. Categorizing Eucken's constitutive and regulatory principles for a third time, the existence of business accounting in the sense of a correction of externalities and the correction of abnormal labor supply are related to the societal quality of his vision of an economic order. The institution of environmental sustainability absorbs Eucken's principle of the consideration of externalities. Eucken's vision of correction of abnormal labor supply will only indirectly be absorbed in the institutional framework. There will be no direct measure for labor market institutions, but there are two indicators for societal participation, both of which capture the spirit of Eucken's aforementioned principle. The reasoning here is very simple, since directly measuring working hours or the existence of a minimum wage would imply to measure an effect and not the cause of SME, which should be avoided in the article at hand.

Li, Huang excellently analyze data from China and show that both health care and education have a positive effect on GDP growth [Li, Huang 2009: 384]. Education is an indicator of societal participation in the institutional framework of SME, health care is treated as an independent institution. Both are positive arguments in a contemporary definition of SME. A study by Bloom et al., who find a significant effect of health on aggregate output and are able to argue that it is a real worker productivity effect, supports this reasoning [Bloom et al. 2004: 11]. While there is not a lot of literature on freedom of the press and prosperity, there is a study hinting at an interesting interrelation regarding the proposed SME dimensions. Brunetti, Weber find that a free press is an effective tool to control corruption. They establish that the higher the amount of press freedom, the lower the corruption [Brunetti, Weber 2003: 1821]. Barro finds in a panel data analysis that male schooling variables are positively related to economic growth and that those of females are not. This suggests that female human capital is not employed well in many countries [Barro 1999: 237]. Since basic education is a prerequisite for societal participation, this again stresses the importance of including education as a positive argument in the contemporary institutional framework of SME. Adding another contemporary note based on Barro's findings to the definition of SME is the part of the institution of societal participation that refers to the empowerment of women. Malhotra, Schuler reviewed 45 empirical studies on the empowerment of women from different scientific disciplines ranging from sociology to economics. None of the studies focused on the relationship of female participation in society and economic growth and only one focused on development processes [Malhotra, Schuler 2005: 81]. This research gap might demand further analysis in the future, but for now, women's participation will be a positive argument in the contemporary institutional framework of SME.

It is undisputed that CO₂ emissions need to be reduced. Keeping with economic theory on externalities, the optimal level of CO₂ emission will hardly be zero, but without a doubt, drastic reduction is necessary to limit global warming. Empirical evidence from e.g. Soytas, Sari implies that the reduction of carbon emission in a country like Turkey does not negatively affect economic growth [Soytas, Sari 2009: 1672-1673]. While this evidence might only be true for Turkey, it can still be read as a trend statement for countries of a similar level of development. If a reduction of CO₂-emission is not harmful to growth, it needs to be an integral part of the model of contemporary SME; and even if it were harmful, efforts to reduce emissions and thereby the correction of externalities would still be an integral part of the contemporary model of SME.

Figure 1 summarizes the institutional framework of the proposed contemporary definition of SME that links Eucken's classic principles with rather contemporary elements, such as considering corruption and women empowerment as influencing factors. Eucken's principles are displayed in the lower boxes, the institutions defining a contemporary SME in the upper ones.

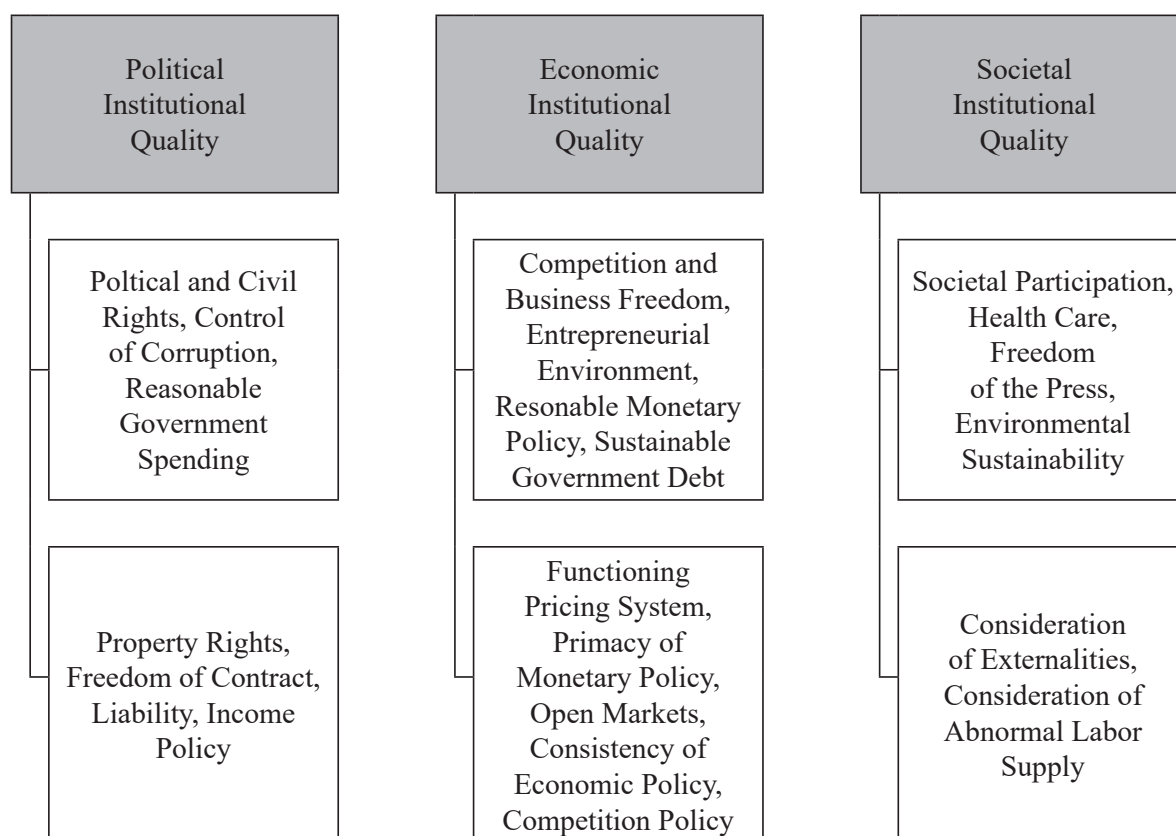


Figure 1. The institutional framework of contemporary SME

Source: by author.

Conclusion

In the article at hand, the need for research on and reform of SME was highlighted, since a considerable part of Germany's population does not rally behind their well-functioning economic order anymore. In order to propose a contemporary framework of SME, an institutions-based approach was employed. Relevant literature was screened in order to identify those institutions that fall in line with Eucken's classic principles on the one hand and that have empirically proven to be prosperity enhancing on the other, since prosperity is assumed to be one of the primary objective of SME. The resulting framework of institutions will most likely not serve as a blueprint when establishing an economic order, since it only consists of formal institutions. Research on the relationship between formal and informal institutions has shown that it is imperative that these fit well together, and since informal institutions are deeply rooted within the culture and the traditions of a country, it is unlikely that a single framework of formal institutions will yield the same results when employed in different countries. It is rather one possible framework of an economic order that would have to be adapted to the specific set of informal institutions. Nonetheless, it is a framework that can be used as a benchmark of contemporary SME in theoretical and empirical analyses.

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Soziale Marktwirtschaft – Ein zeitgenössisches institutionenbasiertes Modell

Zusammenfassung. Die vorliegende Studie weist auf die Notwendigkeit der Erforschung und Reform des Themenkomplexes der Sozialen Marktwirtschaft hin. Obwohl diese sozio-ökonomische Ordnung Deutschland nach dem zweiten Weltkrieg einen bis dato unbekanntes Wachstumspfad ermöglicht hat, zeigen Studien dass sich große Teile der deutschen Bevölkerung heute nicht mehr mit dem Konzept identifizieren. Die vorliegende Studie verwendet einen Institutionen-basierten Ansatz und stellt damit ein zeitgenössisches Modell Sozialer Marktwirtschaft vor. Dazu wird die relevante Literatur auf solche Institutionen hin untersucht, die einerseits mit Walter Euckens konstituierenden und regulierenden Prinzipien übereinstimmen, und die sich andererseits in empirischen Studien als wohlfahrtsfördernd herausgestellt haben, da ökonomische Wohlfahrt als eins der hauptächlichen Ziele von Sozialer Marktwirtschaft unterstellt wird. Das resultierende Modell wird realistischerweise keine Blaupause für die Entwicklung von Wirtschaftsordnungen sein, jedoch kann es als Maßstab für zeitgenössische Soziale Marktwirtschaft in theoretischen und empirischen Analysen dienen.

Schlüsselwörter: Soziale Marktwirtschaft, Reform, Institutionen