

# SOCIAL DEMOCRACY READER 2

*Simon Vaut, Carsten Schwäbe et al.*

## Economics and Social Democracy



AKADEMIE  
FÜR SOZIALE  
DEMOKRATIE

**NEW**

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## Economics and Social Democracy

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## FOREWORD

### to the 4<sup>th</sup> German edition

Germany is a rich country with prosperity and opportunities for many – but not for all. Our society is becoming more and more unequal in terms of income, wealth and life chances, as well as regionally. This inequality damages our economy every bit as much as our democracy.

More than ever, then, we need to tame the centrifugal forces of capitalism, to harness its productivity, but also to ensure that it benefits the many, not just the few, and that democracy does not end at the factory gates. The market is a good servant but a bad master.

But how can we make this happen? What characterises a modern, value-oriented social democratic economic policy? Answers to these questions are crucial to anyone who wants to make a difference in politics.

Only those who know where they are headed will be able to inspire others to get behind their ideas and achieve their goals. All the more reason, then, to try to clarify one's own trajectory.

The aim of this Reader is to contribute to such clarification. In it, key economic theories are explained, economic orders are described, central values and orientations are established and defined and we ask what these values mean for practical social democratic economic policy. It goes without saying that there are no conclusive answers. What makes a social democratic economic policy work has to be subject to continual revision and rejustification. This volume therefore does not seek eternal solutions but to invite the reader to keep on thinking.

This book is the second in the series Social Democracy Readers, in which basic questions of social democracy are put on a solid scholarly foundation and expressed in clear language.

No discussion of economics in the twenty-first century would be complete without looking at the upheavals that globalisation has brought in its train. In this volume we shall examine globalisation in terms of its effects on the framework and shaping of the German economic order. In the Reader *Globalisation and Social Democracy* we examine the context of globalisation and the political options for shaping it. Further volumes deal with the issues of the foundations and the history of social democracy, the welfare state, Europe, integration and migration, the state and civil society, peace and security.

We would like to thank Simon Vaut, Tobias Gombert and Carsten Schwäbe. Simon Vaut was the principal author of the first edition, which Tobias Gombert enriched through his editorial work and teaching activities, while Carsten Schwäbe has developed it further for this fourth edition. Our thanks go also to Thomas Meyer and Michael Dauderstädt, as well as Andrä Gärber and Markus Schreyer for their advice on the book's conceptualisation and reconceptualisation. Further thanks go to all the authors for their outstanding cooperation. Without their contributions the Reader would not have been possible; any shortcomings are down to us.

The symbol of the Academy for Social Democracy is a compass. The purpose of the Academy for the Friedrich-Ebert-Stiftung is to provide a framework within which standpoints and orientations can be clarified. We would be delighted if you were able to benefit from this in working out your own political path. Social democracy thrives on constant public debate and commitment.



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*Social Democracy Readers*

Bonn, August 2018

# 1. INTRODUCTION

*»Global capitalism is heaping up large quantities of capital which, however, do not necessarily create new wealth. Untrammelled financial markets boost speculation and expectations that conflict with sustainable and long-term economic action. If the sole aim is rapid and high returns on capital, all too often jobs are destroyed and innovation hindered. Capital must serve the purposes of value creation and prosperity.« (Hamburg Programme 2007: 7)*

## *Harnessing capitalism*

The relationship between state and market and the opposition between labour and capital are timeworn issues of political contention. This predates the market economy and modern democracy but today they are more contentious than ever.

It is clear that a democracy must be unrelenting in its efforts to counteract the increasing inequality to which capitalism is prone; otherwise it will itself come under threat. The super-rich have been able to convert economic into political influence; political representatives continue to be remote from the electorate; and public trust and thus the basis of coexistence are being eroded.

But how can such countermeasures avoid putting the brakes on capitalism's enormous productivity? What should a modern, value-oriented social democratic economic policy look like?

The basic values of social democracy are freedom, justice and solidarity. Their aim is to bring into being a society in which the basic values and comprehensive political, social, economic and cultural fundamental rights are realised for all.

## *Balance between economic growth, social justice and environmental sustainability*

In this context what would a successful economic policy look like? According to the approach taken in this book, a modern social democratic economic policy should satisfy three principles simultaneously, reconciling growth, social equality and sustainability.

## *Aims and structure of the Reader*

This book is intended to provide fundamental guidance to the questions of what theoretical foundations social democracy can build on, which economic systems and orders favour its implementation, what economic orders may be found in other countries and what these theoretical problems might mean for specific policy prescriptions.



**Economic policy orientation  
of social democracy,  
Chapter 4**

Thematic structure	Subject of the Reader <i>Foundations of Social Democracy</i>				Liberal democracy						
					Social democracy			Libertarian democracy			
	Subject of the Reader <i>Economics and Social Democracy</i>										
	Chapter 2	Theory	Marx			Keynes			Smith		
	Chapter 3.1.	System			Capitalism						
	Chapter 3.2.	Orders		Authoritarian	Coordinated			Uncoordinated			
	Chapter 5	Countries			Sweden	South Korea	Germany		UK	USA	
Chapter 6	Practical examples										

First of all, at the level of **economic theory**, we shall present the analyses and conclusions of probably the most influential economists of all time, Adam Smith, Karl Marx and John Maynard Keynes. We shall then assess the ideal types of economic liberalism, anti-capitalism and managed capitalism derived from this from a contemporary standpoint and with an eye towards the aims of social democracy. We shall also look at some more recent economic thinkers who address current problems of economic theory and policy (Chapter 2).

*Chapter 2:  
Economic theory*

At the level of **economic systems and orders** we trace the relationship between capitalism and democracy and present the two dominant economic orders in the Western industrialised countries, coordinated and uncoordinated capitalism (Chapter 3).

*Chapter 3: Economic  
systems and orders*

At the level of economic policy programmes we look at the development of the **economic policy orientation of social democracy** from the interaction between basic values, fundamental rights and economic policy goals (Chapter 4).

*Chapter 4: Economic  
policy orientation of  
social democracy*

We conclude the volume with a comparison of the different economic orders in the **USA**, the **UK**, **Germany**, **South Korea** and **Sweden** (Chapter 5) and present selected policy proposals in the following areas of economic policy: energy transition, the economy and labour in the digital age, budgetary policy and decent work and codetermination (Chapter 6).

*Chapters 5 and 6:  
Country models and  
practical examples*

The question of a social democratic economic policy also touches on a multitude of levels taken up in this volume, especially the question of what characterises social democracy itself.

The SPD offers an initial answer to this question in its Basic Programme:

*»The Social Democrats not only guarantee civil, political and cultural basic rights for all people, but also social and economic rights. This safeguards the equal social participation of all by means of social democratisation, especially codetermination, the preventive social welfare state based on civil rights and a coordinated market economy guaranteeing the precedence of democracy over markets.«*  
(Hamburg Programme 2007: 19)

## 2. FOUNDATIONAL ECONOMIC THEORIES

### In this chapter

- the most influential economic theories are presented;
- their contemporary significance is considered;
- their importance for social democracy is presented;
- links are made with contemporary economic theorists.

»Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist«, wrote John Maynard Keynes (Keynes 1966: 323), himself one of the most important economists in history. In this chapter the essentials of his theories and those of the two other most important and influential economists, Adam Smith and Karl Marx, are presented and compared. This marks out the three poles of historically the most important economic theories. The debate on whether there ought to be more market or more state in the economy, however, continued after Keynes, who was active in the first half of the twentieth century. Most recently the financial crisis heightened interest in new, alternative economic theories in both academia and among the broader public. In the second part of this chapter we thus take a closer look at this new pluralism in economic theory.

But are the ideas of economists whose works were published centuries ago still worth looking at? Do their explanations still fit a constantly changing, globalised world or are they now just the obscure products of a bygone age, rejected by history?

Why and in what ways are the theories of Adam Smith, Karl Marx and John Maynard Keynes still valuable for social democrats? They can repay study in two respects: first, in many cases they offer conceptual orientation, which has political benefits. Being able to get one's bearings in a context of competing economic theories helps one to assess the consistency of economic arguments and ensure that one is not left at the mercy of particular theoretical approaches.

Second, although social democrats do not go all the way to the end of the road with any one of these economic theories in particular they do comprise an over-

*Three great economists: Smith, Marx and Keynes*

*Are the classics still contemporary?*

*Great economists as aids to orientation*

*Social democracy:  
borrows from  
all three*

arching normative framework. Social democrats draw from all three theories, but may be said to have a marked preference for the notion of managed capitalism, as described by Keynes.

It must also be said that all three economists have attracted strong criticism. There have been countless attempts to refute them. They have been written off – only to prove the old adage that those condemned to die live longer. No one who seriously intends to get to grips with economics can ignore the ideas of Smith, Marx and Keynes.

*Historical context:  
Smith: mid-  
eighteenth century*

When studying these classic thinkers, however, it is important to take due account of the times they lived in. Adam Smith formulated his ideas in the eighteenth century, when mercantilism held sway. The latter theory advised monarchs that they should fund their lavish courts by controlling trade, focusing on exports over imports, the upshot of which was that they should direct the economy. Smith's scepticism towards the state must therefore be understood in terms of his experience of extravagant and grasping, self-enriching monarchs and not, for example, on the model of modern welfare states.

	Smith	Marx	Keynes
Period	Mid-eighteenth century	Mid-nineteenth century	1930s
Motivating causes	Mercantilism, absolutism	Industrialisation and the immiseration of the workers	Global economic crisis and the rise of dictatorships
Principal object	Capitalism as a model for achieving freedom from the mercantilist and absolutist state	Critique of capitalism, improving the circumstances of the workers and liberating them from exploitation	Democracy can be secured only by stabilising the market economy and especially the labour market
Reference points for social democracy	Freedom and the guiding principle of voluntary cooperation	The guiding principle of 'decent work' and a balance between labour and capital	Guiding principle of a coordinated economy and proactive economic policy

Marx's eloquent critique of capitalism sought an answer to mass immiseration as a result of early industrialisation and the first wave of globalisation in the mid-nineteenth century. This is important because today his ideas are largely viewed through the distorting lens of state socialism in the twentieth century.

*Marx: mid-nineteenth century*

In the 1930s, finally, Keynes analysed an economic liberalism that was clearly in disarray as a result of the global economic crisis. His *General Theory of Employment, Interest and Money* was not least an attempt to come up with proposals to stabilise the economic system and thus to prevent any further sliding of democracies into brutal dictatorships. Keynes' ideas have enjoyed something of a renaissance since the global financial crisis of 2008/2009. Both global regulation of financial markets and state investment programmes are once more the subject of intense discussion.

*Keynes: 1930s*

Getting to grips with the three great economists Smith, Marx and Keynes, besides providing invaluable orientation, also has its practical uses: many economic models and explanations current today were influenced by them, even though their origins may have been forgotten.

*Timeless concepts and models of the economy*

It was Adam Smith who coined the phrase 'the invisible hand' to describe how the market may be steered indirectly by market actors pursuing their own interests. This is supposed to explain the efficiency of the market. In the meantime this idea has become somewhat romanticised into the view that the market can do everything.

*Smith: the 'invisible hand' of the market*

One of Keynes' most frequently quoted statements is that »in the long run we are all dead«. In a nutshell this was a plea for the state to take action to counteract market failures. His remark is directed above all against those who pin their hopes on the market's alleged ability to correct itself, over the long run, instead of relying on the responsibility of the state to step in to tackle economic crises as they occur.

## 2.1. The Classics of Economic Theory

### 2.1.1. Adam Smith – The Founder of Economic Liberalism

*Smith: The Wealth of Nations*

*Historical context: Mercantilism in the mid-eighteenth century*

The foundational work of economic liberalism is Adam Smith's book *The Wealth of Nations*, published in 1776.

At that time Great Britain was in a period of transition from mercantilism to capitalism (cf. Gerstenberger 2006: 40, 57–65; Conert 2002: 64).

In the age of mercantilism, which ran from the sixteenth to the eighteenth century, kings and princes measured the success of their economic policies by the amount of gold and silver they were able to amass. Trade was regarded as a zero-sum game: whatever one country gained, another country had to lose. The aim was constantly to boost domestic production capacities. Exports, also to increase domestic gold reserves, were regarded as positive, imports as inherently negative. Mutual benefits from trade (imports and exports on both sides) and specialisation did not come into it. Prohibitive protective tariffs were thus slapped on imported goods, while the import of raw materials was promoted or ensured through colonisation. Courts aimed at directing the economy. The guild system regulated precisely who was permitted to follow which activities and the amounts of goods that could be produced.

**Adam Smith** (1723–1790) is regarded as the father of economic liberalism. He was a moral philosopher and a customs agent in Scotland.

He put forward the theory that the greatest prosperity could be achieved if everyone pursues their self-interest in the free play of market forces. In 1776 Smith published the book *An Inquiry into the Nature and Causes of the Wealth of Nations* (generally known as *The Wealth of Nations*), which is considered to be the foundation of modern economics. His basic ideas are still to be found in economics textbooks today.

Rather less well known is his book *The Theory of Moral Sentiments*, in which moral philosopher Smith asserted that fairness, trust and honesty are indispensable for economic activities and that mutual empathy is the mainspring of social interaction.

*Smith's goal: defeating mercantilism*

Smith wrote what might be regarded as his 'capitalist manifesto' in order to break open this rigid economic order. His ideas met with a ready reception and helped to liberalise the economy and trade.

Smith wrought a fundamental change in theories of the wealth of national economies. He measured wealth solely in terms of productive work performed and not, as the mercantilists had done, in terms of gold reserves.

Smith identified three ways of achieving general prosperity:

- pursuit of self-interest and property
- division of labour and specialisation
- free trade and competition

He described the mechanism by which the pursuit of self-interest and property can have a productive outcome and ultimately serve the common good:

*»It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own self-interest. We address ourselves not to their humanity but to their self-love, and never talk to them of our own necessities, but of their advantages.« (Smith 1974: 17)*

In the very first sentence of *The Wealth of Nations* Smith described the division of labour as the principal driver of economic development:

*»The greatest improvement in the productive powers of labour [seems] to have been the [effect] of the division of labour.« (Smith 1974: 9)*

He explained the benefits of the division of labour using the example of a pin-making factory. A worker can only produce a few pins a day working on his own. If, however, production is divided into several stages and carried out by a number of specialised workers who focus on a single stage of production several thousand pins can be manufactured in a day.

Finally Smith advocated free trade and free competition. Similar to the division of labour between various workers countries that are able to trade freely with one another could specialise in whatever they can produce to best advantage. Productivity would thus be likely to rise overall. Allocation by the 'invisible hand' of the market, according to Smith, is efficient and creates more incentives than any kind of central economic planning and isolation. As an example David Ricardo, who built on Smith's trade theory, took trade between Scotland and Portugal.

*Three sources of prosperity*

*Pursuit of self-interest*

*Productivity through the division of labour*

*Prosperity through free trade and competition*

*Exploiting 'comparative advantage' through trade*

While Scotland can produce wool particularly well Portugal is a good place to produce wine. Smith asserted that the two countries have an absolute cost advantage for their respective products. If the two countries concentrate on their products and pursue trade instead of trying, with a great deal of effort, to produce both wine and wool both would benefit from efficient, larger scale production. Ricardo added that even in the case in which Scotland could produce both wine and wool more favourably it would still benefit from trade and specialisation because by concentrating on its strength in wool it would be able to produce even more. This is what is meant by a country's comparative advantage.

These ideas deviated from the contemporary view that trade is a zero-sum game. Ironically, as a customs agent Adam Smith was responsible for ensuring compliance with mercantilist trade regulations for over a decade.

*What is 'Laissez-faire'?*

In order to let the wellsprings of prosperity – the pursuit of profit, the division of labour, trade and competition – do their work the state, in Smith's view, should act on the market only indirectly and leave it as much leeway as possible. This gave rise to the doctrine known as 'laissez faire'.<sup>1</sup> The idea is that the state should confine itself to guaranteeing public safety, defence of the realm and legal certainty and the provision of infrastructure and education and otherwise not interfere in the market. This would allow the maximisation of productivity. The 'invisible hand', which guides free markets efficiently, is a natural consequence of the individual pursuit of one's own interest.

*Unleashing the productive forces*

Smith created the theoretical basis for the liberalisation of the economy, which in particular with the advent of industrialisation in the nineteenth century unleashed unprecedented productive forces. Smith assumed, however, that a free market economy would automatically achieve equilibrium and did not anticipate crises and recessions.

*Problems with the division of labour*

But like Marx, who analysed the exploitation of workers and alienation due to labour, Smith saw the dark side of capitalism. He feared that an ever more detailed division of labour would lead to the degradation of the worker because of »a life spent in performing a few simple operations«, and called for more education to circumvent it.

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<sup>1</sup> 'Laissez faire' (French) means something like 'allow [people] to get on with it'.



In his second, albeit less famous major work *The Theory of Moral Sentiments* (1759) Smith describes people's need to behave decently and fairly and to overcome their egoism as social beings with collective inclinations. This contradicts those who regard him as the principal witness for the defence of the view of human beings as purely utility maximising *homo oeconomicus*.

Smith saw himself first and foremost not as an economist but as a moral philosopher and emphasised the importance of fairness, trust and honesty in economic activities.

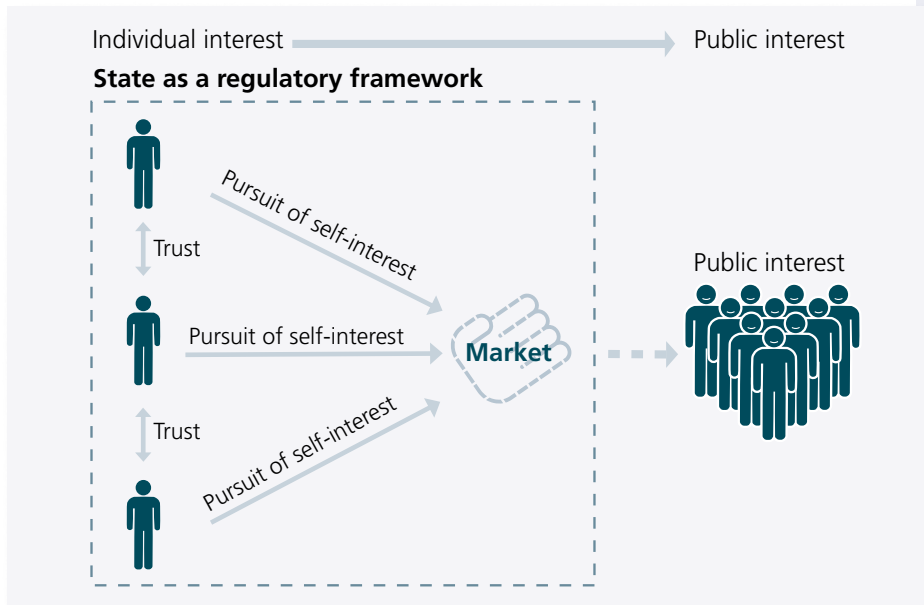


Figure 1: Smith: *Self-interest in the public interest*

The theory of classical economic liberalism that is founded on Smith was the prevailing view until the global economic crisis of 1929. Only in the wake of that did widespread doubts arise concerning whether markets, guided by the invisible hand, always return to equilibrium. The profound crisis and the lasting high unemployment it caused could not be explained in terms of laissez-faire economics. Classical economic liberalism was shaken to its foundations. Nobel Memorial Prize winner Joseph Stiglitz commented, looking back, that the problem with the invisible hand is that it is invisible because all too often it simply isn't there (Stiglitz 2002).

Following in the wake of the 1929 crisis came several decades of so-called 'Keynesianism' (see Chapter 2.1.3). Only after many years confined to the shadows did economic liberalism experience a renaissance in the 1980s, with the advent of neoliberalism.

*The 'Chicago  
School'*

Perhaps the best known of the economists who took up Smith's ideas once again, propagating and further developing them, were Friedrich August von Hayek and Milton Friedman. The latter founded an economic liberal ideology since known as 'the Chicago School', where Friedman was a professor. The neoliberals, however, were only interested in Smith's critique of the state and his plea for a free market. Hayek and Friedman took no account of his *Theory of Moral Sentiments*.

*Reinterpretation  
under the aegis of  
Thatcher and  
Reagan*

Their reinterpretation of Smith's work achieved particular influence above all in the United States, under President Ronald Reagan, and in the United Kingdom, under Prime Minister Margaret Thatcher. The guiding principle of politics at that time was that »the state is not part of the solution to our problems, the state is the problem«. The upshot of this was deregulation, privatisation and the rolling back of the state.

*Washington  
Consensus*

The market faithful also exerted considerable influence over the policies of the World Bank and the International Monetary Fund. Within the framework of the so-called 'Washington Consensus' these institutions proselytised the economic liberal ideology in, among other places, Latin America, the post-communist states and, after the Asian crisis of 1997, also in South-East Asia. The deregulation of financial markets was also largely inspired by this ideology. Among its consequences were the severest crisis of the global financial architecture in decades and a worldwide recession from 2008. The extent and scale of the crisis have led to something of an economic and political rethink. As an alternative to economic liberalism, with its blind faith in the market, approaches emphasising a new balance between state and market and the primacy of politics are now gaining the upper hand.

## 2.1.2. Karl Marx's Critique of Capitalism

**Karl Heinrich Marx** (1818–1883) was a German philosopher and political journalist.

What liberal economists regarded as stability and growth arising from the free development of the market, Marx described as class struggle, exploitation, immiseration and a system prone to crises, which may well lead to a proletarian revolution.

In the area of economic theory Marx's principal publication was the partly posthumous *Capital*, whose three volumes appeared between 1867 and 1894. The *Communist Manifesto*, published in 1848, had an enormous political influence.

German philosopher Karl Marx's critique of capitalism is often regarded as a theoretical counter-model to the ideas of Adam Smith. That is only partly the case. Marx studied Smith's work closely and came up with a similar analysis. If anything, Marx stressed capitalism's productive powers and capacity for innovation even more strongly than Smith had done. The conclusions he drew were very different, however. In contrast to Smith Marx saw capitalism as inherently unstable

and destructive. It leads not to the 'wealth of nations' but to the immiseration of the vast majority of workers.

In order to be able to grasp Marx's thinking we have to be able to envisage the precarious living conditions of workers in the period of early industrialisation in the nineteenth century. A text produced by the Museum of Industrial Culture in Duisburg conveys a vivid impression (Baier et al. 2002: 18).

*»While the affluent built an exclusive residential area on the outskirts of the city dreary rows of ugly apartment houses were built for the workers, which were overcrowded, unhygienic and extortionately priced ... For example, often a whole family and a lodger slept in one room, with several people sharing a bed in rotation: sleeping patterns corresponded to shift work. Working conditions in the factories were geared entirely to the machines to which the workers who served them had to adapt themselves. Seventy-hour working weeks were the rule and in the textile industry even 80 hours. Child labour was widespread, social security was almost unknown and health care was poor.«*

This description also applies, more or less, to living and working conditions in many poorer countries today.

*Marx: Relationship to Smith*

*Historical context: Early industrialisation in the mid-nineteenth century*

*Exploitation as part  
and parcel of  
capitalism*

Marx saw these inhuman working and living conditions not as some unfortunate accident but as an inevitable consequence of capitalism. According to his analysis, the free market necessarily leads to misery and exploitation because capitalists' profits are the result of the exploitation of the workers.

*The concept of  
'surplus value'*

Central to Marx's theory was the concept of 'surplus value', which he presented in the first volume of *Capital*, published in 1867 and explained further in the volumes published posthumously. Surplus value is the value that the capitalist realises as profit over and above his invested capital; in other words, if he has invested 100 euros in production (a proportionate reward for the goods and the means of production) but is able to get 110 euros on the market. This surplus value, according to Marx, can only come from people's value-creating labour; in other words, if the worker creates more value than is paid to him in the form of wages.

According to Marx's labour theory of value **surplus value** arises from the profit taken by the capitalist from the workers' output after deducting wage costs and expenditure on the means of production. Surplus value is therefore synonymous with the exploitation of the workers. Marx makes a further distinction between absolute surplus value, which comes into existence simply through extra work (longer working time), and relative surplus value, which is the result of productivity gains (Wirtschaftslexikon 2017).

**Further reading:**

Volker Happe,  
Gustav Horn and  
Kim Otto (2017), *Das  
Wirtschaftslexikon.  
Begriffe. Zahlen.  
Zusammenhänge*  
[A Lexicon of Eco-  
nomics. Concepts,  
Figures, Contexts],  
Bonn.

Marx described how the workers received wages at the minimum subsistence level. The capitalists, by contrast, became rich from the difference between this wage and the value of output (surplus value).

He concluded that the capitalist, driven by ever more intensive competition, will try to increase this surplus value. Wages would fall further, working hours would be lengthened and the use of machinery would increase, resulting in rising unemployment. At the same time, competitors would gradually be squeezed out of the market. Finally, society would be increasingly divided into the propertyless and a small group of people in whose hands capital would be concentrated.

*Concept of  
'alienation'*

Besides the concept of 'surplus value', in his 1844 *Economic and Philosophical Manuscripts* Marx coined the term 'alienation of labour'. Marx, like Smith, discerned in alienation the dark side of the division of labour in production. In mass production workers are involved in only small, discrete and monotonous stages of production. They lose all contact with the finished product and are thus deprived of any related satisfaction.

For Smith, competition and the division of labour were the source of progress. For Marx, by contrast, competition and the division of labour were the fundamental evil of capitalism and the cause of exploitation and alienation. He saw that the productive advances of his time benefited only capital owners, while the workers were impoverished.

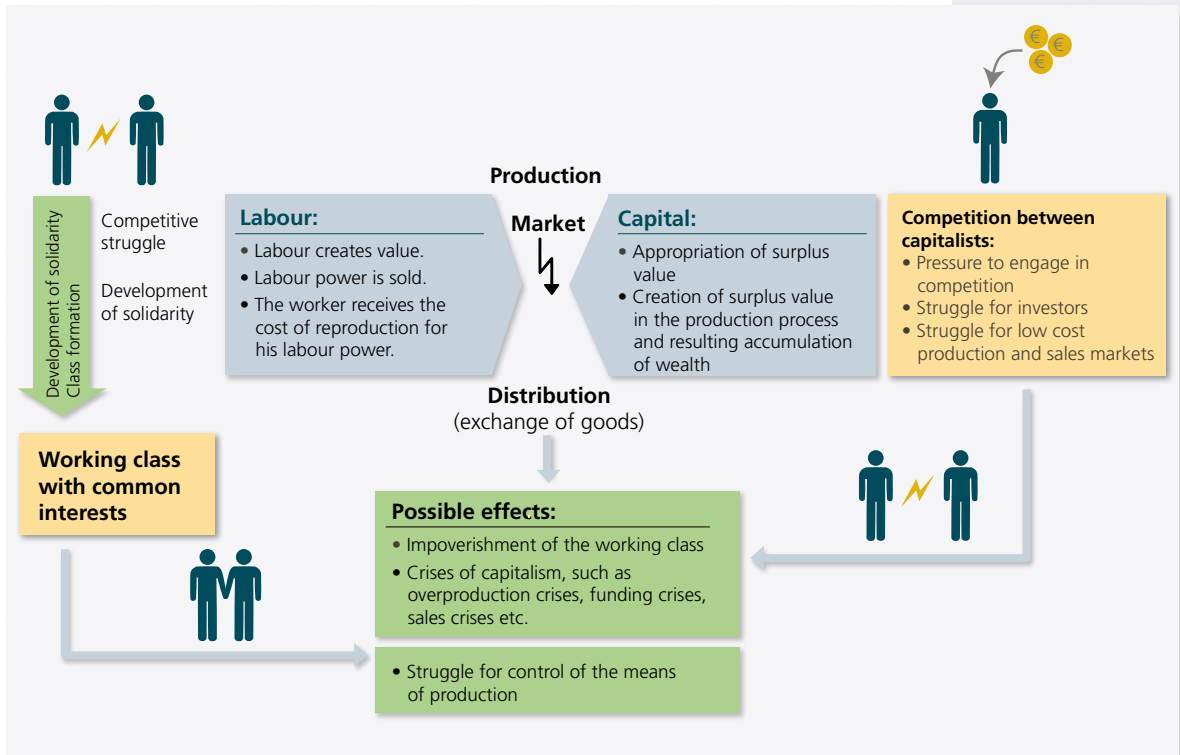


Figure 2: Basic structure of Marx's argument

According to Marx, an economic system based on profit was unstable and prone to crises. In his view, it could lead to a revolution by the exploited.<sup>2</sup>

*Instability of capitalism*

»Centralisation of the means of production and socialisation of labour at last reach a point where they become incompatible with their capitalist integument. This integument is burst asunder. The knell of capitalist private property sounds.« (Marx 1991: 684 f.)

<sup>2</sup> In research on Marx views differ on whether he considered that revolution was an inevitable historical development or only a possible one. Decisive for the various standpoints is whether one distinguishes between various creative periods or bases one's view on his work as a whole. For more details see: Heinrich (2004: 169–178).

*Private ownership of  
the means of  
production as  
characteristic of  
class society*

One last key notion of Karl Marx's theory, which he addressed above all in the *Communist Manifesto* of 1848, is 'property', understood here as private ownership of the means of production.

For Marx, private ownership of the means of production is a key characteristic of class society under capitalism. After the proletarian revolution that he predicted in his early writings it would, in his view, be abolished. The working class, because of the low level of its subsistence wages, would otherwise have no means of acquiring substantial property. The capitalists, by contrast, had acquired their property through exploitation.

*Political demands in  
the Communist*

In the *Manifesto* of the Communist Party Marx therefore demanded, among other things:

- the centralisation of credit in the hands of the state by means of a monopolistic national bank with state capital;
- the centralisation of transport in the hands of the state;
- a multiplication of state-owned factories, instruments of production, land reclamation and improvement of all lands in accordance with a common plan (cf. Marx/Engels 1987: 54).

*Manifesto  
Problems of  
nationalisation*

Later on, however, Marx's most important interpreter, Friedrich Engels, also saw certain drawbacks in such nationalisation: »The more [the state] proceeds to take over productive forces, the more it actually becomes the national capitalist and the more citizens it exploits. ... Capitalist relations are not done away with but rather brought to a head« (Engels 1988: 553 f).

*History as a  
sequence of class  
struggles*

The following words have been attributed to the economist John Kenneth Galbraith: »Under capitalism man exploits man. Under communism it's the other way around.« The economic achievements of countries such as the Soviet Union and the former German Democratic Republic, which sought to emulate the demands of the *Communist Manifesto* for centralisation and socialisation of the banks, the transport system and the means of production, fell far short of those of the capitalist market economies. Although there were no unemployment or economic crises and little inequality there consumer options were limited.

Marx interpreted history as a succession of class struggles that culminate in the confrontation between the proletariat and the bourgeoisie, and perhaps finally

in a proletarian revolution. He developed the utopia of a classless society without competition or private ownership of the means of production.

The terms '**bourgeoisie**' and '**proletariat**' that Marx often used refer to the opposing classes. The term 'proletarian' is derived from the Latin 'proletarius', which simply means 'belonging to the lowest social stratum'. The term 'bourgeoisie' comes from French and refers to the 'mercantile middle class'.

History has shown, however, that the impoverishment of the workers Marx described and the increasing concentration of property among capital owners are not inevitable. A fairer distribution of prosperity could be achieved not least through the organisation of and develop-

ment of solidarity among workers in trade unions and the creation and consolidation of the welfare state.

The concentration of capital was disrupted by what Austrian economist Joseph Schumpeter called 'creative destruction'. He described how companies repeatedly undergo restructuring through innovations, competition, crises or the opening up of new markets.

*»The opening up of new markets, foreign or domestic, and the organizational development from the craft shop and factory to such concerns as U.S. Steel illustrate the same process ... that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of creative destruction is the essential fact about capitalism.«*  
(Schumpeter 1942: 137f)

The automobile industry replaced coachmen, blacksmiths and stable boys. The typewriter manufacturer has had to make way for the computer manufacturer. These are examples of creative destruction that, on one hand, fosters innovation but, on the other hand, creates new uncertainties and requires enormous flexibility from people.

The experiment with state socialism, which based itself on Marx, has failed and its theoreticians have been discredited. Has the theory therefore been refuted? The fact is that, so far, no functional alternative has been found to an economic order based on market efficiency and private property that has stood up in practice.

*Impoverishment  
not inevitable*

*Schumpeter:  
'creative  
destruction'*

*Collapse of state  
socialism*

*State of the  
analysis*

Marx was a better analyst than guide. No practicable solutions can be derived from his doctrines and his predictions have not come true. His analyses still attract attention, however. More than anyone else Marx heightens one's awareness of the dangers and crises of an unrestrained capitalism.

*How is Marx to be  
categorised? Willy  
Brandt: »the striving  
for freedom«*

What can we say about Marx, then? Perhaps Willi Brandt put it best, on a visit to the Karl-Marx-Haus in Trier in 1977: »One does justice to Marx best by taking him down from his pedestal, in both a positive and a negative sense. ... Whatever people have made of Marx or would like to make of him, the pursuit of freedom, the liberation of man from servitude and abject dependence was the principal motif of his thought and actions« (Brandt 1977: 11, 13).

Since the financial and economic crisis of 2008/2009 there has been renewed awareness of Marx's crisis theory in economic debate.

### 2.1.3. John Maynard Keynes: Managing Capitalism

*Keynes –  
a middle way?*

Both Adam Smith's doctrine of free market capitalism with as little state intervention as possible and Karl Marx's rejection of competition and private ownership of the means of production are problematic. But might there be a middle way, a coordinated capitalism that could utilise the productive forces of the market, while offsetting and cushioning its destructive forces?

**John Maynard Keynes** (1883–1946) was a British economist who had a major influence on twentieth century economic theory. In his influential work *General Theory of Employment, Interest and Money* (1936) he called into question the ability of markets to heal themselves and his work formed the basis of what came to be known as 'Keynesianism', the aim of which is to manage capitalism. Keynes also worked on the development of the Bretton Woods system, which laid down the rules for the global economy and financial markets in the post-War period.

*Keynes' critique  
of neoclassical  
economics*

British economist John Maynard Keynes analysed Janus-faced capitalism, which, although efficient and productive, was also structurally unstable. Keynes was committed to a market order based on private property and competition, but



was strongly critical of mainstream neoclassical economics, which drew on Smith's doctrines.

For example, he criticised the fact that its »assumptions are seldom or never satisfied, with the result that it cannot solve the economic problems of the actual world« (Keynes 1966: 319).

In the face of the catastrophic global economic crisis of 1929 Keynes also called into question the 'invisible hand'. The market had not, as Smith had led us to assume it would, returned to equilibrium, but rather unemployment seemed stuck at a high level and the economy was stagnant. Keynes discerned a downward spiral: if fewer goods are produced and people are made redundant, consumers and producers alike will be plagued by uncertainty, spending less money and investing less ('panic saving'). Demand falls further and companies produce even less, cutting more jobs, expenditure falls further and so on and on. The crisis deepens and the economy may fall into a lasting depression. After a global depression that reflected this diagnosis exactly Keynes' ideas met with a ready reception. Furthermore, Keynes was not only able to identify situations in which the free market did not function but, in the form of anti-cyclical economic management, developed ideas about how to counteract it.

In a downturn the state has to intervene in the market and substitute for private demand, borrowing and spending more money. One option is to put more money in people's pockets directly, for example, by cutting taxes. The danger here, however, is that the effectiveness of such measures may fizzle out if people continue to save in the face of uncertainty. A better idea is for the state to spend directly, for example, by building new schools or roads. This additional expenditure will cause more people to be employed, who in turn will consume more, creating more demand and setting in motion a positive spiral. Keynes explained this as follows:

*»If we spend more than 150 million pounds everyone will have a higher income; and those who are unemployed no longer need unemployment benefit. In addition, this spending will bring many other people into employment. The money will circulate in the economy and be spent on all manner of goods and not be concentrated on a few industries.«* (Keynes 1939, quoted in Weinert 2008)

*Doubts about the  
'invisible hand'*

*The dangers of an  
economic down-  
ward spiral*

*Active state inter-  
vention required*

*State management  
of the economic  
cycle*

»In the long run  
we are all dead«

This is how he justified abandoning the belief that the market will always return to equilibrium, as Smith had assumed. His dictum, cited above, that »in the long run we are all dead« constituted an appeal to the powers-that-be that it is more important to create jobs and growth today than to trust in some nebulous future improvement and a self-regulating market. This is more evident than ever in the twenty-first century, looking at the economic situation – especially youth unemployment – in Southern Europe today.

Keynes conceded, however, that there are risks involved in market intervention because it is extremely difficult to decide when to step in and to what extent. He wrote:

*»The outstanding fact is the extreme precariousness of the basis of knowledge on which our estimates of prospective yield have to be made. Our knowledge of the factors which will govern the yield of an investment some years hence is usually very slight and often negligible.«* (Keynes 1966: 126)

The so-called  
'Keynesian  
revolution'

His analyses and his recommendation that the state should intervene in the market were so influential that the term 'Keynesian revolution' is often used to express the extent of his departure from the ideas of both Smith and Marx. The adherents of these thinkers reacted accordingly. For economic liberals and conservatives Keynes was a socialist in disguise, while Marxists reproached him with continuing to put too much faith in the market. What is certain is that Keynes was adamantly opposed to the dictatorships that were emerging at that time – not only in Germany – and that his recommendations were aimed at preserving democracy.

*»The authoritarian state systems of today seem to solve the problem of unemployment at the expense of efficiency and of freedom. It is certain that the world will not much longer tolerate the unemployment which, apart from brief intervals of excitement, is associated and, in my opinion, inevitably associated with present-day capitalistic individualism. But it may be possible by a right analysis of the problem to cure the disease whilst preserving efficiency and freedom.«* (Keynes 1966: 321)

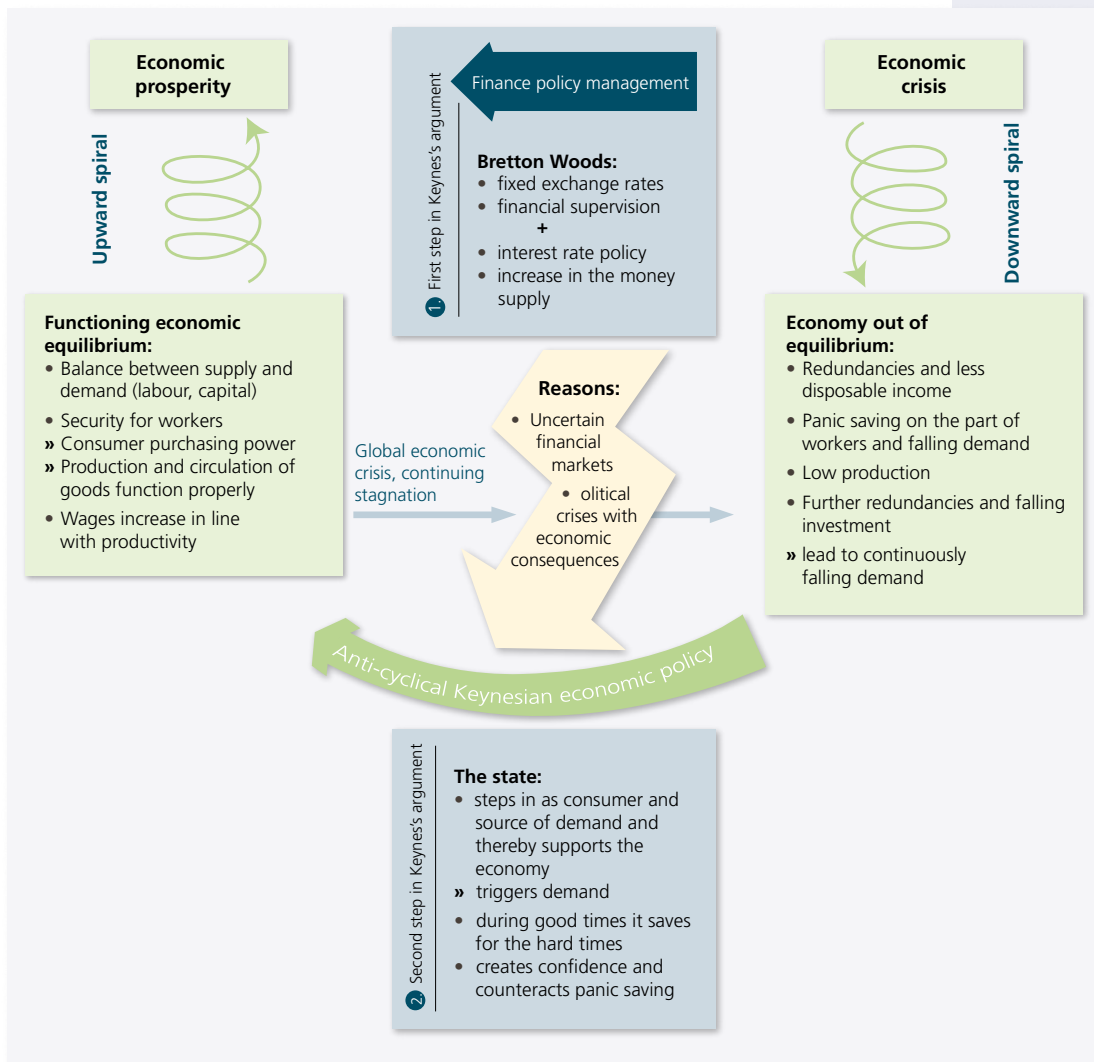


Figure 3: Basic structure of Keynes' arguments

On top of all that Keynes' 'psychological law' provided a reason why redistribution was not only socially desirable, but also economically rational. A dynamic economy requires sufficient demand. Because as incomes increase the savings rate tends to rise, it makes sense to boost the income of low earners, whose savings rate is lower.

*The 'psychological law'*

*Keynes' influence  
on the twentieth  
century*

Keynes' influence on twentieth-century economics was second to none. His recommendations were first put into practice in the United States from 1933 under the New Deal launched by President Franklin D. Roosevelt. First, public investment in, for example, infrastructure was stepped up considerably. Second, consumption was boosted by increases in social benefits because people on low (or no) incomes have a low savings rate. Up to the 1970s Keynes' doctrine was the conventional wisdom. In Germany his views were represented in particular by economist Karl Schiller, who was Social Democratic federal minister of economic affairs and of finance from 1966 to 1972. During this period even conservative US president Richard Nixon declared »we are all Keynesians now«.

*Problems with  
Keynesianism*

From the mid-1970s, however, Keynesianism entered into crisis. On one hand, anti-cyclical budgetary policy ceased to function as Keynes had envisaged. Although expenditure was increased during crisis periods public debt was not repaid when the good times returned. As a result, public debt accumulated and the leeway for deficit spending fell from crisis to crisis. On top of that came the two oil crises. The enormous hike in oil prices triggered a vicious circle. Wages were increased, but the gain was eaten up by rising energy prices, leading to further wage rises, which pushed up inflation, resulting in further wage pressure. State economic stimulus packages no longer worked, the economy stagnated and inflation continued to rise (stagflation). Neoliberal and neoclassical economists, who had continued to hawk their business-friendly supply-side policies, seized their chance.

**Stagflation:** When economic stagnation and inflation coincide (Wirtschaftslexikon 2009).

*The Bretton-Woods  
System*

Finally, as chief British negotiator, Keynes played a key role in the construction of the so-called Bretton Woods system. For Keynes global trade imbalances were a significant cause of instability in global economic development. These occur when some national economies import more than they export, thereby becoming debtor states, while other national economies as creditors export more than they import. Keynes' plan for a clearing union envisaged, among other things, that creditor states should be deterred from achieving their trade surpluses by trading with undervalued currencies. In order to bring high exports back into balance the clearing union would create incentives to boost domestic demand and thus imports. A national economy could achieve this with, for example, higher wages or more investment. Keynes saw the importance of linking such adjustments on the part of creditor states with adjustments by debtor states,

**Bretton Woods System:** In 1944, agreement was reached on the international financial architecture of the post-War period at a conference at Bretton Woods in the USA. At its core was an international monetary system under which exchange rate fluctuations would be curbed through a linkage to the US dollar. The International Monetary Fund (IMF) and the World Bank were set up as institutions for international lending and financial market regulation. The Bretton Woods system remained in place until 1973. After currency market turbulence the dollar peg of exchange rates had to be given up, thereby undermining financial market stability.

Monetary Fund (IMF) was tasked with structuring global economic relations. Although the IMF grants deficit countries financial aid to cope with liquidity problems it comes with conditionalities aimed at suppressing domestic demand and boosting competitiveness. The kind of reforms demanded by the IMF came to be known as the 'Washington Consensus': deregulation, privatisation and lib-

**Washington Consensus:** This designates the economic policy agenda pursued by the International Monetary Fund (IMF) since the 1980s for developing countries experiencing economic and debt crises. Financial aid was provided only in tandem with reforms to liberalise trade, deregulation and the privatisation of state-owned companies. As regards fiscal policy the Washington Consensus demanded tax cuts, while budget deficits were supposed to be reduced largely by means of cuts in spending. By means of the Washington Consensus supply-side and neoliberal ideas were able to establish themselves at the international level. Given the numerous problems and experiences since the financial crisis of 2007, however, there are intense discussions at the IMF – and especially its research department – concerning a new and improved economic policy agenda to replace the Washington Consensus.

however, with both sides thereby sharing the burden of structural reforms aimed at removing trade imbalances (cf. Skidelsky 2009: 260–64). This debate has retained its relevance over the years in the face of global trade and debt crises and efforts to tackle imbalances in Europe.

Keynes was unable to carry the day in 1944, however. In the Bretton Woods system that was actually implemented the International

eralisation, aimed at cutting wages and state spending, supposedly to reduce the trade deficit as imports fall and exports rise. The IMF invariably imposes the burden of adjustment on the deficit countries.

The Washington Consensus came to be established in the 1980s through the neoliberal economic policies of Margaret Thatcher in the United Kingdom and Ronald Reagan in the United States. After decades of such economic liberal policies calls for state intervention in a largely deregulated market are becoming louder, especially since the financial market crisis that

*International  
Monetary Fund  
(IMF)*

**Further reading:**  
*Robert Skidelsky  
(2009), The Return  
of the Master,  
London.*

*Washington  
Consensus*

commenced in 2007. A return to Keynes has been clearly discernible. This can scarcely be surprising, given that what Keynes had to say about the international financial markets is now more apposite than ever:

*»Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done.«* (Keynes 1966: 134)

## 2.2. Ideal-Types of Economic Theory

The ideas of Smith, Marx and Keynes pervade everyday political discourse. When a centre-right (economic liberal) politician declares that the state should be rolled back to its core tasks and says that the state is not part of the solution to the problem but rather it is the problem, his opinion is underpinned by Smith's notion of the invisible hand of the market. During periods of unrestrained globalised capitalism in which markets increasingly go off the rails Keynes' approach to managing the market economy becomes relevant once more. And when one is confronted by images of factories in developing countries in which workers sew clothes for 14 hours a day for exploitative wages one's thoughts are likely to turn to Marx.

That is hardly surprising because Smith, Marx and Keynes ideal-typically<sup>3</sup> represent three different economic approaches that are constantly revived by particular political camps whether the issue of the day is redistribution, the relationship between market and state or other economic policy questions. The three ideal-types can be described as follows:

1. The state should keep its distance from economic processes. The pursuit of property is the driving force of economic activity and must therefore not be infringed (the libertarian view, deriving from Smith).
2. The capitalist economic system, which is based on private ownership of the means of production and competition, leads to the exploitation and impoverishment of the masses. It should therefore be abolished (the communist view, based on Marx).
3. The economic order is based on private property and the market economy but the state intervenes in the national economy through regulation, redistribution and demand management. Private property is guaranteed, but at the same time socially embedded and has obligations with regard to the community (the social democratic view, leaning on Keynes).

Economic theory makes it clear that the unrestrained market does not work, and neither do attempts to renounce a market order entirely.

<sup>3</sup> 'Ideal-typical' is meant here in the sense of sociologist Max Weber, namely the deliberate exaggeration of reality in order to order or capture segments of social reality theoretically. But 'ideal-typical' also means that in this introductory volume only a simplified glimpse of the relevant ideas is possible.

*Smith, Marx and  
Keynes today*

*1. Undiluted  
capitalism*

*2. Anti-capitalism*

*3. Managed  
capitalism*

*»As much market as  
possible, as much  
planning as  
necessary«*

*What answers do  
social democratic  
politicians offer to  
these questions?*

History teaches us that both market fundamentalism and the complete abolition of the market have failed. Capitalism must be managed and coordinated if one wishes to get closer to the basic values of social democracy within its framework. The SPD's 1959 Godesberg programme summed this up very well under the aegis of the influential SPD economist Karl Schiller: »as much market as possible, as much planning as necessary«.

But what challenges do politics and society face in managing and regulating capitalism?

*Where does  
economics  
stand today?*

The economic theories we have presented so far must always be judged in terms of the exigencies of the particular time if one is to have any hope of drawing from them practical recommendations for economic policy. History shows that capitalism has not, as Marx predicted, succumbed to its internal contradictions. Nor has it stabilised in a harmonious equilibrium, however, as Adam Smith expected, but remains prone to crises, as Keynes showed. Thus scholarly debates have continued unceasingly in pursuit of the best economic policy recipes. Depending on their pet assumptions and theories professional economists reach divergent conclusions about the same problem.

In a period in which controversy raged concerning the European Central Bank's (ECB) unconventional low-interest rate policy newspaper headlines like the following were not uncommon: »German economists reproach the ECB's public financing«<sup>4</sup> or »Germany is doing well out of Draghi. Leading economists praise the ECB«.<sup>5</sup> Economists were keen participants in contemporary economic and monetary policy debates, although their views differed sharply. In 2013, for example, 246 national and international economists signed an appeal that clearly stated the supposed benefits and urgency of the ECB buying government bonds.<sup>6</sup> On the other hand, 136 economists signed a different document reproaching the ECB for fundamentally violating its mandate to maintain price stability and the principle of no bailouts with its bond purchasing programme.<sup>7</sup>

4 <http://www.faz.net/aktuell/wirtschaft/eurokrise/neuer-appell-deutsche-oekonomen-werfen-der-ebz-staatsfinanzierung-vor-12569316.html>.\*

5 <http://www.n-tv.de/wirtschaft/Fuehrende-Oekonomen-loben-die-EZB-article17466261.html>.

6 <https://berlinoeconomicus.diw.de/geldpolitik/ein-aufruf-zur-unterstuetzung-des-anleihekaufprogramms-omt-der-europaeischen-zentralbank/>.\*

7 <http://www.faz.net/aktuell/wirtschaft/eurokrise/neuer-appell-deutsche-oekonomen-werfen-der-ebz-staatsfinanzierung-vor-12569316.html>.\*



This episode shows that there is no dominant opinion in economics. There are two main reasons for this. First, economics, like any scholarly field, is – as Karl Popper put it – not built on solid bedrock but 'rises from a swamp'. That means that data, facts and observations from which economists draw their conclusions are indeterminate or may simply be wrong. Second, economics is to a considerable extent value based.

In contrast to the natural sciences its assumptions and theories are determined by specific models of human beings and society. An economist who believes that people are best understood in terms of utility-maximising *homo oeconomicus* will come to quite different assessments than one who regards people as social and complex beings.

An article by economic journalist Andreas Hoffmann provided a sobering reminder of the high ideological content of supposedly fact-based economics and of why economists' recommendations should be viewed with a critical eye:

*»I can never board a plane without thinking about subsidies. Economists hate subsidies. Subsidies are spawn of the Devil and paralyse the economy. But without subsidies no Airbus would ever have got off the ground. We can fly Airbus only because some heads of government wanted to build some planes. In the absence of that Boeing would rule the skies in the same way that Bill Gates rules computers. ... [The same goes for] the power of trade unions. Allegedly, trade unions are detrimental to successful businesses. But in that case why exactly are German auto manufacturers, machine builders, metal and electrical companies so successful throughout the world? Given the strength of the trade unions in such companies why don't they come to grief? It doesn't do much good to bring up the real world with real economic experts. They will give you a disdainful look and declare that it's not a question of reality but of the »regulatory/institutionalist approach« ... But why does this map lead us astray so often? ... Eight days before Black Thursday in October 1929 star economist Irving Fisher declared that there would never be a stock market crash. No researcher predicted any of the five recessions here in Germany nor the internet boom in the 1990s. In autumn 2002 the Institute [for Economic Research] predicted 1.4 per cent growth for 2003; in the event, the economy contracted by 0.2 per cent and currently everyone is wracking their brains about why jobs are being created here and the economy is growing again. Oil is too expensive and Angela Merkel is making a mess of her reforms.« (Süddeutsche Zeitung, 16 September 2006)*

*No dominant view,  
for two reasons:*

- 1. No science is built  
on 'solid bedrock'*
- 2. Economic  
propositions are  
value-based*

*Economics is not an exact science*

Clearly, economics is not an exact science, able to make accurate predictions, but rather comes up with more or less plausible, empirically based theses based on assumptions.

*As a consequence, one is expressing one's own opinion*

But what are the consequences of this? Certainly not that we should deny that economics is scientific at all or that we can interpret its assertions any way we want. It is important, however, that economists disclose their assumptions and basic stance so that anyone approaching their findings is able to put them in context and evaluate them. Equally important is that anyone with an interest in politics be fully aware of the differences between economic approaches and not regard the pronouncements of particular economists as absolute truth, but instead be able to frame them in the general debate.

*Two camps: supply-side and demand-side policy*

Economic views can very roughly be divided into supply-side policy and demand-side policy camps, although to be sure there are overlaps between the two.

### Supply-side policy

Supply-side economic policy is in the tradition of Adam Smith and was followed up by economists such as David Ricardo and John Stuart Mill as neoclassical theory. In the 1960s and 1970s Milton Friedman's monetarism represented a modern supply-side theory, which he developed in self-conscious opposition to the dominant Keynesianism. Supply-side economic theories are based on the assumption that the free market will, at least in the long run, return to equilibrium in the face of external economic disruption, entirely in the spirit of Adam Smith's invisible hand. According to this theory economic actors, as *homo oeconomicus*, always act rationally and in accordance with their own interests. In this perspective state intervention in the market disrupts economic adjustment processes.

### 'Competitiveness' and social democracy:

competition is a core component of a market economy and supply-side policy is often advocated for the purpose of boosting competitiveness in relation to other national economies. Competition can occur at two levels: price and quality.

Free competition around costs leads to starvation wages, miserable working conditions and exploitation of the environment. From a social democratic standpoint such competition has to be restricted in favour of social and environmental standards and aspects such as employment and environmental protection should be ring-fenced in a market economy, for example, by laying down – ideally – global standards in these areas or import bans on goods that fail to meet them (Wirtschaftslexikon 2017).

*Supply-side policy:  
Adam Smith,  
David Ricardo,  
John Stuart Mill*

The main supply-side demand is thus the establishment of the most favourable possible conditions for companies to enable optimal production. Hence the term 'supply-side policy': the idea is to optimise the supply of goods and services. According to Say's law, supply creates its own demand (as Mill formulated it) because additional production generates additional wages and profits. The state, on this account, should keep its distance from the economy because decentralised decision-making by free economic actors is most efficient. Subsidies, public ownership and regulation should be minimised and taxes and duties should be kept as low as possible in order to furnish the supply side with the greatest possible freedom to do business. Wages are understood from this perspective first and foremost as a cost factor that dampens economic activity, swollen by social insurance contributions and excessively high collectively agreed wages.

### **Demand-side policy**

Demand-oriented economic theory was founded by John Maynard Keynes and taken up by economists as different as Hyman Minsky and Paul Krugman. Demand-side economic policy contradicts the assumptions, in line with Marx and Keynes, that the free market tends towards stability. Keynes developed these ideas in the face of the high unemployment during the global economic crisis of the 1930s, in which the labour market itself was unable to overcome under-employment. Economic actors in particular in economic crises do not behave rationally – Keynes referred to 'animal spirits'. Demand-side oriented economists thus rely on an active role for the state in promoting employment and managing the economy. Key to this is ensuring constant demand in the national economy. To that end wages need to grow at least in step with productivity. Henry Ford, for example, who introduced mass production into his factories and achieved a corresponding productivity boost, advocated higher wages for the sake of maintaining demand: he's reputed to have remarked that »cars don't buy cars«.

If private consumption and investment slacken the state has to step in with anti-cyclical investment programmes and employment-intensive measures to maintain demand. Wages are regarded as a demand factor that stabilises the economy and should always rise in line with productivity. In response to such additional demand companies start investing again, employment picks up and economic growth remains steady. This form of anti-cyclical economic policy also means, however, that in economic boom periods the state should ensure that demand

*Demand-side  
policy: John  
Maynard Keynes*

*Anticyclical  
economic policy*

does not get out of control, by means of higher taxes or lower expenditure. Budget surpluses should be used to pay off debt incurred from credit-financed economic stimulus programmes in a recession.

*Economics of  
evolutionary  
innovation: Joseph  
Alois Schumpeter*

These ideal types represent an attempt at classifying economic theories. Some famous figures stand outside this schema, however, such as Joseph Alois Schumpeter, who neither acknowledged that there can be equilibria in capitalism nor believed that economic equilibrium is a worthwhile economic policy goal. His perspective on economic activity was not static but dynamic. He understood capitalism as a process of continuous 'creative destruction' of old companies and economic sectors by superior innovations. On this basis he founded the theory of the economics of evolutionary innovation.

*Taxonomy of  
German economic  
research institutes*

Economic research institutes generally represent a certain fundamental orientation (supply-side or demand-side oriented) within economic theory and thus align themselves in accordance with one of the theories presented here. The nine largest economic research institutes in Germany, too, can be classified as rather 'supply-side oriented' or 'demand-side oriented'. The influence of their research work on the economic policy debate is not to be underestimated. For that reason it is important to be aware of their core economic policy standpoint and to keep it in mind when assessing their analyses and recommendations. All nine institutes also work together, however, especially in producing economic prognoses that form the basis for state budgets and influence the planning of many companies.

	Supply-side oriented	Demand-side oriented
<b>Pioneers</b>	Adam Smith, David Ricardo, John Stuart Mill, Milton Friedman	John Maynard Keynes, Hyman Minsky, Paul Krugman
<b>Basic ideas</b>	Companies should be able to pursue profits under favourable conditions and as far as possible free of the interference of the state.	Constant demand is ensured by anti-cyclical management of the economy. In this way growth and employment are stabilised.
<b>Economic actors</b>	Always rational	Limited rationality
<b>Free market</b>	Always recovers equilibrium	Inherently unstable
<b>View of the state</b>	Passive state	Active state
<b>Attitude to wages</b>	Wages are a cost factor that reduce profits and thus investment.	Wages are a demand factor and must rise in line with productivity.
<b>Characteristic of the period</b>	Since the 1980s	1930s to 1970s, revived since 2008
<b>German economic research institutes</b>	<ul style="list-style-type: none"> <li>• ifo Institute for Economic Research (ifo)</li> <li>• Cologne Institute for Economic Research (IW)</li> <li>• Institute for the World Economy (IfW)</li> <li>• Rheinland-Westphalian Institute for Economic Research (RWI)</li> <li>• Halle Institute for Economic Research (IWH)</li> <li>• Centre for European Economic Research (ZEW)</li> </ul>	<ul style="list-style-type: none"> <li>• Institute for Macroeconomics and Economic Research (IMK)</li> <li>• Institute of Economic and Social Research (WSI)</li> <li>• German Institute for Economic Research (DIW)</li> </ul>

#### Further reading:

*Michael Dauderstadt (2009), Krisenzeiten: Was Schulden vermögen und was Vermögen schulden [What debt is capable of and what wealth owes? (Playing on ‚Vermögen und Schulden, assets and liabilities), Friedrich-Ebert-Stiftung, Bonn.*

## 2.3. Key Tasks and Challenges of Economic Policy Today

In order to be able to regulate and coordinate a market economy economic policy must answer two questions:

1. What are the rules of play in terms of which all actors in a market economy must orient themselves?
2. When and where should the state intervene in pursuit of its economic policy aims?

*Regulatory  
framework of the  
market economy*

The first question addresses the regulatory framework of the market economy and its individual sectors (agriculture, energy and so on). Economic policy within the regulatory framework of a market economy is thus termed in German *Ordnungspolitik*. This encompasses the definition of property rights, the drafting of contracts and employees' rights in the workplace. *Ordnungspolitik* in Germany also includes free collective bargaining and thus the drafting of contracts between employers and trade unions, as well as competition law, which, for example, prohibits mergers between over-large companies in order to ensure functioning competition without monopolies. **Ordnungspolitik** has a long-term orientation and is supposed to provide companies, consumers and employees with a reliable basis for their activities.

*State intervention  
and investment  
beyond the  
regulatory  
framework*

The second question goes beyond the establishment of the regulatory framework because economic developments such as the Energy Transition or the Industrial Revolution, as well as cyclical fluctuations require direct state intervention and investment on top of the economy's regulatory system. These economic policy interventions in a market economy's activities and development processes are termed '**process policy**'. The main policies for economic management are monetary policy and fiscal policy. Another example is the promotion of renewable energies with stipulated feed-in tariffs for green electricity. These are constantly adjusted and are supposed to expire after renewable energies are in place. Further examples of process policies are changes in government spending, permission for Sunday opening and ministerial authorisation in the public interest of a merger that the Competition Office prohibited under competition law. Process policy measures are usually short- to medium-term and related to discretionary (case-by-case) and not rule-based economic policy decisions.

Process policy intervenes in market processes because in such instances the state is clearly visible as an actor and actively influences market actors, for example, in a certain technological direction, such as renewable energies. Libertarian democracy, which is intent on ensuring negative civil rights and liberties – therefore on limiting the influence of the state – thus aims at minimising process policy measures. As far as they are concerned, *Ordnungspolitik* is the only legitimate economic policy. Social democrats, who are mindful of both negative and positive civil rights and liberties, thus make use of both *Ordnungspolitik* and process policy measures. This also stems from the fact that social democrats seek to balance three economic policy principles: growth, social equality and sustainability.

But what are the challenges facing economic policy today? It remains the case, as Eduard Bernstein put it, that »economic policy questions are always distribution questions, too, and thus value-based and never ideology- or interest-free«. Economic policy must, on one hand, take value-based decisions and on the other hand strike a balance between different interests. A particular problem facing our economic system today, but also our society, is undoubtedly social inequality (see Chapter 2.4.).

Another challenge concerns how economic policy should be shaped. Although the regulatory framework must constantly be adjusted to new developments, such as digitalisation, too disruptive reforms of *Ordnungspolitik* lead to uncertainty and make planning – for example, of investments or other decisions – more difficult. Process policy interventions, too, can lead to uncertainty and thus should be clearly explained, especially as regards the aims and phasing out of measures. Certain developments, however, require prompt policy responses and adjustments, which economic policy must be able to provide.

## 2.4. More Equality: Economically Warranted, Politically Necessary, Socially Just! \*

At first glance, Germany is doing well. Record employment, a balanced budget, modest but positive economic growth and all this despite international turmoil.

### *Inequality in Germany*

It must also be noted, however, that Germany is one of the countries in which social inequality has risen most. Depending on what data one uses, the richest 10 per cent of Germans own more than 50 per cent of net assets, while the lower half own only 1 per cent.

In comparison with the rest of Europe there is a particularly unequal distribution between very high and very low wages. Inequality in most cases also means inequality of opportunity. Social origin determines people's social participation and mobility options in Germany more than in virtually any other industrialised country. More and more people feel left behind and marginalised, while others fear social regression and all too many are turning away from democracy and the parliamentary system in disappointment.

### *Inequality and growth*

It was long believed that inequality was indispensable for growth. Now many economists believe the opposite. While the international debate has long been well under way, thanks to, among others Thomas Piketty (*Capital in the Twenty-First Century*) and the late British inequality researcher Anthony Atkinson (*Inequality. What Can Be Done?*), the German debate is only just getting off the ground.

Even so one still hears jeremiads against the dangers of egalitarianism in relation to combatting income inequalities and high wealth concentration. The neoclassical economic narrative that inequality generates economic growth via the 'trickle-down effect' was refuted long ago, but it still enraptures those in thrall to *Ordnungspolitik*.

In the meantime more than 80 per cent of Germans take the view that social differences in Germany are too great. Almost as many regard that as a threat to economic development. And the majority of more recent investigations warn

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\* Slightly modified extract from the volume *Gleichheit! Wirtschaftlich richtig, politisch notwendig, sozial gerecht* [Equality! Economically justified, politically urgent, socially just], edited by Jochen Dahm, Thomas Hartmann and Max Ostermayer. We thank Verlag J. H. W. Dietz Nachf., Bonn for their permission to publish it here.



against precisely that, in particular those by international organisations such as the OECD, the World Economic Forum and the IMF, who can hardly be reproached with being anti-capitalist.

According to them, high and increasing social inequality has a negative effect on poorer people's health care and educational opportunity. This diminishes Germany's pool of talent in a global knowledge economy based on the division of labour. What rich – and getting richer – households accumulate is increasingly channelled into international financial markets, while investment in Germany's real economy grows scarcer. This weakens aggregate demand and inhibits growth.

Since the French Revolution equality has established itself as one of the great political ideals. In the nineteenth century the labour movement emerged to fly the flag for legal and political equality, under the aegis of which they sought not only the emancipation of the workers, but also equal freedom for all. In the meantime a hard won, but strong consensus has come to prevail that legal and political equality are fundamental principles of democracy. And although equality is the basic norm underpinning questions of distribution, requiring no justification, the question of how much material inequality can be justified in terms of need and merit has always been a matter of political controversy.

As things stand today, it is evident that more equality in the economic and social spheres is the task of our time. What this means is the elimination of differences in social and economic life circumstances, not differences in terms of human attributes and inclinations: the focus is not 'egalitarianism' but the equal status of all.

*»Where unequal distribution divides society into people giving and people following instructions it infringes upon equal freedom and is thus unfair. Therefore justice requires equal distribution of income, property and power because major inequality in distribution jeopardises equal opportunities in life. That is why we need social democracy.« (Hamburg Programme 2007: 15)*

*Effects of social inequality*

*Equality in historical and contemporary context*

That also means that a democracy under capitalism must constantly be on guard against rising inequality; otherwise it puts itself in danger. The super-rich are able to convert their economic influence into political power and not only do those who find themselves left behind give up bothering to vote but public trust is eroded along with the very basis of community. But what can be done? How can society be prevented from drifting apart? What level of equality do we need to attain fairness? And how much inequality can our democracy cope with?

The book *Equality! Economically Justified, Politically Urgent, Socially Just*, published by JHW Dietz Verlag in Bonn looks at the causes and consequences of various forms of inequality and proposes concrete solutions based on its analyses. Its analysis and ideas and the possibilities it presents make stimulating reading.

Within the framework of the project 'Good Society – Social Democracy #2017plus' the Friedrich-Ebert-Stiftung, together with partners from academia, politics, the trade unions and civil society, has produced studies and hosted events in an effort to stimulate the German equality debate. A good society needs debates and exchanges – sometimes disagreements – about new ideas and tools.

But the direction of travel is clear: more equality is economically justified because inequality strangles sustainable economic growth. More equality is a matter of political urgency because many are turning away in frustration, attracted by allegedly simple political alternatives and because the prospect of oligarchy looms. And more equality is socially just because too much inequality curtails people's opportunities for participation and social mobility and their individual freedom.



This October, FES Connect, the first global digital newsletter of the Friedrich-Ebert-Stiftung in English turns two!

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*From Keynesianism  
in the 1970s to the  
Washington  
Consensus in the  
1990s*

## 2.5. New Visionaries: Towards a Pluralistic Economics

Which of the two theories is more influential? As already mentioned, between the global economic crisis in the 1920s and up into the 1970s Keynesian demand-side policy was dominant. In the 1970s, however, turbulence increased in the global economy, among other things because of the ending of the Bretton Woods system and two oil price shocks, in which OPEC states tightened production and raised the oil price dramatically. The result was a stagnating world economy and rising prices, in other words, inflation, due to the higher oil price and thus higher energy costs. It was the latter that caused Keynesian economic management to break down rather than a lack of demand. In this situation demand stimulation served only to boost inflation, paving the way for neoclassical economics to make a come back. From the 1980s onwards supply-side policy was revived by Ronald Reagan in the United States and Margaret Thatcher in the United Kingdom, while in Germany Helmut Kohl introduced a somewhat diluted version.

*German economists:  
mainly supply-side  
oriented*

The majority of German economists even today are rather inclined towards the supply side. This can be seen, for example, in the recommendations issued by the German Council of Economic Experts (whose members are known as the 'five wise men') in its annual report to the German government.

Within the framework of the debate on greater pluralism in economics students across the world have congregated in organisations such as the Network for Plural Economics in Germany. In discussion circles and at their own events they discuss various theories and economists from past and present in an effort to ensure that they do not become, as Keynes put it, the »slaves of ... defunct economist[s]«. In this spirit it is worth looking briefly at some other major economic thinkers.

### **Milton Friedman and the Monetarist Turn**

#### **Short biography:**

- 1912–2006
- Founder of the Chicago School as a counter model to Keynesianism
- Advised the Chilean dictator Augusto Pinochet and US president Ronald Reagan

### Quotations:

»We have a system that increasingly taxes work and subsidizes non-work.«

»The social responsibility of business is to increase its profits.«

In a period in which Keynes' ideas about the Great Depression and the economic tasks of the state still prevailed Milton Friedman developed a counter-model. As far as he was concerned the crisis of the 1930s was not the result of a failure of the financial markets but that of the monetary policy of the US Federal Reserve (the Fed). In the run-up to and during the crisis the Fed had permitted a major reduction in the money supply as many banks went to the wall instead of actively intervening to inject new money into the banks as lender of last resort (Friedman and Schwartz 1971).

Friedman criticised the prominence given to demand in Keynes' theory. He doubted that temporarily boosting government spending could increase consumption. Because people – as rational utility maximisers – must know that an economic stimulus programme would not raise their regular income over the long term they would refrain from consuming more. For Friedman, therefore, fiscal policy was not the right instrument for policies aimed at coping with economic fluctuations, but rather monetary policy, which he thought could be effective at least in the short term. Low interest rates could boost demand at least for the time being. The effect would be limited, however, because the higher demand would pull up the price level after a while. That means that over the long term monetary policy has no effect on growth but only on inflation, with rises in tandem with the higher money supply.

Friedman's pupil Robert Lucas even doubted the short-term effectiveness of monetary and fiscal policy. According to Lucas, people have 'rational expectations' about the future: market actors anticipated an increase in the money supply by raising prices. Furthermore, they see higher government spending as likely to lead to future tax increases and thus private consumption does not rise but falls. In his view monetary and fiscal policy cannot influence economic fluctuations or unemployment in either the short or the long term (Lucas 1972).<sup>8</sup> Friedman and Lucas were both awarded the Bank of Sweden's Nobel Memorial Prize for Economics.

*Friedman:  
Countering Keynes*

*Robert Lucas:  
ineffectiveness of  
monetary and  
fiscal policy*

<sup>8</sup> The assumption of rational expectations simplifies the development of mathematical economic models, but in macroeconomics adherents in particular of behavioural economics reject it.

Friedman derived an economic policy agenda from his monetarist theory that put the market centre-stage and marginalised the state as a disruptive element: fiscal policy should not engage in any economic management and monetary policy works, if at all, in the short term. From this standpoint state intervention in the economy, even if well-intentioned, is questionable. Friedman believed in the efficiency of the market and stressed the importance of tax cuts and deregulation to unleash market forces. Friedman also took a dim view of the welfare state.

His political agenda also came into vogue in the 1970s (see Chapter 2.3.) in the wake of the problems experienced by Keynesianism. Margaret Thatcher in the United Kingdom and Ronald Reagan in the United States implemented his political agenda in the same manner as the International Monetary Fund when granting crisis-hit states financial assistance. Friedman advised not only Reagan but also Chilean dictator Augusto Pinochet. The German Bundesbank, too, was not immune to his allure. The consequences of this policy can be discerned in the rising inequality, social problems and economic and financial crises that have plagued us since the 1980s. The ideas of Friedman and kindred thinkers are today increasingly being called into question in both academia and politics.

### **Friedrich August von Hayek and the State's Information Problem**

#### **Short biography:**

- 1899–1992
- An adversary of Keynes as professor at the London School of Economics in the 1930s and 1940s
- From 1962 professor at the University of Freiburg im Breisgau
- Most important representative of the Austrian school

#### **Quotations:**

*»The fact that in the market economic order there is much more knowledge of facts than any individual person or even any individual organisation can know is the decisive reason why the market economy performs better than any other form of economy.«*

*»The more the state plans, the more difficult planning becomes for the individual.«*

Although, like Friedman, Hayek ranks as a representative of economic liberalism he and his comrades in the Austrian school of economic theory criticised the focus of mainstream economics on mathematical equilibrium models, something they had in common with thinkers on the left. Hayek did not base his view of the superiority of the market on its efficiency or infallibility. In his opinion people are neither perfectly rational nor in possession of complete information. If complete information really was available, according to Hayek, the state would be able to match the efficiency of the market economy by means of central planning.

But it is precisely because of the fundamental information problems and imperfection of the market that Hayek declared the market economy to be the best way of ordering things in the face of scarce goods and resources. Knowledge and information for individual trading or for economic policy measures are to be found mainly locally, in the minds of actors in households and enterprises. The requisite knowledge only exists decentrally therefore, so that the best solution is for economic decision-making to be as decentralised as possible. This guarantees that as much relevant information as possible is made available to actors participating in economic transactions. Because, according to this view, knowledge is not available in concentrated form economic policy interventions in the market or attempts to plan an economy fully are condemned to fail from the very outset. A centrally planned economy is not in a position to procure and process information that only exists decentrally (Hayek 1945).

The upshot of Hayek's theory for economic policy is that the state must disengage from all economic processes and merely safeguard the functioning of the »spontaneous order« of the market by means of private property and legal enforcement of contracts by all economic actors (including the state). Contracts ensure the management of economic processes, which develop – spontaneously – by mutual consent in the context of ignorance of future events. Only tried and tested rules and institutions remain in existence. Others are discarded, so that in Hayek's conception of the market the spontaneous order manifests itself as an evolutionary process of further development and adaptation of contracts and institutions. Every attempt to replace this spontaneous order founders on the state's information problem and leads, through the relentless effort to procure information by means of surveillance and repression, to totalitarianism (Hayek 2014).

*The market economy as the best way of ordering things*

*Decentralised economic decision-making*

*The governance of economic processes and the subordinate role of the state*

The emphasis on the spontaneous order and the rejection of centrally imposed rules, whether in a dictatorship or a democracy, determine what Hayek understands by freedom. To him freedom means nothing more than not being subject to the constraints of the state (negative freedom). Positive civil rights and liberties, such as equal opportunities in education funded through taxation as a public good, are rejected as infringements of negative freedom. Furthermore, Hayek distinguishes between unfreedom as coercion by the state and power, which he defines positively as »the capacity to achieve what one wants« (Hayek 1991: 163).

If someone, because they lack education or capital, does not have the power to utilise the existing spontaneous order to their benefit that does not denote a lack of freedom, according to Hayek (on this see Butterwegge et al. 2007: 62–65). Hayek's one-sided view of freedom contradicts that of social democracy, which construes negative and positive rights and civil liberties on an equal footing.

### Hyman Minsky and the Instability of Apparently Stable Financial Markets

#### Short biography:

- 1919–1996
- Built on Keynes' work as a critic of neoclassical economics
- His work on financial markets began to receive much more attention in the wake of the financial crisis

#### Quotation:

*»Stability leads to instability. The more stable things become and the longer things are stable, the more unstable they will be when the crisis hits.«*

Hyman Minsky criticised the fact that in contemporary economic theory Keynes' ideas generally resurfaced only when markets returned to equilibrium but after some delay because of the 'stickiness' of prices. Along with Keynes he rejected the widely held hypothesis that markets – in particular, financial markets – are always efficient. On the contrary, Minsky emphasised that economic and financial crises should not be regarded simply as shocks, which strike the economic



system from outside, but as phenomena conjured up by the capitalist economic system itself (Minsky 1992).

Minsky refers to Keynes here, who understood that the capitalist monetary and banking system is a lot more than an instrument for facilitating trade. Financial markets rather enable the funding of transactions over a certain period of time: investment in a company is financed by means of credit in the present, while its profits will be realised only in the future, in which the debt incurred has to be repaid with accrued interest. Minsky goes one step further and explains that also states and even private households finance part of their spending or their consumption through credit.

From this core characteristic of modern financial capitalism Minsky derives its inherent proneness to crisis. In his view financial market actors are not necessarily rational, but can be swayed by 'sentiment'. The longer economic growth remains stable, the greater the trust in stability. But with that, market actors' willingness to take risks increases. Minsky illustrates all this on the example of buying a house. Normally, a mortgage agreement takes account of the fact that the borrower's income is high enough to enable them subsequently to repay the debt with accrued interest. If people – and especially bankers – are feeling particularly optimistic, however, then a loan on a house might be given on the condition that for the first few years the borrower will merely pay interest (if that). Both sides are speculating that the value of the house will continue to rise, so that while it is still under construction or thereafter it only has to be sold and the debt can be repaid, even at a profit.

With this Minsky anticipated the explanation of the financial crisis triggered by the collapse of the US housing market that began in 2007. A giant speculative bubble had formed that brought the international banking system to the brink of collapse. In the early 2000s the appetite for risk had also grown because no one expected a real crisis any more. In search of ever higher profits bigger and bigger risks were run and new securitisation and insurance instruments were developed with a view to making these higher risks more manageable. As long as house prices continued to grow the system could continue to function. When they began to fall, however, euphoria turned into panic. House prices plummeted and loans could no longer be repaid. Because many loans were traded in the financial markets all of a sudden not only the real estate market but the

*Modern financial capitalism's proneness to crisis*

*The financial crisis in the US real estate market that began in 2007*

international financial system as a whole was threatened by collapse through the insolvency of systemically important institutions.

Minsky's policy recommendations can be divided into short- and long-term measures. Over the long term regulation must be improved to prevent such exuberance and the incurring of excessive risk in financial markets. In the short term the state and the central bank must step in as lender of last resort in the event of an unfolding crisis. Because just as in the circumstances of market euphoria financial markets tend to lose control, so when crisis hits they can be plunged into dangerous panic, which can make the crisis much worse than it needed to be. It is likely that Minsky would have considered the guarantees and bank bailout packages adopted in response to the financial crisis as justified, whereas the US government's hesitation to save Lehman Brothers from insolvency only made a bad situation worse.

### **Elinor Ostrom's Solution to the Tragedy of the Commons** **Short biography:**

- 1932–2012
- Environmental economist
- Founded a research centre that has collected more than 1,000 case studies on the successful management of scarce goods at local level
- The first and, to date, the only woman to win the Nobel Memorial Prize for Economics

#### **Quotation:**

*»What we have ignored is what citizens can do and the importance of real involvement of the people versus just having somebody in Washington make a rule.«*

One of the main problems of economics is how to cope with goods that no one can be prevented from consuming, but which become depleted with increasing consumption. The tragedy of so-called 'common goods' can be found in a variety of forms in our world. A typical example is fishing. If everyone were to fish without restraint then fish stocks, which can be replenished only to a limited extent over the course of time, would soon run out. And because competing fishermen know that their catch diminishes if others catch more everyone

involved will try to catch as much fish as possible. The dilemma is that no one has an incentive to do anything to preserve the viability of the fish population by moderating their catch.

While conventional theories offer only two solutions – privatisation or nationalisation – Elinor Ostrom devised another alternative, based on her empirical work on cases in which such common goods were successfully preserved. It often happens that the local people involved are able to solve the problem of the commons in their own ways, without the state or the transfer of the common goods into private ownership. For example, lobster fishermen in the US state of Maine in the 1920s applied various rules and comprehensive monitoring of compliance in order to protect the endangered lobster stocks. For example, the fishermen marked pregnant females with a 'V' and released them again. The 'V' also made it possible for customers to detect freeriders, a simple and effective control mechanism (Stollorz 2011).

In Ostrom's view, it is important to understand that a general rule for all the different regions, cultures and common goods does not help. Local people know better what rules work best in dealing with common goods. Ostrom thus derived sensible design principles for such rules from her empirical research. One such principle is the need for clear **boundaries** to distinguish legitimate users, as well as the common goods themselves (for example, those of a sea) from their environment. Besides that, monitoring of rule compliance must also be ensured. **Graduated sanctions**, which start out fairly low for a first offence but become harsher for repeated infractions can help those concerned to get used to the new rules. This also enhances general acceptance of the system. Well thought out **conflict resolution** mechanisms help to regulate disputes between users or in relation to the relevant authorities. It is important that governments confer on local people the **right** to implement the rules they negotiate among one another. Because common goods are usually closely interlinked in socio-ecological systems a system of **polycentric governance** emerges that is not hierarchical, but whose institutions exist side by side and are negotiated on a mutual basis (Ostrom [1990] 1999).

Ostrom's research showed that decentralised agreement on rules for common goods is possible even for more than 1,000 participants. This is illustrated by the increasing volume of open source software on the internet in whose pro-

*Beyond privatisation  
and nationalisation:  
how to deal with  
common goods*

*Design principles for  
rules on dealing with  
common goods*

*Ostrom's research  
as guidelines for  
distributing  
refugees*

gramming many people participate voluntarily, coordinating it themselves. The current relevance of Elinor Ostrom's research is also shown by a proposal for the distribution of refugees in Europe that Gesine Schwan mooted in mid-2016. Instead of centrally negotiating allocation by quotas for the EU member states municipalities could decide locally whether they would be willing to take refugees and how many. Under the proposed scheme municipalities would receive financial aid from an EU fund in proportion to the number of refugees they took. Even in euro-sceptic countries such as Poland there are municipalities such as Wrocław that are willing to take some refugees. In this way the decision is taken locally; citizens are directly involved and decide specifically on their absorption capacity and how it would be organised. Thus angry citizens would be turned into real participants in local politics (Lobenstein 2016).

### **Paul Krugman – From a New Trade Theory to Combating Austerity Policy**

#### **Short biography:**

- Born in 1953
- Awarded the Nobel Memorial Prize for Economics for his new trade theory
- Known throughout the world for his tart commentaries in the New York Times

#### **Quotation:**

*»Now is the time for government to spend more, not less, until the private sector is ready to carry the economy forward again – yet job-destroying austerity policies have instead become the rule.«*

*Krugman's new  
trade theory*

Paul Krugman is well known as a passionate commentator on current developments in the global economy. Millions of people all over the world follow his articles because he knows how to explain complex economic theories in simple terms. In the academic world Krugman made a name for himself with his new trade theory.

Hitherto it was assumed that trade makes sense in particular between very different countries, because both countries can specialise. Krugman considers

this theory to be refuted by reality. In fact, trade takes place primarily between very similar countries, especially industrialised countries. They do not exchange very different but rather very similar goods and services. For example, Germany continues to export many cars to France and vice versa. Developing countries, by contrast, participate much less in world trade and generally undertake only very poorly paid, simple stages of production.

Krugman explains this structure of world trade in terms of the ratio between fixed costs and variable costs. Fixed costs, for example, include costs incurred for building and operating a factory. Variable costs arise, among other things, for purchasing raw materials that are then processed, for example, steel. The more of a product is produced the lower the often high fixed costs fall in relation to variable costs. Economists then talk of achieving economies of scale. This comes up against demand, however, which does not always want the same product but rather a diverse product landscape. These differing interests are brought into line by trade: supply gets access to global markets, which it can satisfy more cheaply through mass production, and demand obtains a wider variety through other foreign suppliers. And even though Krugman strongly supports boosting global trade, developing countries can conclude from his work that they can supply the world market cost effectively and competitively only by means of mass production. Young, recently established industrial companies find it difficult, however, to make any headway amidst tough international competition. Thus protectionist measures make sense for developing countries until internationally competitive firms can establish themselves (Rodrik 2011).

Since the 2000s Krugman has also publically advocated something of a revival of Keynesian ideas. For example, although he welcomes the economic stimulus packages implemented during the crisis from 2008 onwards in the United States and Europe, he criticised them for not going far enough (Krugman 2009 and 2012). In Europe Germany in particular continues to impose what Krugman considers devastating austerity policies on the southern European countries. He compares austerity policy with the Medieval practice of bloodletting and although particularly in Greece the situation has become progressively worse Germany and the Troika continued to insist on austerity (Krugman 2015).

Krugman rejects the thesis that the Euro crisis is a public debt crisis. Although this fits in the case of Greece it does not apply to Spain or Ireland, whose public

*The ratio between fixed costs and variable costs and the structure of world trade*

*The revival of Keynesian ideas*

*Krugman's assessment of the euro crisis*

debt was indeed continuously falling during the run-up to the crisis. Spain, for example, is suffering more from the bursting of the domestic real estate bubble and the EU-prescribed austerity policy is hindering urgently needed investment and sustainable recapitalisation of the banking system. Instead of this Krugman is calling for Europe to launch a comprehensive economic stimulus programme, which would give new hope to southern Europe in particular. Germany, furthermore, should reduce its trade surplus by boosting imports through wage increases and ramping up public investment. Krugman welcomes the measures taken by the ECB. As far as inflation is concerned he considers a temporary rise to 4 per cent instead of 2 per cent, to cut debt, as acceptable.

### **Mariana Mazzucato and the State as Entrepreneur**

#### **Short biography:**

- Born in 1968
- Professor of the Economics of Innovation and Public Value at University College London (UCL)
- Invited by Labour Party leader Jeremy Corbyn to join the party's economic advisory committee (2015–2016)
- Awarded the Friedrich-Ebert-Stiftung's Hans Matthöfer prize for economic writing in 2016 for her book *The Entrepreneurial State*

#### **Quotation:**

*»In order to tackle societal challenges such as climate change, youth unemployment, obesity, ageing and rising inequality the state must take the lead – not simply by correcting market failures, but by actively re-establishing markets.«<sup>9</sup>*

For a long time the dominant view in mainstream economics was that the state should not intervene in economic policy. When it comes to promoting innovation and new business models the market, it was claimed, is better than the state. Technology-specific support such as feed-in tariffs under the Renewable Energies Law for generating electricity from wind, sun, biomass, water or geothermal energy have been rejected, for example, by Germany's Council of Economic Advisors as distortion of competition (SVR Wirtschaft 2015: 323–327). Instead the state is merely supposed to conduct basic research and leave everything else to entrepreneurial activity in the market.

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<sup>9</sup> Freely translated from Mazzucato (2015).

Mariana Mazzucato refuses to accept this distorted view of the state. In her view the state has already played a key role in countless innovations, for example, by setting standards, funding research projects or direct investment. Mazzucato shows that the state has made decisive contributions to the development of the railways, electrification, the computer industry, the internet and environmental technologies. A particularly striking illustration of her thesis is provided by the role of the US government in the growth of Apple. She shows that over the years, apart from its innovative and extensive product lines, Apple has spent a very small portion of its turnover on research and development compared with other international ITC companies. Mazzucato shows that Apple has concentrated on integrating existing knowledge in new products. The most innovative iPhone technologies, such as battery technology or the acoustic control system Siri, can clearly be traced back to state research projects (Mazzucato 2014). Mazzucato does not neglect Steve Jobs and Apple's path-breaking ideas on integrating these technologies, but she emphasises that the company's runaway success requires not just individual initiative but also the right help and environment from society as a whole.

Mazzucato's book *The Entrepreneurial State* is a bestseller and has contributed to a rethinking of German and European economic and innovation policy (Mazzucato 2014). This is because the state will be required to play an active entrepreneurial role also in the future in order to achieve innovative economic growth, but also to cope with societal challenges such as climate change and ambitious CO<sub>2</sub> reduction targets. Mazzucato regards it as not just unavoidable but necessary that the state back specific technologies and companies because companies left to their own devices will not tackle societal challenges or pursue new, innovative but also risky technologies. She attributes this to the private sector's risk aversion: venture capitalists or large companies generally invest in a new technology only after the state has already wagered on a particular technology and taken on the risks itself.

Based on the state's central role in innovation processes Mazzucato demands a much greater role for politics and administration in shaping the economy. If the state is restricted to correcting market failures new ideas will be nipped in the bud that would otherwise have actively stimulated new, innovative economic developments. Instead of outsourcing entrepreneurial thinking the government and administration should develop such competences itself. Only a smarter state can make the most of its own entrepreneurial qualities.

*The state as  
economic actor*

*The future  
entrepreneurial  
role of the state*

*A more prominent  
guiding role for  
politics and the  
administration*

## Thomas Piketty and Capitalism's Inherent Inequality

### Short biography:

- Born in 1971
- Worldwide bestseller with his long book *Capital in the Twenty-First Century*, awarded the Friedrich-Ebert-Stiftung's 'Das politische Buch' prize in 2015

### Quotation:

*»My premise is not to tax to destroy the wealth of the wealthy, it's to increase the wealth of the bottom and the middle class.«*

Thomas Piketty stirred up considerable academic and public controversy with his research on the inequality inherent in capitalism over the past 200 years. His contribution is based on the gathering and analysis of data on the development of incomes and wealth in the Western industrialised countries. In contrast to most studies on distribution his database does not comprise household survey data but official income and wealth tax statistics. On top of that Piketty takes up questions that economists often sidestep on the distribution of incomes and wealth.

Piketty himself summarises his main argument as follows: »When capital profit is permanently higher than the growth rate for production and income, which was the case up to the 19th century and threatens to become the rule again, capitalism automatically produces unacceptable and arbitrary inequalities that radically put in question the achievement principle on which our democratic societies are based« (Piketty 2014: 13–14).

Piketty emphasises that, empirically, capitalism has always led to increasing concentration of income and wealth. With the exception of the two world wars, in which this dynamic was disrupted because of the widespread destruction of wealth, and a period thereafter – les trente glorieuses – in which high incomes and wealth were very highly taxed, capitalism has a tendency to increasingly concentrate prosperity in fewer and fewer hands.

He identifies this dynamic from the data, which show that economic growth – in other words, the added wealth produced in a year – flows more strongly to the owners of capital and profit incomes than to wage earners. Piketty does not

*The consequences of capitalism call the performance principle into question*

*Concentration of wealth in the hands of a few is inherent in capitalism*



attribute this tendency to a conspiracy on the part of the rich elite to expropriate income illegitimately. Rather this development is inherent in the very workings of capitalism, which over the years only becomes more entrenched. If in the course of this development the owners of capital and profit incomes save a considerable amount of their earnings in the following year they will accrue an even higher share of economic growth. And because this increasing income enables them to save yet more, the wealth of the wealthy continues to grow. By contrast, poorer households gain nothing from this self-reinforcing process.

In this central tendency of capitalism towards inequality Piketty sees a danger that it is simply incapable of distributing income and wealth fairly if left to its own devices. Instead he sees the development towards a society in which unearned inheritances determine who will belong to the rich. He also believes that increasing inequality endangers social cohesion and the functioning of democracy. Piketty remains deliberately abstract in his policy recommendations because first and foremost he wants to stimulate debate. Although he advocates a global wealth tax and top rate taxes of 80 per cent on the highest earners he considers that such a reform is not politically feasible.

The inequality researcher Anthony Atkinson built on some of Piketty's ideas in his 2016 book on inequality, but also argued that the significance of the influence of rich elites on policymaking must be taken into account. Although he regards redistribution through the tax system as important he emphasises that society must also exert influence over primary incomes obtained in the market and accordingly take measures to correct inequality in the market through additional means. Atkinson also recommends a progressive inheritance tax and the provision of a kind of social inheritance to be made available to everyone as a kind of starting capital on attaining their legal majority. With his creative and detailed proposals on overcoming inequality Atkinson provides possible answers to the questions that Piketty has thrown up with his empirical inequality analysis (Atkinson 2016).

*The dangers of  
increasing inequality*

*Atkinson's  
development  
of Piketty*

### 3. ECONOMIC SYSTEMS AND ECONOMIC ORDERS

#### In this chapter

- the relationship between capitalism and democracy is discussed, which, on one hand, is strained and, on the other hand, is mutually supportive;
- different types of capitalism are described that differ in terms of their degree of coordination;
- the term 'social market economy' is explained;
- the positive effects and dark side of globalisation are presented from the standpoint of social democracy.

#### 3.1. Capitalism and Democracy

*Does 'super-capitalism' destroy democracy?*

*Historically intertwined: democracy and capitalism*



»Does supercapitalism disrupt democracy?« asked the economic magazine *Manager Magazin* on its title page in March 2008 alongside a picture of a locust. The topic of the article was the fundamental tension between democracy and capitalism.

First of all it is important to point out that many democratisation processes have gone hand in hand with the emergence of free markets. In eighteenth and nineteenth century Europe at first the call for individual freedom was linked to an economy based on free competition and private property. This was accompanied by a desire for legal certainty and binding fundamental rights and civil liberties, as well as a demand for political participation and representation of citizens in the state. The independence of the United States of America was heralded by a call for »No taxation without representation«; in other words, by the claim that economic and political participation belong together. After 1989 economic liberalisation and democratisation also went hand in hand in the post-communist states.

## The relationship between market and state

Often the state is allotted the task of maintaining law and order. On this account it is supposed to define the rules of play for the market economy and ensure compliance. John Maynard Keynes categorised the relationship between market and state quite differently: »The important thing for government is not to do things which individuals are doing already, and to do them a little better or a little worse; but to do those things which at present are not done at all.« (Keynes 2011 [1926]: 47)

From Keynes' standpoint the activities of the market and the state should not be mutually exclusive but complement one another because the market will not take on every function in a modern economy. On one hand, the state assumes the provision of so-called public goods, such as defence of the realm, street lighting and fundamental research. Also crucial here is the fact that, as Mariana Mazzucato has found (Mazzucato 2014) the market is unwilling to invest in potentially innovative but risky technologies that may promote growth. On the other hand, the market mechanism is blind to the social or environmental challenges now facing national economies.

Public goods are goods to which everyone should have free access and whose use by those who do not pay is difficult to prevent. Because no profit incentive attaches to providing such goods the state has to take on the task and finance it through taxation. Most economists recognise that the state is key to the provision of public goods. The scope of its responsibility is a matter for debate, however.

For a long time it was not up for question whether democratic states were fundamentally more successful economically than non-democratic systems. In the meantime, however, it has become plain that there are also states that are by no means democratic but which nevertheless have enjoyed high economic growth in a capitalist economic system. The most familiar example of this is China, which has developed economically since it was transformed into a capitalist country at the end of the 1970s but without being democratised in the process. There are a number of other states in which economic liberalisation has not gone in tandem with political liberalisation (yet?). This is evidenced by, among other things, the annual Economic Freedom of the World index, in which economic and political freedom is measured. In 2014 Hong Kong and Singapore ranked in the top two places for economic freedom (cf. Gwartney et al. 2016).

*Are democratic states economically more successful?*

It should be kept in mind that there are states with authoritarian and non-democratic capitalist systems. On the other hand, all existing democratic states hitherto have been based on a market economy.

*Tension between  
capitalism and  
democracy*

Naturally the relationship between democracy and capitalism is fraught with tension. Democracy is based on equality: »one person, one vote«. Capitalism, on the other hand, goes hand in hand with inequality.

*Inequality can lead  
to 'defective  
democracies'*

As a result of inequality powerful economic actors can assume such a powerful veto position that a 'defective democracy' emerges. Political scientist Wolfgang Merkel defines it as follows:

*»Defective democracies are systems of governance characterised by the presence of a largely functioning democratic electoral system for regulating access to government, but which, as a result of disruption of one the functional logic of one or more of the other partial regimes lose the complementary supports that are essential in a functioning democracy for safeguarding freedom, equality and control.« (Merkel et al. 2003: 66)*

*Disruptive factors  
for democracy*

This means that elections are held and other elements of democracy are present, but that disruptive factors undermine them. This is the case, for example, when an actor is economically so powerful in a particular society that he can exercise a veto over collective decisions. One might imagine, for instance, an investor who is able to blackmail a country with relocation, threatening to withdraw capital in order to obtain political concessions such as reductions in environmental or labour standards. Such a system cannot be described as real democracy, only formal democracy.

*Crouch:  
'Postdemocracy'*

Colin Crouch describes this situation in his book *Post-Democracy*. He sees three problems for democracy which he derives from a capitalism that has grown too mighty: »In a world in which, on one hand, capital flows are global and on the other hand the two main actors in democracy – governments and citizens – act at the national level, multinational companies have the opportunity to elude the sovereignty of the nation-state [and the democracy that goes with it]« (Crouch 2008b: 4).<sup>10</sup> Besides the globalisation of capitalism, which is not regulated by a democratically legitimised authority, the increasing social inequality generated by capitalism obstructs the functioning of democracy. The political voice

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<sup>10</sup> On the macroeconomic effects of increasing inequality in Germany see Albig et al. (2016).

of socially vulnerable groups, often in precarious employment in the service sector, becomes ever weaker, not least because they feel abandoned and thus turn away from politics. Large companies as well as prosperous citizens, having the requisite resources, find it much easier to organise and thus exert a decisive influence on the political system. From these two problems of multinational companies and underrepresentation of some social groups Crouch infers a third problem for democracy: because the political class identifies more and more strongly with corporate interests their links to the general population become more tenuous (Crouch 2008a).

In the Social Democracy Reader *The Foundations of Social Democracy* (pp. 76–80) the tensions between democracy and market capitalism are presented on the basis of Thomas Meyer's *Theory of Social Democracy*.

Figure 4 depicts the paradox of democracy. On one hand, capitalism is a precondition of democracy, while on the other, an insufficiently regulated market can create conditions that foster social exclusion, resulting in defective democracy.

*Paradox of  
democracy*

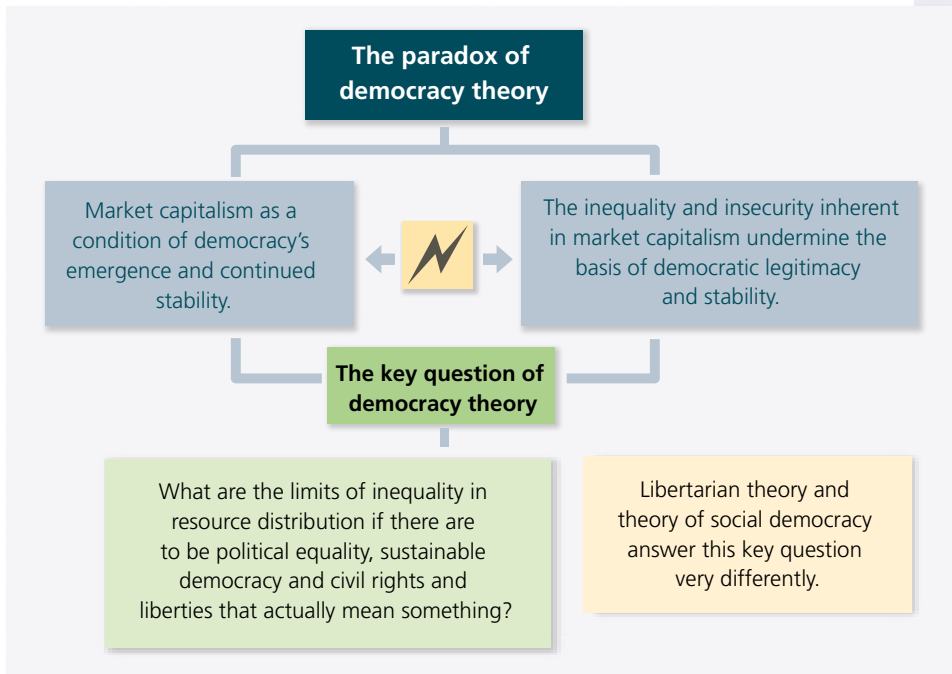


Figure 4: *The paradox of democracy theory*

*Milton Friedman:  
market economy  
leads to democracy*

It is this distinction and its awareness of the risks capitalism poses to democracy that differentiates social democracy from libertarian democracy. Libertarian economists such as Milton Friedman claim that the market economy also leads to political freedom and democracy.

Criticism of capitalism has always been a hallmark of the political left, although since the 1920s there has been no question of breaking with capitalism along Marxist lines.

It came to be recognised, thanks to the efforts of such foresighted thinkers as Rudolf Hilferding and Eduard Bernstein, that a lot can be done to improve it.

*Capitalism must  
be scrutinised*

In recent years criticism of capitalism has not featured much on the political agenda. But the future of social democracy will depend on its ability to scrutinise capitalism and draw the right conclusions.

There can be no radical systemic change. A coordinated capitalist economy is the only kind able to provide a functioning democracy together with a stable economic order that takes account of social justice. Rather we have to take a closer look at its shortcomings to come up with appropriate reform options.

*'Decent  
capitalism'*

What an 'improved capitalism' might look like is presented in the book *Decent Capitalism: A Blueprint for Reforming Our Economies* by Sebastian Dullien, Christian Kellermann and Hansjörg Herr (Dullien et al. 2009). If markets are properly regulated a dynamic economic model can be fostered that benefits all.

*Corneo's criticisms  
of capitalism:  
capitalism is  
wasteful, unfair and  
alienating*

In his book *A Better World* economist Giacomo Corneo (2014) asks »is capitalism over?« He levels three criticisms that fundamentally call capitalism into question, already elaborated by Marx in his critique of capitalism:

### **1. Capitalism is wasteful**

Capitalism is profligate with resources. On one hand, unemployment and idle production plants are eloquent testimony to the fact that capitalism has been unable to mobilise all available resources wisely for the sake of progress. On the other hand, it is extremely wasteful with natural resources, as can clearly be seen in the overexploitation of forests and fish stocks. Although global agricultural production makes it possible to feed everyone on earth

many people still die of starvation while in the industrialised countries obesity has become a major public health concern. The constant drive for growth and profits, on one hand, and for the latest products, on the other, have also conjured into being a mode of production aimed relentlessly at new purchases rather than the long-term use of consumer goods. Why growth is needed and of what kind are secondary considerations in capitalism, for which the accumulation of profits and growth are all that really count. Ever more accelerated innovation cycles for the sake of short-term profits also come at the expense of the quality of individual goods, and as if that were not enough in the dominant mode of consumption purchase decisions are determined more by prestige (advertising) than by the actual use value of an appliance.

## **2. Capitalism is unfair**

Capitalism does not distribute resources or generated wealth in accordance with needs and deserts, but in accordance with purchasing and market power. The scale of inequality both between the global north and south and between rich and poor households is grotesque. Inheritance gives rise to whole dynasties that simply pass on their wealth from generation to generation and are able to live from capital gains and interest. The inequality researcher Thomas Piketty has laid this on the line in no uncertain terms. For him and many others this state of affairs flies in the face of justice.

## **3. Capitalism is alienating**

The striving for more and more income is inherent in capitalism as its fundamental action orientation. This focus on competition and increasing material wealth results in man's alienation from his work, his consumption and political participation. The striving for efficiency in the workplace thwarts the development of social skills. Furthermore, the main aim in commercial occupations is to sell products to consumers as all costs, regardless of whether they actually need them. At the same time, consumption itself leads to alienation for some. The compulsion to acquire the latest products of the coolest brands is generated, on one hand, by the desire to earn more and more and on the other, to display the trappings of success through one's consumption. Sociologist Herbert Marcuse coined the term 'repressive satisfaction of needs' in this context. Needs are conjured up by marketing and competitive consumption at the expense of real use value. Finally, poorer and

socially vulnerable people feel increasingly excluded from society. They are alienated from society and thus also from democracy by their lack of material security as well as by the status differences that consumption fosters.

### *The theories of neoliberalism*

Capitalism as a system influences human behaviour through the underlying economic theories of neoliberalism. These theories are based on the assumption that people always act rationally in pursuit of their own interests. This is what is meant in economics by so-called 'homo oeconomicus'. Former editor of the *Frankfurter Allgemeine Zeitung*, Frank Schirrmacher, points out in his book *EGO. Das Spiel des Lebens* (Ego. The game of life) that there is no necessity for people to be like this but rather theory and the capitalist system built on top of it compel us to engage in self-interested action: anyone who does not play by the rules of capitalism will suffer for it. He writes »But the problem is that theory does not just describe behaviour, but compels it; it is not just descriptive but prescriptive. It doesn't just postulate egoists, it creates them. The rationality that it proudly lays claim to does not come about of its own accord. When there is no other choice it compels the players to see reason. In its terms, the insight that it can be in one's own interest to renounce making the highest profit (or victory) can arise only from fear of punishment, not from any moral code« (Schirrmacher 2013: 68). That fear plays a role in the capitalist economy is clear from the fact that economic decisions are generally made out of fear of losing something in the face of cutthroat competition.

A multitude of reforms have been instigated in an effort to mitigate these three key points of criticism. Environmental regulation attempts to set limits on capitalism in order to ensure ecological sustainability, while social standards and labour rights are supposed to make competition fairer and more tolerable, ameliorating its inherent stresses and strains. Inequality is supposed to be moderated through the tax system and public spending.

### *The idea of an unconditional basic income*

But more radical proposals have also been put forward. For example, many people from very different parts of the political spectrum and diverse interest groups are strongly backing the idea of an unconditional basic income. According to some of its supporters, financed with a substantial increase in taxation it could be paid to all citizens, with a view to replacing all existing social benefits. Some critics, however, regard this as flying in the face of key labour incentives. The Social Democracy Reader *The Welfare State and Social Democracy* provides an overview of this debate (pp. 106 and 107).<sup>11</sup>

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11 <http://library.fes.de/pdf-files/akademie/10932.pdf>.



Another proposal concerns inequality, which is ratcheted up by the constant passing on of wealth. Anthony Atkinson, for example, proposed that inheritances should be distributed more evenly. This could be ensured, for example, by a kind of minimum inheritance from the age of 18. Young people could use it to get their lives under way, perhaps to further their education, or even to start a new business. Such a minimum inheritance could be funded with higher inheritance and wealth taxes (Atkinson 2016). That would be easier said than done, however. One response to a very high inheritance tax might be for people to take measures to reduce bequests. It might be possible to tackle such tax avoidance by means of a wealth tax, but again it would not be easy, as shown by the abandonment of a wealth tax in Germany in response to a ruling by the Federal Constitutional Court.

Corneo (2014: 214–277), again, envisages targeted reform of company law to realise the socialist goal of the widest possible distribution of social returns or profits by market economic means. He advances the market socialist idea of fostering a market economy without capitalists, in which profits are socialised and thus can be distributed more fairly.

For a more detailed presentation of Corneo's proposed regulations see Corneo (2014: 259–277). This model of stock market socialism is highly complex and would require a fundamental reorganisation of company law and the transition to the proposed new system would be fraught with legal obstacles. Nevertheless the idea does offer another interesting contribution to the debate on alternatives to current capitalism, by means of which the allegations of wastefulness, injustice and alienation could be overcome or at least ameliorated.

### **What does this mean for social democracy?**

- The emergence of capitalism and democracy are closely intertwined.
- Capitalism leads to inequalities that can undermine democracy. Social democracy must find answers to this.
- Criticism of capitalism is necessary for the formulation of the required improvements and the development and debate of alternative policies. On the other hand, no alternative economic system has yet emerged that is compatible with fundamental democratic principles. For the foreseeable future therefore there can be no question of doing away with capitalism.

## 3.2. Coordinated and Uncoordinated Capitalism

### *Uncoordinated and coordinated capitalism*

In Chapter 2 of this volume ideal-types of economic system were presented taking off from the economists Adam Smith, Karl Marx and John Maynard Keynes. In the real world there are numerous mixed models. Peter A. Hall and David Soskice (2001) have identified two models in the Western industrialised countries that they call uncoordinated and coordinated capitalism in their book *Varieties of Capitalism*. This approach has considerable explanatory power for the analysis and evaluation of economic systems.

### **Differences between economic systems along the following dimensions:**

- financial system
- labour relations
- education and training system
- relations between companies

### **Uncoordinated capitalism**

Liberal, uncoordinated capitalism is categorised within this framework as follows:

- Financial system: companies are financed largely through the capital market (shares). In recent decades that has meant that companies operate in accordance with the so-called 'shareholder value principle'.<sup>12</sup> On this basis capital owners are willing to invest even in risky ventures, speculating on the prospect of rapid returns.
- Labour relations: employment relations are rather short-term ('hire and fire') and employment protection is weak, not least because the aim is short-term profits. Wages tend to be negotiated at individual or company level. Employer organisations and trade unions are relatively weak.
- Education and training system: this tends to produce generalists. That means that education and training predominantly turn out general, not occupational qualifications. This facilitates mobility between different occupations in the labour market but also a lack of job-specific expertise.
- Relations between companies: there are few company networks (for example, when companies have seats on one another's supervisory boards) and little long-term inter-company cooperation (for example, on research). Sectoral associations are rather lobbyists for their companies and not actors with a societal responsibility.

### *Financial system*

### *Labour relations*

### *Education and training system*

### *Relations between companies*

<sup>12</sup> The focus of the shareholder value principle is to achieve the highest possible profit for shareholders and a rising share price. The stakeholder principle, by contrast, takes into account the interests of other participants, such as the employees, cooperating companies and even societal groups in how a company is run.

This system can adjust to market changes flexibly and rapidly. That means that this production model favours innovative industries, but is also more unstable and uncertain for employees.

## Coordinated Capitalism

Coordinated capitalism is characterised as follows:

- Financial system: as a rule financing takes place by means of bank loans. This is more 'patient' capital than is the case under the shareholder value model and facilitates long-term investments. This form of company financing, however, may impede capital access for market actors that have not yet established themselves, such as company start-ups. Management is also supervised, evaluated and influenced by actors other than the market, such as banks, employees and state authorities (stakeholder model).
- Labour relations: wages are negotiated at sectoral level (sectoral collective agreements) instead of individually at company level. Employment relations tend to be more long term. Stability and social justice are interlinked. There are well-organised employer organisations and trade unions, as well as company codetermination.
- Education and training system: the training model links firm-specific to sector-wide qualifications and is sustained by the peak-level organisations of both the employees and the employers (dual training system). This makes it possible to impart both firm- and sector-specific expertise.
- Relations between companies: there are multiple linkages between companies through cross-holdings of shares. Sectoral organisations play an important role in the political system.

Coordinated capitalism is characterised by high stability, but also less dynamism and flexibility than uncoordinated capitalism. In this system product lines and processes change continually and in fine detail. Innovation tends to take place in small steps. The system cannot adjust to new problems rapidly.

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*Financial system*

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*Labour relations*

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*Education and  
training system*

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*Relations between  
companies*

Both systems have specific advantages and disadvantages. In terms of performance and competitiveness neither model is fundamentally superior to the other. The difference is illuminating for two reasons:

*Analytical level*

1. Analytically: the model can explain why different production models take shape. The Anglo-Saxon countries, with their flexible labour markets and easy access to risk capital, favour new industries, for example, in IT. No wonder therefore that newly founded IT firms such as Facebook, Google, Microsoft, Amazon and a whole series of start-ups emerged in the United States.<sup>13</sup> Countries with coordinated capitalism, such as Sweden and Germany, have highly competitive industries, such as in the automobile sector and the machine sector. The kind of goods produced in such sectors have very long lead times because of the high capital investment. In these industries not fundamental innovations, but rather constant improvements are sought. These factors favour locations where well trained employees are available who tend to remain loyal to their employer and there is access to 'patient' capital. The German car industry comes easily to mind.

*Normative level*

2. The models differ from a normative standpoint. The values of social democracy are realised rather in countries with coordinated capitalism. Longer term employment relations offer employees more security than a 'hire-and-fire' labour market. Similarly, companies that invest over the long term and are not driven primarily by short-term expectations concerning returns foster a more stable world of work.

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<sup>13</sup> Mazzucato (2015) has shown, however, that Apple and other IT giants owe part of their success to state research and the conditions created by the state in Silicon Valley (see Chapter 2).

**Social Market Economy** As regards the German variant of coordinated capitalism, the 'social market economy' or, alluding to the former seat of government of the Federal Republic of Germany (Bonn), 'Rhine capitalism' established itself during the post-War period. The social market economy was a reaction to the social upheavals of industrialisation, on one hand, and the horrors of the Nazi dictatorship, on the other. It attempts to strike a third way between unfettered capitalism and a centrally planned economy.

The economist Alfred Müller-Armack had a decisive influence on this approach, as he explained in his 1947 book *Wirtschaftslenkung und Marktwirtschaft* (Economic management and market economy):

*»We can call this third form of economic policy a social market economy. This means ... we consider the market economy to be essential as a supporting framework of the future economic order, although this should not be a liberal market economy, left to its own devices, but a purposefully managed – and indeed socially managed – market economy.«* (Müller-Armack 1947: 88)

That meant real competition, free pricing and private ownership of the means of production, on one hand, and social justice by means of social insurance and progressive taxation, on the other. The role of the state was not determined precisely. In the early years of the Federal Republic market intervention was limited, for example, in order to prevent monopolies. From the 1970s influence over the economy was extended, among other things through economic management.

Rhine capitalism became respected throughout the world because it managed to reconcile economic and employment growth with an expanding welfare state. Other European countries also sought to emulate this model.

Ludwig Erhard's promise of »prosperity for all« was certainly not kept for everyone because, among other things, with the oil crises of the 1970s and German reunification new social problems emerged, in particular on the labour market. It was possible to create a broad middle class, however, which decisively stabilised the young democracy.

The popularity of the idea has in the meantime led to a certain arbitrariness. The social market economy is these days invoked across the political spectrum, but with considerable variation as regards the balance between social policy, regulation and the market economy. For example, the DGB's basic programme characterises the social market economy as a 'major historical advance'. On the other hand, the employers' association Gesamtmetall has set up an organisation called the 'New Social Market Economy Initiative'.

## 4. ECONOMIC POLICY ORIENTATIONS OF SOCIAL DEMOCRACY

*Christian Krell, Carsten Schwäbe, Simon Vaut*

### **In this chapter**

- the values of social democracy – freedom, justice and solidarity – are presented, along with their associated fundamental rights;
- the economic-policy principles of social democracy – a dynamic economy, social justice and sustainability – are extrapolated from them;
- ideas on future growth are discussed.

In order to clarify the economic-policy principles of social democracy first of all we take a broader look, beyond the narrower confines of economic policy proper, at the values in terms of which social democrats look at society as a whole. After all, policy design must always keep society as a whole in view, even when the particular focus is on specific domains, such as economic and social policy.

### 4.1. Fundamental Rights and Values of Social Democracy

*Freedom, justice  
and solidarity*

Freedom, justice and sustainability, these are the core values of social democracy. Social democrats are striving for a society in which these values are realised. These basic values have equal rank and are mutually dependent, as well as both supporting and imposing limitations on one another.

The basic values of social democracy are described, derived and illustrated in detail in the Reader *Foundations of Social Democracy*.

In the present volume therefore we shall look at them more briefly:

- Freedom means leading a self-determined life. First and foremost this means freedom from arbitrary inference from the state or society. Real freedom can be achieved, however, only if economic and social conditions have been created in which people are able to exercise their freedom.

*Freedom: a self-  
determined life*

- Justice is grounded in the equal dignity of all people and requires not only equality before the law, but equal opportunities for social participation and social security, regardless of family background, social origin, wealth or gender.
- Solidarity is people's willingness to step up for one another and to help one another. Social Democrat Johannes Rau described solidarity as the cement that holds society together.

Although in principle all shades of political opinion are committed to these fundamental rights it would be wrong to assume there is a cross-party consensus in relation to freedom, justice and solidarity. The different parties have very different views of what they mean.

## 1. Understanding of individual basic values

The individual basic values can indeed be interpreted in very different ways. Not everyone understands freedom in the same way, for example. Classical liberals (in contrast to how this word is currently used in the United States), for example, emphasise the so-called negative civil rights and freedoms, namely defensive rights against state despotism and protecting private property. Social democrats go further and stress that real freedom requires not only defensive rights but also positive enabling civil rights and freedoms. Real freedom from a social democratic perspective would mean, for example with regard to freedom of expression, that it is not enough to codify such freedom in the statute books; beyond that, everyone must be in a position, by means of education and so on, to make effective use of their right to freedom of expression.

## 2. The relationship between fundamental rights

The interpretation not only of individual rights but also of their relations to one another is extremely important. It makes a considerable difference whether the basic rights have equal status or more importance is ascribed to one basic right than to another. This can be illustrated in terms of classical political liberalism: in the classical liberal understanding of the basic values freedom represents the core value. More importance thus tends to be attributed to freedom of competition, for example, or freedom of property than to the value of justice, which can curtail freedom of property. Social democracy does not weigh the basic values differently; it emphasises that they all have equal status.

*Justice: participation and security*

*Solidarity: stepping up for one another*

*Historical roots*

*Different interpretations of basic values*

**Further reading:**  
*Reader 1, Foundations of Social Democracy (2014), Bonn, 4<sup>th</sup> revised edition, pp. 15 ff.*

*Different weightings of basic values*

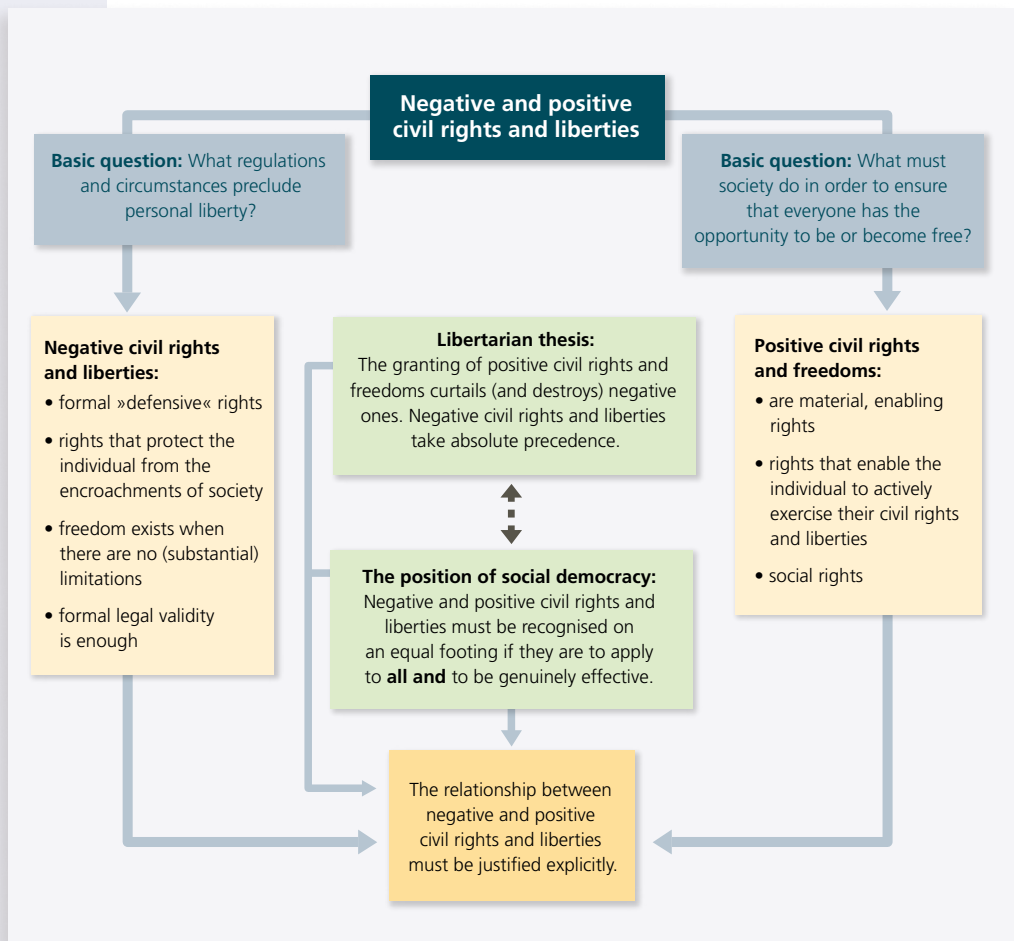


Figure 5: Negative and positive civil rights and liberties

Different shades of political opinion, but also different cultures thus associate different things with the basic values. There is therefore no broad and generally accepted basis for a particular economic-policy orientation. That is also because of the basic values' high level of abstraction.

1966: two  
UN covenants

Reference point:  
UN human rights  
covenants

Economic-policy orientations must be described in specific terms. Precise and concrete guidance cannot be supplied by the basic values alone. The political scientist Thomas Meyer therefore proposes that social democracy should be based not only on basic values, but also on basic rights. As a central point of reference for a theory of social democracy Meyer therefore adduces the funda-



mental rights laid down in the United Nations (UN) human rights covenants of 1966 (see Chapter 3 of the Reader *Foundations of Social Democracy*).

The Covenant on Civil and Political Rights (Civil Covenant) designates primarily the so-called negative civil rights and freedoms, that is, defensive rights against arbitrary encroachment by the state or society on personal freedoms. This includes, for example, the right to personal freedom and security (Article 9) or the right to untrammelled freedom of opinion (Article 19), as well as free and secret ballots (Article 29).

The Covenant on Economic, Social and Cultural Rights (Social Covenant) designates primarily the so-called positive rights and civil liberties, in other words, enabling rights that are supposed to enable the freedom of the individual through measures taken by the state and society. They include, for example, the right to work (Article 6), as well as fair, safe and healthy working conditions (Article 7), the right to organise in free trade unions (Article 8), the right to social security (Article 9) and the right to free education and higher education (Article 13).

The Civil Covenant has now been ratified by 168 states and the Social Covenant by 164 states worldwide. Some caution is justified, however, because they have also been signed by states that systematically violate fundamental civil rights and liberties. It is evident that the formal validity of the UN Covenants is not enough to realise the »ideal of free human beings enjoying freedom from fear and want«. There is often a gulf between legal entitlement and legal implementation. In any case, the rights in the Social Covenant impose no obligation on states regarding their immediate implementation but only their gradual realisation. It is the aim of social democrats to implement this political, civil, social economic and cultural basic rights laid down in the Covenants universally, so that they are not merely formal but have real effect.

But can positive and negative human rights and civil liberties be weighed against one another? Are they really equally important? Or does one have precedence over others? Oskar Lafontaine instigated a debate on this when in an interview he raised the question of what use freedom of expression was to AIDS sufferers in Africa (Der Tagesspiegel, 15 August 2008). Do civil rights and liberties mainly benefit the well-off, who are able to express their views through the media? Does someone so poor they can't even afford to buy a newspaper really benefit

### *1. UN Civil Covenant*

### *2. UN Social Covenant*

*Often a gulf between legal entitlement and implementation of UN covenants*

*Cross-cultural and cross-national*

*Can civil rights and liberties be weighed against one another?*

from freedom of the press? Nobel Prize-winning Indian economist Amartya Sen came to the conclusion that »there has never been a famine in a democratic country with free media« (Sen 1999). In other words, the basis for famines is usually distribution problems in the sense of inadequate access to the available food. A government that has to answer to its citizens and wants to be re-elected cannot afford to ignore social ills, especially if there is a free media to publicise them. Freedom, according to Sen, thus also leads to social justice. Sen believes that state and society must lay the foundations for personal responsibility as regards both action and freedom. Freedom only has meaning if there is a minimum level of social security and public services, for example, health care and education.

*Negative and positive basic rights depend on one another*

*Willy Brandt:  
»Freedom from want and fear«*

Fundamental civic and social rights, positive and negative civil rights and liberties thus depend on one another and cannot be played off against one another. Willy Brandt also emphasised this connection in his farewell speech as party leader: »If I had to say what is more important than anything else besides peace I would say, with no ifs or buts, freedom. Freedom for the many, not just for the few. Freedom of conscience and of opinion. Also freedom from want and fear« (Brandt 1987: 32). Important for Brandt therefore were, on one hand, freedom from arbitrary action and oppression and thus the negative civil rights and liberties, but also, on the other hand, freedom to enjoy a materially secure life and thus the positive civil rights and liberties. This clear commitment to the global realisation of basic rights distinguishes social democracy from libertarian democracy.

*Different models of democracy ...*

*... with common roots*

### **Social Democracy and Libertarian Democracy**

Social democracy and libertarian democracy are first of all theoretical ideal-types that can scarcely be found in reality (see Chapter 3.2. of the Reader *Foundations of Social Democracy*). But it is important to develop a clear view of these different models of democracy to be able to establish where they stand.

They differ considerably with regard to the relationship between positive and negative civil rights and liberties. Libertarian democracy starts out from the position that granting positive civil rights and liberties curtails negative civil rights and liberties and can even vitiate them. Social democracy, by contrast, assumes that negative and positive civil rights and liberties must be regarded as having equal status if they are to apply to all and have real effects.

Purely formal application of civil rights and liberties, as libertarian democracy proposes, is not enough from the standpoint of social democracy because economic inequalities can lead to:

- relationships of dependence and subordination,
- degrading employment relations and
- unequal opportunities to exercise civil rights (cf. Meyer 2005b: 15).

From a libertarian standpoint it is more than sufficient if the state does nothing to restrict freedom of expression, for example, by refraining from censoring the press. From the viewpoint of social democracy, however, the state must go much further and actively foster real and equal opportunities for the expression of opinions. This includes equal access for all to information and education, which people need to be able to form an opinion in the first place. On top of that, the property rights of those who own the mass media should not be such as to enable them to use their media power to establish a one-sided monopoly of opinion. Such abuse would violate the social obligations of property ownership, which is an important hallmark of social democracy. From a libertarian standpoint such intervention in freedom of ownership is inconceivable.

Despite their common roots social democracy and libertarian democracy are based on different assumptions that lead to very different goals in terms of economic order.

Key differences are evident, for example, in their respective understandings of the market. Libertarian democracy views markets as an expression of freedom and thus strives towards a self-regulating market. Social democracy, by contrast, emphasises that entirely free markets can lead to undesired consequences for society as a whole. The financial crisis of 2008 exemplifies this. Social democrats thus call for the social embedding of markets by means of a politically defined framework and state regulation.

It is clear that although social democracy and libertarian democracy, viewed historically, have similar reference points in classical liberal democracy they are quite distinct from one another, especially from an economic-policy standpoint.

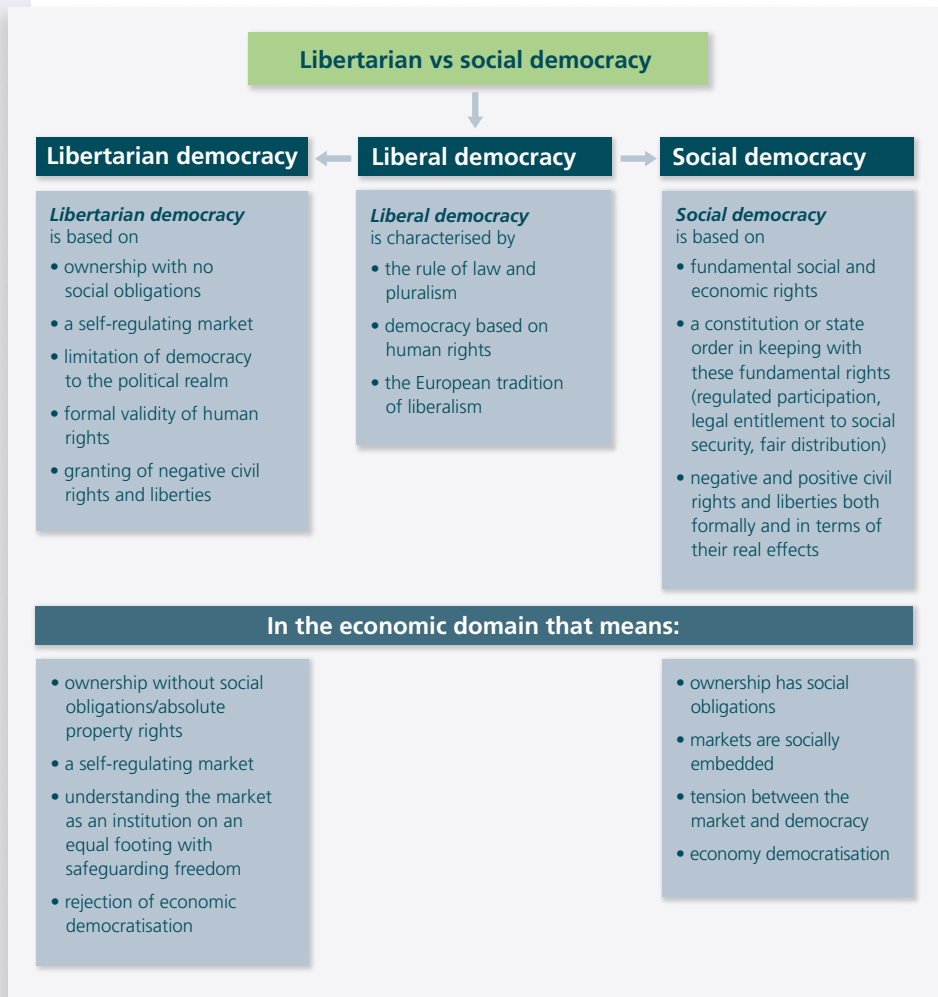
*Mere formal validity  
not enough for civil  
rights and liberties*

*Example: freedom  
of expression*

*Diverse goals*

*Social and  
libertarian  
democracy*

*Markets must be  
socially embedded*



*Figure 6: Classical liberal, libertarian and social democracy in comparison  
(also in the economic domain)*

The social democratic conception of the market also finds expression in the SPD's Hamburg Programme:

*» In our view, markets are a necessary form of economic coordination and superior to others. Untrammelled markets, however, are blind to social and environmental concerns and unable by themselves to provide public goods in sufficient quantities. To enable markets to realise their positive potential they need rules, a state with the power to apply sanctions, effective laws and fair prices.«*  
(Hamburg Programme 2007: 17)

## 4.2. Economic Policy Principles

What do the basic values and fundamental rights of social democracy mean for its economic policy in concrete terms?

Our assumption is that social democratic policymaking, if it wants to realise its basic values and render the fundamental rights to which it subscribes really effective, must take its bearings from three principles:

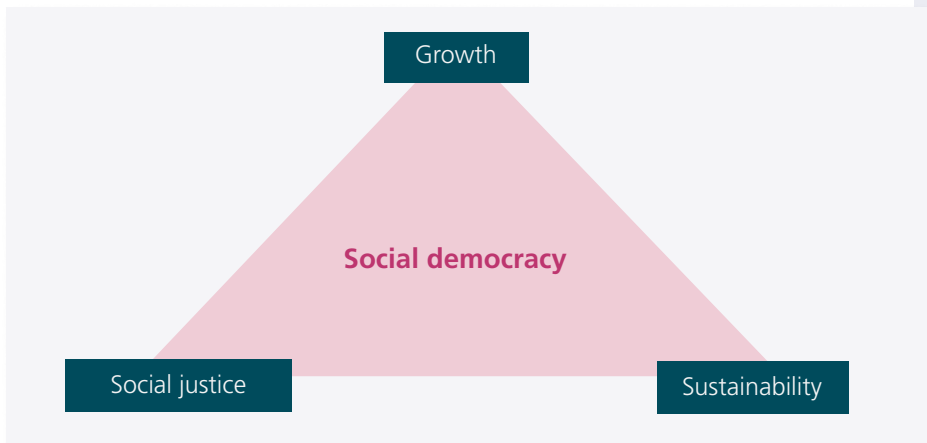
- growth
- social justice
- sustainability

From the standpoint of social democracy economic policy has to put these three principles on an equal footing. This distinguishes social democracy from conservative, libertarian and left-wing populist approaches that tend to concentrate on only one of these principles. Only if these principles are considered to be of equal status is public interest-oriented progress possible.

Every economic-policy measure can be assessed in terms of whether it takes equal account of these principles. These principles are therefore an evaluation benchmark for a social democratic economic policy.

*Three principles*

*Growth, social  
justice and  
sustainability*



*Figure 7: Triangle of social democratic economic-policy principles*

## Growth

*UN Social Covenant:*

*»Freedom from fear  
and want«*

»People«, according to the UN Covenants, should live »free from fear and want«. Specifically, the goal is described as »steady economic, social and cultural development and full and productive employment«. Freedom from want necessarily presupposes basic material security. Gross national product must be sufficient to ensure a minimum level of prosperity so that everyone can exercise their fundamental right to individual development. This applies, on one hand, to everyone's individual prosperity and on the other to the prosperity of society as a whole by providing sufficient resources for publicly defined tasks.

*A society based on  
freedom, justice and  
solidarity conditional  
on a minimum level  
of growth*

A free and fair society based on solidarity thus requires prosperity. This prosperity must be realised and secured by means of economic growth, which means that high productivity is indispensable for a healthy economy. Historically, we can see that economies with constant growth have been able to distribute the social product more equitably. Growth is therefore a prerequisite for realising the values and goals of social democracy described above.

*How should growth  
be defined?*

But what is growth exactly? In recent decades social democrats have changed their views on what constitutes the right kind of growth.

**Economic growth:** Growth means an increase in GDP in comparison with the previous year. GDP as a measure of wealth corresponds to the sum of the value of all the new goods and services produced by an economy. While nominal GDP is not adjusted for prices, real GDP takes inflation into account. This is because it is possible that, although less was produced and thus real growth was negative, nevertheless nominal GDP increased because prices rose more steeply.

*1967, Stability and  
Growth Act: »steady  
and adequate  
growth«*

Under the aegis of Social Democratic Economic and Finance Minister Karl Schiller »steady and adequate economic growth« was embedded as a key policy goal in Germany's Stability and Growth Act of 1967. Furthermore, economic growth, low unemployment, low inflation and balanced trade were laid down as the goals of economic policy in the so-called 'magic square'. Very much in the spirit of Keynes the state is therefore supposed to tackle economic fluctuations and avoid recessions.

Furthermore, both the Basic Law and social democracy stipulate that equal living standards should be brought into being throughout Germany. This means that we should not be satisfied with strong economic development in individual regions, but rather all regions should be developed and benefit from dynamic economies.

### Growth in the Hamburg Programme

*»Wealth and high quality of life have always been priorities in the Social Democrats' economic policy. In the past progress was mainly understood in terms of quantitative growth. Nowadays we are forced by rapid climate change, overstrain of the eco systems and growth of the world population to give development a new future-oriented direction to turn development into progress. We want sustained progress by combining economic dynamism, social justice and ecological responsibility. This requires qualitative growth in combination with reduced consumption of resources. People shall have a chance to earn their own living by decent work without fearing exploitation. Every person shall receive a fair share of wealth creation. We want to safeguard the natural foundations of life also for future generations.«*  
(Hamburg Programme 2007: 42)

For social democrats, for example, structural change away from coal-generated energy in the Ruhr and in the Lausitz region represents a particular challenge that must be met by means of a regionally-specific structural policy. Similarly the very different levels of economic development in Europe represent a major problem for social democracy.

The effects of growth on the environment and on the earth's natural resources were first demonstrated in a study published in 1972 by the Club of Rome, entitled

*1972, 'The Limits of Growth': critique of growth orientation*

*The Limits to Growth*. In no uncertain terms it raised the question of whether we should really be striving for growth and whether it can be maintained permanently.

Since that time the debate on our understanding of growth has become increasingly intense. The euphoria about growth that characterised the 1960s was followed by a more critical attitude from the 1970s onwards. In the meantime a differentiated view has developed, using a qualitative conception of growth that, among other things, is supposed to foster social progress while reducing resource consumption (see Chapter 4.3.). This nuanced approach makes it possible to balance growth with sustainability and social justice.

*Nuanced conception of growth*

### Social Justice

Social justice is necessary as an economic-policy principle to ensure fundamental social rights so that people are better able to exercise those rights. At the same time, social justice also makes sense from an economic standpoint.

*UN Social Covenant:  
»adequate  
livelihood«*

Anyone who takes social democracy's basic values and fundamental rights seriously must aim at an economic policy imbued with social justice. The UN Covenants, for example, demand an »adequate standard of living«. Furthermore, women are supposed to be »guaranteed conditions of work not inferior to those enjoyed by men« and receive »equal pay for equal work«. »Adequate food, clothing and housing« are also demanded, together with »the right of everyone to education« so that »full development of the human personality« is ensured.

### **Social justice in the Hamburg Programme**

*»There is no fair distribution of income and property in Germany. The Social Democrats' tax policy shall limit imbalances and promote equal opportunities. We support wage increases oriented towards productivity growth and inflation. We want to put more capital into the hands of the workforce. Participation of workers in corporate capital as an additional source of income grants the workforce fairer participation in their company's success. It also promotes innovation and productivity.« (Hamburg Programme 2007: 43f.)*

*Economic growth  
as a condition for a  
materially secure life  
in dignity*

The aim of social democracy is a society in which everyone is guaranteed material circumstances that enable them a dignified existence and the ability to participate in social and democratic life regardless of their economic success in the market. Economic growth is thus not an aim in itself for social democracy, but rather a necessary condition, which must also take account of social equity and justice. The gains of a dynamic and productive economy must be distributed fairly. Only in this way can it be ensured that people are able to earn their living through decent work free from fears about their livelihoods and receive a fair share of an increasing gross national income.

*Social justice  
anchored in the  
Basic Law*

In Germany social justice in the economic order is also stipulated in Article 19 of the Basic Law, which defines Germany as a social federal state. Furthermore, Article 14 establishes the social obligations of ownership: »ownership carries with it an obligation. Its exercise should also serve the welfare of the general public«.

*Social obligations of  
property: examples*

The owners of residential housing, for example, should not use it as a speculative asset but keep it in good condition and rent it out. Managers are responsible not only for shareholders' dividends but also to society, for example, by maintaining jobs and protecting the environment. Anyone who receives a particularly large



share of social wealth owes a proportionate obligation to society. The social obligations of property are a characteristic feature of social democracy.

But doesn't social justice contradict the merit principle of the market economy? Doesn't social justice obstruct the incentives that are so important for a dynamic economy and for growth? These questions point to a very real tension between an orientation towards growth and social justice.

But there is also a converse relationship. The development of productivity and growth cannot do without a social foundation. Value creation requires a minimum level of social justice. Better income distribution stabilises demand. The economist Dani Rodrik has shown that states that ensure a high level of social security have generally been successful economically. This is due, among other things, to the fact that social security increases people's motivation. People on a solid social footing are more ready and willing to adjust to change, undertake risk and embrace the new (cf. Rodrik 1997: 178ff).

There is a fairly strong consensus on this state of affairs. Even Hans-Werner Sinn, former head of the IFO Institute for Economic Research emphasised that »[solidarity] gives young people the security and the self-confidence they need to make use of risky but promising opportunities in life. To that extent I am not convinced that the widespread prejudice that the welfare state will cost us dear is true. On the contrary, I consider it perfectly possible that it is precisely that that has unleashed a large proportion of the productive forces that were responsible for the economic boom in the post-war period« (Sinn 1986: 566–77).

Furthermore, inequality leads to concrete socio-political problems. Wilkinson and Pickett look at this in their book *The Spirit Level: Why More Equal Societies Almost Always Do Better*. They note that health and educational problems and crime tend to be much worse in unequal societies than in societies with a more equal distribution of income and wealth (Wilkinson/Pickett 2016).

Social democracy thus seeks a balance between growth and social justice. One example of this is the Swedish model. As the countries presented in Chapter 5 show, high social equality is one of the reasons for Sweden's considerable economic success.

*Contradiction  
between social  
justice and the  
merit principle?*

*Rodrik: wealth  
creation requires  
social justice!*

*Even critics admit  
that the welfare  
state boosts  
productivity*

*Balance between a  
growth orientation  
and social justice*

## Sustainability

Sustainability is the third key principle of social democratic economic policy. It has an ecological, an economic and a social dimension.

*The origins of  
the concept of  
'sustainability'  
lie in forestry*

Generally speaking, sustainability is associated primarily with environmental issues. Indeed, the first reflections on sustainability arose from ecological considerations. The term 'sustainability' originated in forestry: in the eighteenth century forestry expert Georg Ludwig Hartig asserted that only so much wood should be taken from a forest as would be able to grow back again. Today, environmental sustainability means that the environment should be kept intact as the basis of life for succeeding generations. Resource and species conservation, climate protection and limiting environmental impact are crucial aspects of this. The fundamental rights contained in the UN Social Covenant, with its reference to the »improvement of all aspects of environmental ... hygiene« (Article 12), also emphasise that the natural basis of life for all must be protected. This is not only because otherwise future generations would be deprived of fundamental conditions of life, but also because people are dependent on clean drinking water and air in the here and now.

Social democrats have long pointed to the importance of sustainability:

*1972: Gustav Heine-  
mann's notion of  
sustainability*

*»We have to pose the question of whether the earth will find itself in a disastrous state if the population explosion continues and humanity continues to exploit finite natural resources at an accelerating rate, as it seems set to do. For the sake of our children's and grandchildren's futures all of us must be prepared to call a halt and if necessary to make sacrifices.« (Gustav Heinemann, 1972)*

*1983: Brundtland  
Commission*

In 1983 this idea was taken up in the report produced by the Brundtland Commission set up by the United Nations under former prime minister of Norway Gro Harlem Brundtland:

*»Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.« (cited in Hauff 1987: 46)*

The concept of sustainability also has an economic dimension, however. This is emphasised in the concluding report published in 1998 by a commission of enquiry set up by the German Bundestag on »The concept of sustainability – from guiding principle to implementation«. Economic sustainability means that the creation of wealth must be possible for future generations, too, if the social market economy is to be maintained. To that end public spending, especially on the welfare state, must be properly financed and there must be long-term investment in education, research and infrastructure.

The importance of economic sustainability is particularly clear in light of the global financial market crisis. A purely short-term orientation towards yield with no thought to sustainability endangers not only individual companies but whole national economies.

*Economic dimension  
of sustainability*

*Warning example*

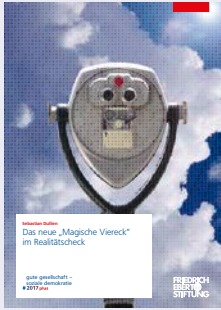
*Hamburg  
Programme:  
»sustainability  
means: thinking  
from the standpoint  
of the future«*

### **Sustainability in the SPD's Hamburg Programme**

*»The principle of sustainability means: thinking in terms of the future, resisting both the primacy of short-termism and the dominance of economic considerations and the logic of business management. It means conceiving of politics in terms of society and understanding democratic variety, environmental durability, social integration and cultural participation as guiding principles of social democratic policy.«*

(Hamburg Programme 2007: 17f.)

Sustainability also has a social dimension: social sustainability means that all members of society enjoy permanent participation in society and permanent amelioration of social tensions. This entails the sustainable safeguarding of basic needs and social participation.



*Dullien, Sebastian  
(2015): 'The new  
»Magic Square«,  
Friedrich-Ebert-  
Stiftung working  
paper within the  
framework of the  
project 'Good  
society – social  
democracy  
#2017 plus'.*

## FROM THE OLD TO THE NEW 'MAGIC SQUARE' OF ECONOMIC POLICY

Against the background of the first major economic crisis of the post-war era then Minister of Economic Affairs Karl Schiller (SPD) pushed through the Stability and Growth Act that joined certain economic policy instruments with the goals of the 'magic square' (adequate and steady economic growth, a high level of employment, stable prices and balanced trade). This macroeconomic objective still applies to economic and finance policy today. Moreover, further challenges have arisen, such as climate change, demographic change and digitalisation, that will exert a decisive influence on the economies of tomorrow and demand political solutions.

How should economic policy goals be determined in future and their achievement measured? One proposal by Dullien and Van Treeck (2012) links the magic square to the following priorities:

- **Material prosperity and economic sustainability**

The indicators pertaining to this objective measure an economy's performance and consistency. Gross domestic product is the key indicator, although it has to be adjusted not only for inflation but also for population and number of hours worked. In this way wealth creation per capita is calculated and its ratio to hours of work input. Besides employment and consumer spending this priority also factors in a balanced current account, in other words, imports and exports more or less on a par. Balanced trade is supposed to prevent permanent trade deficits but also surpluses, which put other countries into persistent trade deficits.

- **Sustainability of state activities and state finances**

Besides a balanced budget this includes the reduction of existing debts because Germany, like other European countries, is obligated under the Maastricht Treaty to keep the government debt ratio below 60 per cent of GDP. Sustainability of government activities also means, however, maintaining investment at the level required to keep public infrastructure in good condition (for example, as regards transport: roads and railway tracks; as regards education: schools and universities).

- **Social sustainability**

Indicators derived from equality and happiness research measuring social progress should be appended to the objectives of economic policy. The at-risk-of-poverty rate measures the proportion of the population left with below 60 per cent of the median income after transfers.<sup>14</sup> The income quintile ratio measures how much more the richest 20 per cent earn in relation to the poorest 20 per cent. Besides poverty and distribution this objective also includes educational success, by – ideally – reducing the number of school leavers not in further education or training to zero.

- **Environmental sustainability**

This also factors in the reduction targets for CO<sub>2</sub> emissions and a resource-conserving economy and lifestyles by measuring primary energy consumption and the proportion of renewable energy. This last indicator reflects the progress made with regard to the energy transition, which in Germany is enshrined in law.

If new challenges arise in individual areas, especially in relation to social and environmental sustainability, further indicators can be introduced. By using consistent annual measurements and laying down specific targets we can reliably assess the extent to which an economy is living up to its democratically determined goals. Monitoring of this kind helps economic policy to rapidly correct undesirable developments.

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14 Median income is the income level that divides the richer half of the population in an economy from the poorer half. The at-risk-of-poverty rate therefore measures relative poverty and not absolute poverty, for example, on the basis of the subsistence minimum. Relative poverty means that participation in society is much more difficult on such a comparatively low income. According to the OECD the average net disposable household income in Germany was around 27,000 euros in 2015.

## 4.3. How Much Growth Is Enough?

### Qualitative Growth and Post-Growth Economics

*Are the three principles in mutual tension?*

Growth, social justice and sustainability are mutually dependent, but they also stand in tension with one another, which has to be negotiated. Willy Brandt took up this point as early as 1973 in relation to the principles of growth and sustainability:

*Willy Brandt on the relationship between growth and sustainability*

*»Neither the individual nor society can live at the expense of nature. In that way the development of our environment will run counter to human well-being. ... Noise, air and water pollution in fact call into question the benefits of economic growth. Nevertheless, I would warn against taking the intellectual short-cut of seeking the way out in, for example, a general reduction of growth and productivity. It is much more a matter of the where, how and to what purpose of economic growth – and of understanding that growth and economic principles must be in the service of humanity. If ›circumstances‹ are not to rule over us, but we want to rule over them we must give the matter more thought and, at least once in a while, work a bit harder.« (Willy Brandt, inaugural speech, 18 January 1973)*

*Key questions: growth: where, how and what for?*

Brandt is pointing to the fact that fostering economic growth cannot be unconditional and that serious thought has to be given to where, how and for what purpose there should be growth. Whom should it benefit and who should profit from it? For social democracy therefore growth cannot be pursued blindly but with a focus on quality, taking into account social justice and sustainability on an equal footing.

*Sustainability can foster growth – example: environmental industrial policy (Chapter 7)*

After serious reflection, as Brandt advocated, it rapidly becomes evident that although the three principles are prone to tension they are also dependent on and can foster one another. It is already clear that a dynamic economy is conditional on social justice. Even environmental sustainability can drive growth. In Germany today the sectors dealing with renewable energies are among the main growth drivers of the economy and provide a considerable number of jobs.

As a measure of economic progress, however, gross domestic product (GDP) has many blind spots. From the standpoint of social democracy the picture that emerges from focusing on GDP alone is incomplete, describing only the sheer volume of production. But that leaves the following questions unanswered:

- How is the domestic product that has been generated distributed? Is this distribution fair? Is a minority able to corner the bulk of resources? What criteria are used for distribution? Need, performance or social stratum?
- How environmentally friendly is production? Are resources invested in environmental protection? Or is growth obtained through the overexploitation of nature?
- How is growth generated and where do the gains go? Is it obtained by means of consumer and public debt? Or is there sufficient investment in infrastructure, education and research so that long-term growth is possible?
- How are non-monetary contributions factored in? Is GDP growing merely because people are working more? If voluntary work or work within the family are converted into paid work why does GDP grow even though in fact the level of production remains the same? What is the size of the black or underground economy?

To answer these questions a more complex conception of economic advance, as well as a more differentiated understanding of growth are needed, going well beyond how much an economy produces in total. Many attempts have been

made to complement GDP with other indicators. This includes the 'magic square', which among other things looks at the distribution of created wealth and sustainability (see Chapter 4.2.). Since 2016 the United Nations has also set development goals that, in contrast to the Millennium Development Goals, were not defined only for developing countries, but also aspire to measure eco-

### **'Qualitative Growth' in the SPD's Hamburg Programme**

*»We are working for sustainable progress, combining economic dynamism, social justice and environmental common sense. By means of qualitative growth we wish to overcome poverty and exploitation, make possible prosperity and decent work for all and do something about looming climate change. It is important also to safeguard the natural bases of life for future generations and to improve the quality of life. To that end we wish to put the possibilities opened up by scientific and technological progress in the service of humanity.«*  
(Hamburg Programme 2007: 5)

nomic, social and ecological progress in all the countries of the world. The 17 Sustainable Development Goals provide a comprehensive picture of what should be understood to constitute prosperity and progress and the kind of indicators that should be used to measure them.

**Further reading:**

Michael Dauder-  
städt et al. (2015),  
Globalisation and  
Social Democracy.  
Social Democracy  
Reader 7, Bonn.

## 17 SUSTAINABLE DEVELOPMENT GOALS



End poverty everywhere and in all its forms.



End hunger, achieve food security and better nourishment and promote sustainable agriculture.



Ensure a healthy life for everyone at all ages and foster their well-being.



Ensure inclusive, fair and high-quality education and foster opportunities for lifelong learning for all.



Achieve gender equality and self-determination for all women and girls.



Ensure the availability and sustainable management of water and sanitation for all.



Ensure access to affordable, reliable, sustainable and up-to-date energy for all.



Ensure permanent, inclusive and sustainable economic growth, productive full employment and dignified work for all.



Build resilient infrastructure, promote inclusive and sustainable industrialisation and support innovations.



	Reduce inequalities both within and between states.
	Make cities and communities inclusive, safe, resilient and sustainable.
	Provide for sustainable patterns of consumption and production.
	Take comprehensive measures to combat climate change and its effects.
	Maintain oceans, seas and marine resources under the aegis of sustainable development and use them sustainably.
	Protect and restore land ecosystems and promote their sustainable use, manage forests sustainably, combat desertification, halt and reverse land degradation and stem the loss of biodiversity.
	Foster peaceful and inclusive societies on the basis of sustainable development, enable access to justice for all and establish effective, accountable and inclusive institutions at all levels.
	Strengthen means of implementation and revitalise global partnership for sustainable development.

*Figure 8: Goals and indicators of the UN Sustainable Development Goals*

*Source: United Nations (2016), The Sustainable Development Goals Report 2016, New York.*

The Sustainable Development Goals thus not only encompass indicators to measure economic progress but are also oriented towards social development in the world, in particular with regard to wealth distribution, gender equality and inclusion.<sup>15</sup>

<sup>15</sup> Germany's Ministry for Economic Cooperation and Development provides a comprehensive presentation and analysis of the 17 Sustainable Development Goals on its website (in German) at: [http://www.bmz.de/de/ministerium/ziele/2030\\_agenda/17\\_ziele/index.html](http://www.bmz.de/de/ministerium/ziele/2030_agenda/17_ziele/index.html).

*Post-growth  
strategy: further  
growth is not  
desirable*

*Measures entailed  
by a post-growth  
strategy*

*Social democracy:  
growth and sustain-  
ability need not be  
contradictory*

## **From the Limits of Growth to the Post-growth Economy?**

While growth is indispensable to overcome poverty in developing and emerging countries, in the industrialised economies the question arises of where the limits of growth lie and whether further growth is necessary at all. The object of criticism of advocates of a post-growth strategy is not only, as in the case of the Club of Rome in its Report *The Limits of Growth*, that environmental sustainability is not compatible with relentless growth, but also that continuing growth is no longer desirable. On one hand, after a certain point further income growth is no longer accompanied by increased well-being, and on the other hand, continuous growth could even bring negative social effects in its wake. In response, the post-growth strategy proposes a range of measures:<sup>16</sup>

- People should 'declutter' their lives, renouncing all activities and consumption that bring few or no benefits (sufficiency strategy).
- Dependence on 'monetarily based external supplies of resources' is rejected. Instead consumption and production should be as close as possible to one another, doing as much for oneself as possible. Key skills for greater self-sufficiency should therefore be revived.
- Instead of a national and international division of labour across regions and continents value creation chains should be completely tied to certain regions.
- Instead of buying things new the focus should be on repair and prolonging the lifespan of goods already in use.

These proposals would be politically difficult to implement, especially as regards regionalisation. Furthermore, the dogmatic insistence on a supposed antithesis between growth and sustainability or social progress is questionable to say the least. From a social democratic standpoint there does not have to be a contradiction between growth targets, on one hand, and sustainability and less-alienating consumption, on the other. Rather 'social growth' should be linked to specific conditions that change the conventional growth path in such a way that growth is compatible with sustainability and social feasibility (Ecke/Petzold 2011: 14–18). This by no means excludes a critical approach to growth, but it does call for more nuance.

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<sup>16</sup> The concept of post-growth, among other things, is dealt with at:  
<http://www.postwachstumsoekonomie.de/material/grundzuege/>.

## 4.4. Assessment of Party Platforms in accordance with the Goals of Social Democracy

In the preceding chapters various economic-policy orientations have been described, above all the difference between coordinated and uncoordinated market economies and the three main aims of social democratic economic policy, namely growth, sustainability and social justice.

In this section we shall briefly compare the basic programmes of the six national political parties currently represented in Germany's Bundestag.

- The **CDU** stands for a **coordinated market economy at a lower level** than today. Echoes of economic liberal ideas are combined with individualist enterprise. Collective forms of codetermination and governance tend to be rejected outright or at least diminished or flexibilised.
- The programme of the **FDP** represents an **uncoordinated and (classical) liberal market economy**.
- The **AfD** also stands for very **economic liberal positions**. Having said that, its programme is **very vague** as regards economic policy.
- **Bündnis 90/The Greens** adhere to a **coordinated market economy** with a view to restructuring it in the direction of a 'solar society'. There are also borrowings from liberal ideas, civil society elements and collective governance elements. Overall the party's programme is the longest, but it is not clear what sort of coordinated economy they have in mind.
- **The Left** (*Die Linke*) is strongly committed to economic regulation and calls for a state that will protect the individual. To some extent it falls outside the spectrum envisaged here: Die Linke aims to transform the current economic system fundamentally.
- The **SPD** is clearly committed to a **coordinated market economy** and its expansion. The general thrust of this broadening is to specify civil rights and liberties as laid down in the UN Covenants. The need to adjust corporate governance is also taken up, especially in the areas of sustainability, the internationalisation of financial markets and the flexibilisation of economic processes and the social safeguards that this entails.

*Political party  
economic-policy  
orientations*

**A detailed comparison of the party programmes is available online at:**

► [www.fes-soziale-demokratie.de/Lesebuecher/Mehrlesen.html](http://www.fes-soziale-demokratie.de/Lesebuecher/Mehrlesen.html)

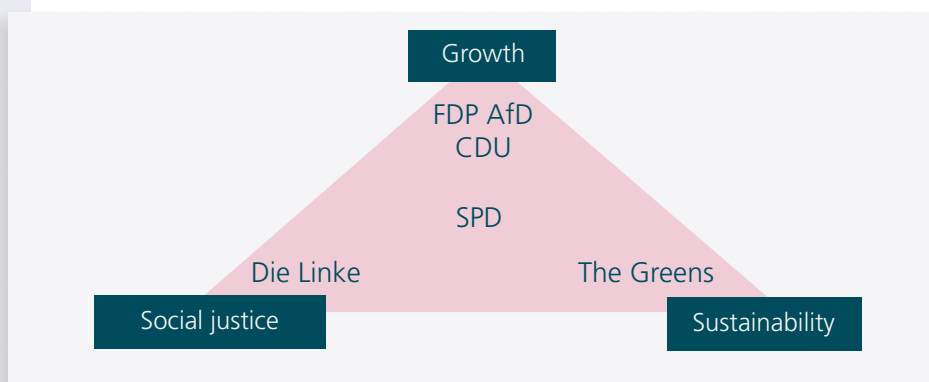
On this basis, the parties can be situated as follows with regard to the three economic policy goals mentioned above.

The CDU and the FDP clearly have an affinity with growth and indeed tend to subordinate the other goals to it. They are sceptical regarding the notion of 'social justice' or even reject it outright.

Insofar as it is possible to tell, given the extreme vagueness of the AfD's programme, its main economic goal would probably be growth.

Bündnis 90/The Greens, with their notion of the 'solar restructuring' of the social and ecological market economy, take their bearings from the goal of ecological sustainability. They support the goal of 'social justice' but the goal of 'qualitative growth' is rather low on their agenda.

Die Linke is clearly oriented towards the goal of 'social justice', while the SPD has a balanced approach to all three goals, which it regards as being on an equal footing.



*Figure 9: Schematic presentation of the parties in accordance with their main economic policy preferences*

*Parties; economic and social competences have to be examined together*

To return to the initial question, it is a hazardous and not particularly meaningful to try to make hard and fast distinctions between the parties' economic and social policies. Analysis of the parties' programmes also shows, however, that they have very different aims in terms of how the economy should be organised and embedded in society. Only by looking at this broader framework is it possible to obtain a reliable understanding of the lay of the land as regards the different parties and to be able to make decisions on that basis.

## 5. ECONOMIC ORDERS: COUNTRY MODELS

### What this chapter is about:

- Based on the differentiation between coordinated and uncoordinated types of capitalism various economic systems are compared within the framework of David Soskice's and Peter A. Hall's theory of varieties of capitalism.
- The dimensions to be examined are the financing system, labour relations, the training system and relations between companies.
- We shall focus on five countries: the United States, the United Kingdom, Germany, South Korea and Sweden.
- They cover a broad range. The United States is closest to the uncoordinated ideal-type, while Sweden is closest to the coordinated one.
- In periods of open markets these different economic models can also exist side by side. They vary in how exacting they are and their merits differ considerably from a social democratic standpoint.

### 5.1. United States<sup>17</sup>

*Simon Vaut*

The United States typifies the uncoordinated market economy (Meyer 2005a: 279ff) and stands solidly in the tradition of market liberalism, scepticism towards state intervention and individualism. Ostensibly the American economic system is aimed at serving the consumer and facilitating the amassing of wealth – at the expense of fundamental social rights (Gilpin 2001: 150).

It has not always been this way, however. In the 1930s, for example, President Franklin D. Roosevelt's New Deal, a major economic stimulus programme, involved much closer coordination of the economy. The policies of President Lyndon B. Johnson in the 1960s, with his »war on poverty«, were along similar lines. But even during these periods the US economy overall was very uncoordinated. The policies of presidents Ronald Reagan and George W. Bush aimed to reduce coordination to a particularly low level and thereby paved the way for the financial

*Typical  
uncoordinated  
market economy*

<sup>17</sup> The descriptions of the USA and Germany lean heavily on the presentations in Meyer (2005a: 279–282). We thank the author for his kind permission to refer to them.

market crash that broke out in 2007 and pitched the world economy headlong into a severe crisis.

*Goals and achievements of Obama's 'Keynesian-style' economic policy*

Barack Obama was elected president against this background in 2008 under the aegis of 'change'. More regulation and coordination of the economy was a key election goal (Galston 2008). The successes of his more 'Keynesian' economic policy (among other things, an economic stimulus package of 625 billion euros) include the creation of 9 million new jobs, access to affordable health insurance for all social strata and, with the signing of the Paris Agreement, a paradigm change in US climate policy (Heinke/Vaut 2012; Vaut 2015).

### **Financial System**

*Financing through the capital market*

US companies are generally financed through the capital market. This increases financial transparency because listed companies have to publish their accounts on a regular basis. Company strategies are determined predominantly by the shareholders' desire for the highest possible returns. This is known as the 'shareholder value principle'.

*Pressure for short-term profits*

A firm's access to capital is dependent on shareholders' earnings forecasts. Mergers and takeovers are less regulated than in other countries. For this reason, company managements in the United States are under constant pressure to maximise short-term profits. Too low earnings can result in the dismissal of the management, capital withdrawal or a takeover.

*Dodd-Frank Act*

During Barack Obama's presidency the Dodd-Frank Act was passed in response to the financial crisis. Its aim was to tighten up banking regulation and to dampen financial institutions' appetite for risk-taking by imposing higher equity ratios.

### **Labour Relations**

*Employer and employee associations tend to operate without any macrosocial mission*

In the United States organisations representing capital and labour are rather lobbying organisations for sectoral interests than macrosocial actors. Trade unions and employers' organisations are generally weak compared with those in coordinated market economies and have few peak organisations. There are assertive trade unions in some sectors, however, able to represent particular interests effectively. In California, for example, there is a well organised trade union for prison guards whose influence on penal system policy is not inconsiderable. Here the individual interests of the organised members take priority over the public interest, however.

Statutory employment protection is barely developed in the United States. For all these reasons labour relations are characterised by short-term employment and wage negotiations at company level. Sectoral collective agreements of the kind familiar from coordinated market economies are largely unknown in the United States as a consequence of the relentless debilitation of the trade unions over recent decades. Robert Reich traces this decline of the trade unions – from a union density of 33 per cent in 1955 to a mere 8 per cent in 2006 – to two factors in particular: first, the deliberate hostility of companies and second, the increasingly hostile policy of successive governments. President Ronald Reagan, for example, imposed a lifelong ban on striking air traffic controllers in 1981 (Reich 2008: 108ff).

*Employment  
protection lacking*

The US system of 'hire and fire' is just the job for volatile companies such as high-tech start-ups, but it also means that it is impossible to build up long-term labour relationships. This contributes to deindustrialisation and the wearing away of the middle class in America.

*Weak trade unions  
as a consequence of  
hostile policies*

### **Education and Training System**

A more flexible labour market is underpinned by a training system that tends to offer general qualifications that can be used across firms and sectors. Because the labour market is relatively unregulated and employee turnover is high US workers tend to go in for general training that they might be able to use in their next job. Coordination between employers' associations is rudimentary, which hampers companies from cooperating in the development of industry-specific training schemes. As a result, workers in the United States tend to acquire general skills well suited to service sectors that are vulnerable to economic ups and downs. The upshot is a lack of skilled workers for many companies and sectors.

*General  
qualifications*

Funding shortfalls affecting publically financed sciences are partly made up through cross-subsidisation from the armaments sector. Numerous innovations deployed in the civilian sector derive from military developments, for example, in aircraft construction, satellite technology and information technology (Reich 2008).

*Cross-subsidisation  
of research by the  
armaments industry*

### **Relations between Companies**

Competition between US companies is much more cutthroat than between companies in coordinated market economies, such as Sweden and Germany. In the latter, companies tend to seek cooperation with other firms, with the state and with the trade unions (Hinchmann 2006: 350). In the United States companies

*Corporate networks  
conspicuous by their  
absence*

are very much at arms length from one another: neither banks nor other firms have seats on boards. Since time immemorial commercial freedom has been an article of faith in the United States, so that the state intervenes in the market only to maintain its viability and, for example, to inhibit the formation of cartels. The strong anti-trust law is supposed to prevent companies from colluding, for example, in price fixing.

### **Summary**

The largely uncoordinated market economy in the United States offers companies the opportunity to respond flexibly to market developments, but it also heightens the incentives to adapt to market change on a short-term basis. The American system of labour relations is thus less effective in the development of costlier production strategies that are able to offer stable long-term employment. Instead it favours innovation strategies reliant on venture capital, such as information technology, as well as a large service sector based on generalist training and low wages.

*Largely  
uncoordinated  
market economy*

The US economy has generally enjoyed higher growth rates than European countries. Since the 1990s the American economy has grown on average by 3 per cent, while EU countries have managed only 2.2 per cent. On the other hand, the gains from prosperity are more unequally distributed and increasingly so. While in the 1950s the salaries of company directors were 25 times higher than those of employees in the same firm, today that has skyrocketed to 350 times (Reich 2008: 144). As a consequence, in the United States private wealth is juxtaposed with public poverty as a result of chronically underfinanced public budgets. This leads, among other things, to a dilapidated public infrastructure in comparison with other countries (Hinchmann 2006: 352).

*Juxtaposition of  
private wealth and  
public poverty*

The growing inequality contributed to the emergence of two highly unusual candidates in the US presidential election in 2016. Among the Democrats for the first time in US history a professed democratic socialist – namely Bernie Sanders – had a real chance at the presidency. Although he ultimately just lost out in the primaries to his mainstream rival Hillary Clinton he enthused the younger generation with a social democratic agenda. By contrast the election was won by a right-wing populist who promised protectionism, further deregulation and the reversal of Barack Obama's reforms.

*Polarisation in the  
2016 presidential  
election*



United States		
Gross domestic product per capita 2016	57,466.8	GDP per capita in US\$ (Source: World Bank 2017)
Average economic growth 2016 in comparison with previous year	1.6 %	Average annual growth of GDP adjusted for inflation (Source: World Bank 2016)
Government debt 2016	107.35 %	Government debt as a % of GDP (Statista / Stata)
Current account Q1 2017	-2.45 %	External trade balance exports and imports of goods as a % of GDP (Source: OECD 2017)
Employment rate Q4 2016	73.7 %	Share of those in employment aged 15–64 in the total population (Source: OECD Outlook 2016)
Harmonised unemployment rate January 2017	4.8 %	Share of unemployed in total active population (Source: OECD 2017)
Income inequality/ Gini coefficient 2010–2015	41.1	Measure of income inequality, 100 = maximum inequality (Source: Human Development Report 2017, p. 206)
Income inequality between men and women	68 %	Earned income of women as a % of that of men (Source: Human Development Index 2015, p. 220)
Poverty index (HDI) 2015	0.920 (10)	The Poverty index is composed of various indices (inc. life expectancy, literacy rate, access to health care), Ranking world-wide: 0 = min. poverty, 1 = max. poverty (Source: Human Development Report 2017, p. 206)
Tax ratios	26 %	Taxes and social security contributions as a % of average gross wages (OECD/Taxing Wages 2017: 20)
Trade union density 2013	10.8 %	Share of active population organised in trade unions (Source: OECD 2016)

## 5.2. United Kingdom

*Christian Krell*

*Pioneer of  
capitalism ...*

*... and of its  
dark side*

The United Kingdom is often described as the pioneer of capitalism. Generally speaking, industrialisation, free trade and liberalism developed there earlier than anywhere else. By the same token, the dark side of unrestrained capitalism was also in evidence from the start. It is not by chance that Friedrich Engels typified the often inhumane living and working conditions of workers in the mid-nineteenth century on the example of »the condition of the working class in England«.

*Uncoordinated,  
liberal market  
economy*

Since that study first appeared British capitalism has improved considerably. Nevertheless there are a number of constant features. The British economic order is still markedly 'liberal': international comparative research on capitalism categorises it as an uncoordinated liberal market economy.

In this section we describe the principal dimensions of the British economy.

### **Financing System and Ownership Structure**

*Financing via  
the financial and  
equity markets*

In British capitalism current earnings are key to company financing. British companies require investment from the 'impatient' capital in the dynamic equity and financial markets. Accordingly, high profitability and a high market value are the main conditions for access to capital. In this respect the United Kingdom distinguishes itself, for example, from the economic system that long typified Germany, in which so-called 'house banks' cooperated with a company over the long term and in this way generally had an accurate view of a company, its strategy and structures. In the United Kingdom investors and financiers make their decisions based on publically available evaluation criteria. First and foremost in this respect is a company's short-term profitability. This kind of market financing has stepped up a gear in recent years, becoming even more dynamic. This has been actively supported by the current Conservative government (November 2018).

*Ownership  
structure: high  
proportion of  
financial and private  
investors*

Ownership structures in the United Kingdom also differ substantially from those in coordinated market economies. In the latter, shareholdings in companies are often held by investors with long-term and strategic interests, such as other companies, banks or the public sector. The situation is very different in the United

Kingdom: around 80 per cent of owners of British companies are financial and other private investors whose main interest is generally to extract the maximum gain possible from the firm.

So-called 'hostile takeovers' – also for the purpose of rapid rent extraction – are much easier than in coordinated market economies because of the far-reaching market-based financing and the structure of the financial markets.

Because of this relentless pursuit of 'returns', hand in hand with a strongly hierarchical internal structure, British companies are able to restructure rapidly in response to new and more profitable markets, while scaling back in less profitable sectors. On the other hand, this short-termism has come to pervade British companies, to their considerable detriment.

### **Labour Relations**

There have been periods in which British trade unions have been particularly strong. The so-called 'winter of discontent' is one example: in 1978/79 nationwide strikes periodically paralysed all public life in the United Kingdom. On the other hand, phases of intense strike action are often not an expression of trade union strength. Strong and well organised trade unions are usually in a position to assert their members' interests in negotiations, without having to resort to strikes. Accordingly the 'winter of discontent' was rather the expression of a lack of negotiating clout.

By international comparison contemporary British trade unions, too, are weak. One reason for this is the relative fragmentation of the trade union landscape. In the 1990s there were still more than 300 trade unions. They are organised not by sector but by occupation, as a result of which in many cases a number of trade unions are presented in one firm. A second reason for the weakness of British trade unions is that in the United Kingdom, typically for (classical) liberal market economies, there is no obligation on companies to assent to works councils or other forms of employee representation. Codetermination in any form – for example of the kind that exists in Germany's coal and steel industry – is virtually unknown in the United Kingdom. Finally, trade union rights have been systematically and relentlessly cut back by successive governments, first and foremost by Margaret Thatcher's conservative governments between 1979 and 1990, and more recently by the conservative Cameron government (initially in coalition

*Orientation towards  
short-term yields*

*Trade unions strong  
only on the surface*

*Trade unions very  
fragmented*

*No mandatory  
employee  
representation*

*Low trade union  
density overall*

with the Liberal Democrats) of 2010–2016. The most recent expression of this is the Trade Union Act 2016 that came into force in March 2017. This law further shrinks trade union rights, particularly the right to strike. For example, strikes now have to be announced weeks in advance and picket supervisors »must wear something that readily identifies« them as such. Most damaging of all, however, is the regulation that in future companies may recruit temporary workers when strike action lead to work stoppages. Even human rights organisations have condemned this infringement of fundamental workers' rights. The new regulations are being evaluated in terms of their compatibility with the European Convention on Human Rights.

Trade union density in the United Kingdom is, as one might expect, comparatively low at present. The proportion of the working population organised in trade unions currently stands at a quarter of all employees (2014: 25.1 per cent). Trade union representation is much higher in the public sector.

The employers are similarly poorly organised. Assertive umbrella organisations are conspicuous by their absence and the importance of employer organisations is declining.

*Wage negotiations  
at company level  
but with a  
minimum wage*

Given these structures wages are usually negotiated at company level or are the outcome of individual negotiating processes between employees and employers. Since 1999, however, there has at least been a national minimum wage, providing a wage floor that may not be undercut.

*Low employment  
protection*

Relations between companies and individual employees are determined to a much greater extent by 'market forces' than in coordinated market economies. Employees tend to remain with one company for comparatively short periods and thus ties to a company tend to be weak. It is relatively easy for a company to dismiss employees because the weak trade unions cannot do much about it and employment protection is low. On the other hand, the flexible labour market makes it easier for well qualified employees to find new employment.

*Strong  
hierarchisation  
within the company*

As already mentioned, British company hierarchies are much more rigid than those in coordinated market economies. Besides the dominance of the chief executive officer (CEO) this also finds expression in work organisation. The team work performed by highly qualified employees of the kind often found

in Germany, for example, is rare in the United Kingdom, which is typified rather by a conventional and strictly maintained division of labour (Wood 2001: 250).

### **Training and Further Training System**

Vocationally specific qualifications are distinctly lacking on the United Kingdom's flexible labour market. The reasons for that are perfectly understandable from the employers' standpoint.

First of all, the relatively short period during which employees (both blue- and white-collar) tend to stay at one company means that it does not really pay to invest much in individual employees and even that competitor firms may reap the benefit. Second, the extremely flexible labour means that qualified employees can be found relatively quickly and equally quickly let go, should it prove expedient. But even on the side of the employees there are few incentives to acquire firm-specific qualifications because the average employee's comparatively brief tenure at any one firm makes it more worthwhile to focus on general capabilities that can also be used in other companies or sectors. The upshot of this lack of occupational qualifications is obvious: productivity in British firms is relatively low in comparison with that in, for example, German firms.

And because the UK labour market is becoming ever more flexible investment in specific qualifications will continue to be futile. One instance of this is the substantially growing prevalence of zero-hour contracts, in which only the employment relationship is specified, not the number of hours. The employer is largely free to determine the number of hours that will actually have to be worked – and thus also earnings – according to need and the order book. Business risk is thus shifted entirely onto the employees.

### **Relations between Companies**

Relations between firms are based on market relations and enforceable, formal legal relations. Companies are only very loosely interconnected. Technology transfer occurs mainly through the exchange of scientifically or technically highly qualified staff. The to and fro of scientists or engineers between research institutes and the free economy is more frequent than in traditional coordinated market economies. By contrast, research communities made up of companies or longer-term cooperation networks are rarer.

*Provision of general  
knowledge*

*Often poor  
occupational  
qualifications*

*Virtually no  
corporate  
cross-holdings*

The structure of the British economy is comparatively strongly oriented towards services. Only 8 per cent of employees work in manufacturing industry and the latter's contribution to GDP, at around 14 per cent, is lower than that of many other OECD states. In the wake of the financial crisis half-hearted efforts have been made since 2009, especially in the traditionally industrial north of England, to revive industrial employment, but with little to show for it. The financial sector, by contrast, has gone from strength to strength.

### **What Will Brexit Bring?**

In the coming years the development of the British economy as a whole will depend to a considerable extent on what happens under the aegis of 'Brexit'. The example of the financial sector illustrates how much the UK economy is intertwined with the continental European economy. The United Kingdom is the world's leading exporter of financial services. The European single market is the biggest customer for these services. Many believe that if the United Kingdom really does leave the European Union numerous banks and financial service providers will shift at least part of their activities from London to the EU, for example, to Frankfurt.

The United Kingdom's already weak industrial sector will come under further pressure if the country crashes out of the European single market. At the time of writing (August 2018) the specific form, timing and features of 'Brexit' are almost entirely unknown. One thing is sure, however: even if the country is able to retain access to the single market it will largely lose any influence over its shaping.

### **Evaluation and Summary**

The British variety of capitalism is a lot closer to the US economic system than to continental European economies. The benefits of British capitalism include a relatively high employment rate and low unemployment, while the downside is the continuing low productivity of British companies compared with German companies (but also with US ones), its pronounced short-termism and the increasing number of precarious jobs.

It is important to underline, however, that none of this is set in stone. The UK political system with its first-past-the-post elections and the centralisation of the state in principle enables governments to make far-reaching structural changes very rapidly, if the political will is there.

United Kingdom		
Gross domestic product per capita 2016	39,899.4	GDP per capita in US\$ (Source: World Bank 2017)
Average economic growth 2016 in comparison with previous year	1.8 %	Average annual growth of GDP adjusted for inflation (Source: World Bank 2016)
Government debt 2016	89.3 %	Government debt as a % of GDP (Statista / Stata)
Current account Q1 2017	-3.40 %	External trade balance exports and imports of goods as a % of GDP (Source: OECD 2017)
Employment rate Q4 2016	69.6 %	Share of those in employment aged 15–64 in the total population (Source: OECD Outlook 2016)
Harmonised unemployment rate January 2017	4.6 %	Share of unemployed in total active population (Source: OECD 2017)
Income inequality/ Gini coefficient 2010–2015	40.8	Measure of income inequality, 100 = maximum inequality (Source: Human Development Report 2017, p. 206)
Income inequality between men and women	53 %	Earned income of women as a % of that of men (Source: Human Development Index 2015, p. 220)
Poverty index (HDI) 2015	0.909 (16)	The Poverty index is composed of various indices (inc. life expectancy, literacy rate, access to health care), Ranking worldwide: 0 = min. poverty, 1 = max. poverty (Source: Human Development Report 2017, p. 206)
Tax ratios	23.3 %	Taxes and social security contributions as a % of average gross wages (OECD/Taxing Wages 2017: 20)
Trade union density 2013	25.4 %	Share of active population organised in trade unions (Source: OECD 2016)

## 5.3. Germany

*Simon Vaut*

*Germany has a  
coordinated market  
economy*

Germany is a typical coordinated market economy (Meyer 2005a: 280 ff) and was long regarded as the textbook combination of dynamic economy, political stability and social equality (Egle 2006: 273–326). With growing unemployment and the economic stagnation that set in in the 1990s, however, the German model lost its allure and was even characterised by *The Economist* as »the sick man of Europe«. Later, however, the magazine had cause to revise its view, speaking from 2005 onwards of the 'German miracle' because the country had managed to achieve record employment, overcame the 2009 financial crisis more quickly than most other countries and real wages had increased even among those on low and medium earnings, in contrast to many other OECD states.

### **Financing System**

*Corporate financing  
through the banks*

In Germany corporate financing through the capital markets plays only a modest role overall. Company managements are not evaluated by the market alone, but also by the banks and other companies intertwined with it, as well as employee representatives and state actors. This favours personal exchanges of information and the development of trust. Corporate financing largely takes the form of bank loans. A company's reputation and network play a role in obtaining such loans alongside its financial data. Investors have access to such data via closely meshed relationships. This access to 'patient capital', independently of short-term results, enables companies to invest in long-term projects and to maintain a well trained workforce even during periods of economic crisis. This tallies with the observation that the managements of German companies are less susceptible to immediate gains or the company share price. Tax regulations, laws and broad corporate affiliations deter hostile takeovers. The linkages between companies and banks, however, have also been criticised as a »bank cartel« (Bury/Schmidt 1996) because they make it more difficult for market newcomers to access capital and favour insiders.

*Access to  
'patient' capital*

Developments in recent years, however, point towards the unravelling of industrial relations in Germany and an increase in international holdings, as we shall see.



The financial market crisis that began in 2007 also upended many German banks, which had to be bailed out to the tune of billions in public money after their speculation in international real estate and government securities went badly wrong. A financial market stabilisation fund of 480 billion euros was made available.

Reforms were introduced aimed at redirecting the banks to their former role of financing the real economy. Because the crisis had shown that nation-states acting alone are able to regulate the financial markets only to a limited extent the German government pushed for a European solution. This includes, on one hand, tightening up the provisions of the Basel Committee on Banking Supervision of the Bank for International Settlements (BIS). Under the 'Basel III' agreement, for example, equity ratios have been tightened. The European Banking Union has Europeanised formerly national competences and established common regulations on financial market supervision and the winding up of credit institutions within the euro zone.

*Reforms in the wake  
of the financial crisis*

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## EXCURSUS: The End of Germany plc?

Since the 1990s, initially largely flying under the radar of the political debate, a major transformation has slowly but surely been taking place in Germany, characterised as the winding-up of Germany plc. The term 'Germany plc' refers to the traditional close interlinking of banks and industry in the country. The origins of these linkages can be traced all the way back to the time of the Kaiser. The purpose was, among other things, to shield German firms externally and to maintain stability internally.

*Is the intermeshing  
of banks and  
industry unravelling?*

These mutual capital holdings of banks and industry have experienced a marked decline in recent years, as German companies have specialised and internationalised.

The result of this liquidation of Germany plc presents a mixed picture. On one hand, the opening up to international capital and ensuing injection of investment and know-how has helped to maintain the competitiveness of many German firms and to bolster their position on world markets. Unit wage costs have fallen substantially, in contrast to all other European countries. As a result exports have

*Pros and cons of  
international  
capital flows*

grown by 50 per cent within a decade, much more than in neighbouring countries (source: Economist Intelligence Unit 2006). On the other hand, pressure for returns on investment and a short-term orientation have increased, as a result of which employment has become much more insecure.

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### **Labour Relations**

Trade unions in Germany have only a moderate level of organisation by international comparison, at 17 per cent (as of 2013, cf. p. 112). Because of free collective bargaining they nevertheless retain a considerable influence over wage formation and working conditions (Egle 2006: 290). Trade unions and employers' organisations are sector-specific: for example, for the metal industry on one hand there is IG Metall and on the other Gesamtmetall. This means that the coordination of collective bargaining occurs within the framework of the sector, thus ensuring that employees in the same industry can expect the same wages. Homogenous wages within a sector mean that there is no wage competition between companies for well qualified workers (Hassel 2006: 14).

In Germany company codetermination as regards work organisation and personnel decision-making is highly developed by international comparison. The Works Constitution Act (*Betriebsverfassungsgesetz*) regulates the size and competences of works councils, as well as the release of works councillors from their work duties. Limited companies are statutorily obliged to take part in codetermination if they have more than 500 employees. This means, for example, that employees at a company can appoint representatives to the supervisory board.

The trade unions regarded the comprehensive reform of the German labour market under the SPD/Greens government between 2003 and 2005 as a slap in the face. Because unemployment subsequently almost halved, however, and, despite the slump in the German economy in 2009, employment rose continuously to a record high of 43.5 million in 2017 the trade unions' negotiating power has again grown significantly. For example, on one hand, collective agreements were concluded with real wage increases, while on the other hand, the trade unions were able to exert pressure to achieve further wage growth by means of the minimum wage and the limitation of contract and temporary work.

*Free collective  
bargaining*

*Sectoral collective  
bargaining*

*Codetermination*

## Training System

The complex production systems of many German companies often rely heavily on well trained employees. The dual training system with its strong practical orientation and technical depth has proved its worth (Egle 2006: 287) as a »core institution of German capitalism« (Hassel 2006: 13). Those undergoing training receive relatively low pay, but in return young people are generally assured skilled employment. This approach has bestowed on Germany one of the lowest youth unemployment rates (as a proportion of the adult unemployment rate) among the OECD states (Hassel 2006: 15).

The comparatively high specialist qualifications grant employees in Germany stronger negotiating clout than in countries in which training systems are rather generalist in nature, which makes workers easier to replace. Germany's quality-oriented production is dependent on qualified specialist workers. In order to protect themselves against ever increasing demands from their employees and to prevent the poaching of well qualified workers by other firms German companies – in the industrial relations system – have organised in individual industrial sectors via coordinated collective bargaining between employers and trade unions. This has resulted in wage convergence among those with comparable skills in the sector as a whole.

Germany's dual training system is under threat, however, for three reasons. First, it is dependent on economic trends. In upswings companies are keen to take on trainees as low-cost and flexible workers, but when things turn down training places are thin on the ground. If this shortage persists it becomes self-reinforcing because those who are unable to find a training place in one year are forced to jostle for position with a new cohort coming up the following year. Second, companies are increasingly ducking their responsibility to train the next generation and skilled workers. And third, the half-life of knowledge and acquired skills is becoming ever shorter. Virtually no training lasts a lifetime. One answer to the challenges of an ever more rapidly changing world of work, according to the trade unions and the Social Democrats is to further develop unemployment insurance into employment insurance. This would enable Germany to substantially expand its underdeveloped basic and advanced training provision (Rahner et al. 2013).

*The importance of  
the dual training  
system*

*Training system  
under threat*

*Multiple interests  
have a say in com-  
pany management*

## **Relations between Companies**

The managements of large German companies seldom have the opportunity to take important decisions on their own. Instead, they require ratification from supervisory boards and networks in which banks and even other companies, employees and state actors are represented. As a consequence it is not so much shareholders' short-term demand for yield that determines company decision-making as the interests of a plethora of stakeholders.

*The enabling and  
empowering state*

The role of the state in Germany's political economy since the Second World War can best be described as enabling or empowering. Although its options for direct intervention in economic processes were limited by federal structures and a variety of independent institutions, such as the Bundesbank and the Federal Cartel Office, the state has nevertheless developed the ability to support societal groups and quasi-public corporate actors to organise themselves and provide them with the necessary, to some extent constitutional resources to regulate and manage areas of the political economy themselves, which in other countries are regulated by the state or given over to the market. The European Central Bank (ECB) and its monetary policy independence, as well as the EU Commissioner for Competition pursue the same political-economic principles that guide the Federal Republic and thus there is no discontinuity. On top of that, the state spends a considerable portion of GNP on social security systems and complies with the constitutional requirement of »equal living conditions« in all federal states, for which purpose it has developed a system of regional redistribution (Streeck 1995).

## **Evaluation**

Germany's economic system pursues a middle path between the Anglo-Saxon market economy and the Scandinavian welfare state (Schmidt 2000).

Employment relationships in Germany tend to be long-term: on average, employees stay with the same employer for ten years, in comparison with eight years in the United Kingdom and seven in the United States (Streeck 1995). Cooperative industrial relations and a high level of qualifications result in productivity increases that enable companies to pay skilled workers well and shorten working time (Hassel 2006).

The wage gap is therefore relatively small in Germany and skilled workers there belong to the middle class, in contrast to other countries. Indeed, Germany's

*Germany: between  
Scandinavia and the  
United States*

middle class is very large, at 66 per cent of the population, in comparison to 44 per cent of Americans and only 26 per cent of the British (Rössel 2005).

Because of the economic crisis the German model came under criticism from the 1990s onwards, however. In particular in the 2005 general election campaign the conservatives led a debate on how Germany had been allowed to go to the dogs and had ceased to be internationally competitive. Despite all the prophecies of doom, however, Germany has proved its high competitiveness as world champion exporter on a regular basis. Among other things this is because of the high quality of its complex industrial goods, especially the automobile industry and systems engineering. The proportion of industrial employees in Germany has remained around 10 per cent higher than in the other OECD countries (Egle 2006: 292). For example, in 2009 Germany emerged from the crisis more rapidly than comparable countries and remains an international role model because of its high proportion of industrial value added.

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## The Development of the Eastern German Economy since Reunification

*Carsten Schwäbe*

With the accession of the German Democratic Republic to the Federal Republic in 1990 the new united German economy faced completely new challenges. Many people hoped that the new *Länder* would, after a transitional period, be able to reach the living standards of the 'old' Federal Republic. The economic, currency and social union had the effect of a wage-cost shock for eastern Germany, however. The introduction there of the German mark at an exchange rate of 1:1 masked the considerable productivity differences between east and west. The previous exchange rate of the East German mark was between 1:5 and 1:8. Although people in eastern Germany could now also buy products from the west the new 1:1 exchange rate meant that eastern German companies were extremely overvalued in relation to their productivity. This meant that these companies were even less competitive in the new common market than they would otherwise have been. On top of that they lost the access they had enjoyed to cheap raw materials and sales markets they had enjoyed in the other Eastern Bloc states before the fall of the Iron Curtain.

*Economic, currency  
and social union as a  
wage cost shock*

*A long way away  
from 'blooming  
landscapes'*

Companies in the east suffered heavy losses and were not in a position to make urgently necessary investments in adapting production to western levels. Besides beefing up private investment for new, competitive jobs, pensions, unemployment and training in eastern Germany all had to be funded. Public infrastructure was in desperate need of modernisation and administrative structures basically had to be rebuilt from the ground up. These tasks required a substantial commitment on the part of the state, which was reflected in the increase in public debt and the need for higher tax revenues, for example, through the solidarity surcharge. Nevertheless, the expectations of the then German government that there would be 'flourishing landscapes' in eastern Germany were dashed.

*Short-lived  
reunification boom  
in western Germany*

In western Germany the accession of the new *Länder* led to a veritable reunification boom because the sales market of the western German economy gained 16 million new consumers at a stroke. This boom and the high wage agreements did not prove sustainable, however, as a result of which even western Germany was hit by falling demand in due course.

Contributory factors in this were the levying of VAT and the Bundesbank's restrictive monetary policy in response to high wages rises and the resulting inflation. In the end the real costs of reunification to the German economy became clear. These costs were met in the form of transfers through various instruments and redistribution within the framework of federal, regional and municipal budgets, and in particular social insurance.

*The consequences  
of 'privatisation  
trumps  
restructuring'*

Another problem was the way in which the Treuhand managed the transition of east German state-owned companies to the market economy. Initially it was believed that privatisation would generate much higher profits from the sale of state-owned companies. In the event the structural problems facing most eastern German firms turned out to be insoluble and privatisation was a flop, leaving the Treuhand in the red. It is reasonable to assume that the losses would have been less if privatisation had not been conducted according to the principle 'privatisation trumps restructuring'. Western private investors often could not care less about the survival of the eastern German companies, which were potential competitors. They wanted to service the market themselves. Gradual privatisation of companies that had long remained in public hands was also implemented in western Germany, but the sales markets for these former western

German state-owned companies were not as run down as was the case for the eastern German companies on accession to the Federal Republic.

As a result of eastern Germany's economic problems not only did state revenues there shrink, but so did the population and in particular the workforce. While between 1990 and 2011 the population of the western German *Länder* rose by 3.8 million overall, to 63 million, in eastern Germany (not including Berlin) it fell by 2 million to only 12.8 million. Skilled workers in particular abandoned the east because there were much better job opportunities in the west, with higher pay to boot.

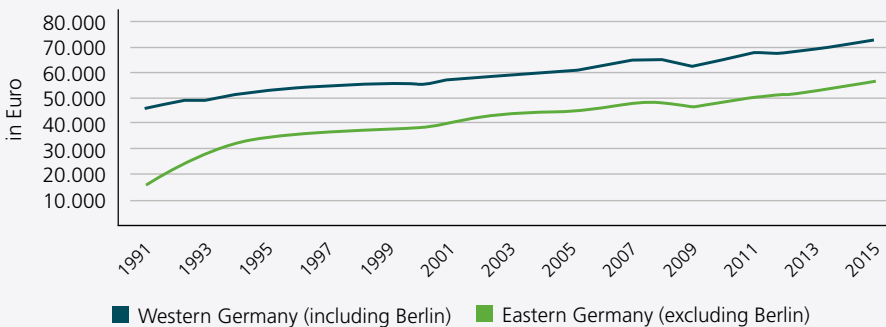


Figure 10: Comparison of per capita GDP at current prices for western and eastern Germany

Source: Statistisches Bundesamt

Despite the high transfer payments the development of the east German economy was slow and even today, as the two regions' per capita GDP show, still well below the level of the west of the country. After the initial impetus the catch-up process was weak, to say the least. Vesper (2015: 38) comes to the conclusion that even in future eastern Germany will require transfer payments from the *Länder* fiscal equalisation scheme and supplementary allocations from the federal level. This is due to the constitutional requirement of equal living standards throughout the country. By 2019, however, infrastructure will be on a par both quantitatively and qualitatively.

*Land* and municipality finances need to be improved not only in the east, however, but also in many regions in western Germany, whose economies are ailing, especially as a result of structural change away from coal and heavy industry.

*Transfer payments  
still vital*

Germany		
<b>Gross domestic product per capita 2016</b>	41,936.1	GDP per capita in US\$ (Source: World Bank 2017)
<b>Average economic growth 2016 in comparison with previous year</b>	1.9 %	Average annual growth of GDP adjusted for inflation (Source: World Bank 2016)
<b>Government debt 2016</b>	68.3 %	Government debt as a % of GDP (Statista / Stata)
<b>Current account Q1 2017</b>	+8.24 %	External trade balance exports and imports of goods as a % of GDP (Source: OECD 2017)
<b>Employment rate Q4 2016</b>	75 %	Share of those in employment aged 15–64 in the total population (Source: OECD Outlook 2016)
<b>Harmonised unemployment rate January 2017</b>	3.9 %	Share of unemployed in total active population (Source: OECD 2017)
<b>Income inequality/ Gini coefficient 2010–2015</b>	30.6	Measure of income inequality, 100 = maximum inequality (Source: Human Development Report 2017, p. 206)
<b>Income inequality between men and women</b>	65 %	Earned income of women as a % of that of men (Source: Human Development Index 2015, p. 220)
<b>Poverty index (HDI) 2015</b>	0.926 (4)	The Poverty index is composed of various indices (inc. life expectancy, literacy rate, access to health care), Ranking world-wide: 0 = min. poverty, 1 = max. poverty (Source: Human Development Report 2017, p. 206)
<b>Tax ratios</b>	39.7 %	Taxes and social security contributions as a % of average gross wages (OECD/Taxing Wages 2017: 20)
<b>Trade union density 2013</b>	17.7 %	Share of active population organised in trade unions (Source: OECD 2016)



## 5.4. South Korea<sup>18</sup>

Carsten Schwäbe

The economy of South Korea has accomplished a remarkable economic catch-up over the past 50 years, advancing from a poor developing country in the 1960s to a member of the Organisation for Economic Cooperation and Development (OECD)<sup>19</sup> in 1996. In 2015 its per capita GDP was a little higher than that of Spain.

The start of this economic development process can be dated to 1961. Before then the South Korean economy was still suffering from the destruction of the Korean War and the cronyism of the political and economic elites. Although South Korea was not rich in raw materials the US financial aid that was supposed to boost the country as a bulwark against communism had provided a strong incentive to corruption. In 1961 there was a military coup. Under the new military leader Park Chung-hee a range of development-policy measures were implemented. The key policy goal was the transition of South Korean industry from labour- to capital-intensive production, which ultimately was supposed to facilitate economic growth through technology-based innovation.

A Korean Development Council was tasked with planning the industrial development process by means of a range of policy measures:

- Firms in preferred sectors (in other words, those regarded as important for economic development) were given simplified and subsidised access to capital, as well as further aid to enable the expansion and further development of production.
- Capital controls prevented firms from investing scarce financial resources abroad.
- Import restrictions and barriers to foreign direct investment protected Korean firms against rival foreign companies that otherwise would have bought them out or driven them from the market.
- The obligatory export quotas imposed by the government, however, forced South Korean companies to sell a portion of their goods on the world market if they wished to continue to receive assistance. This not only helped to build up foreign currency reserves, but also served as a good selection method for distinguishing between efficient and inefficient Korean companies.

*1961: start of South Korea's catch-up process*

*Policy measures*

*Subsidised access to capital*

*Capital controls*

*Import controls*

*Export quotas*

<sup>18</sup> This section is based on a detailed study of South Korea's economic system: Michael A. Witt (2014), *South Korea: Plutocratic State-Led Capitalism Reconfiguring*, in: Michael A. Witt and G. Redding (eds), *The Oxford Handbook of Asian Business Systems*, Oxford, pp. 216–37.

<sup>19</sup> The OECD comprises 36 states that can be regarded as economically developed.

*Softening of  
the 'top-down  
approach'*

This state-guided development process in the South Korean market economy was characterised by a very hierarchical top-down approach. The democratisation of the country in 1989 and above all the Asian Crisis of 1997/1998 softened such hierarchical decision-making, however, because IMF assistance loans to South Korea during this period were conditional on liberalisation and privatisation measures. Nevertheless, South Korea remains a top-down, mixed economy.

### **Financial System**

*The enormous  
importance of  
the banks*

Even though the South Korean financial sector has developed enormously in recent decades corporate financing is still largely indirectly based on bank loans. Direct holdings or shares remain less important.

The banks played a key role in industrial development. They were state-owned and served as industrial-policy instruments for corporate funding, which was the preferred option for managed development. The chosen companies were financed as long as they achieved industrial-policy goals, such as export quotas. Because loans were readily available to the established large family businesses – known as 'Chaebols' – they did not resort to other forms of investment, such as shareholdings.

In the 1980s the banking sector was increasingly privatised. Although during the Asian Crisis part of the banking system was taken back into public ownership, it was subsequently privatised again, in particular through sales to foreign investors. At the same time, the government pressed large firms to reduce their dependence on loans from now foreign-owned banks in favour of domestic investment forms. Because large South Korean corporations were permitted to own insurance companies and other financial institutions they too became funding instruments for enterprises.

### **Labour Relations**

*The importance of  
the trade unions*

Park's military government initially suppressed the trade union movement. In the 1980s, however, the unions became a key factor in South Korea's democratisation. In 1989 just under 20 per cent of workers were trade union members. By 2010, however, this had fallen to only 9.8 per cent, although this is partly because of the sectoral shift towards services. Nonetheless South Korean trade unions are still noted for their active resort to strike action.

Since 1998 South Korea's industrial relations have had a tripartite structure: employers, employees and government all participate in collective bargaining. In comparison with Europe, however, this system is regarded as dysfunctional. Moreover the trade unions are decentralised to a considerable extent, as a consequence of which important sectoral bargaining decisions are often taken at enterprise level. The employers are also reluctant to engage in sectoral bargaining, which makes it difficult for trade unions to establish a strong, unified position.

*Tripartite structure  
of industrial relations*

Until the Asian Crisis South Korea's big companies in particular offered long-term employment contracts. With the necessary corporate restructuring and the rise of services, however, employment became more short term and volatile. Nevertheless in, for example, 2008 the OECD rated employment protection in South Korea better than in the United States or Japan, and only a little below that in northern European countries. On the other hand, because employment protection applies to regular employees in South Korea, too, the trend has been towards part-time work and more irregular forms of employment, associated with lower pay and fewer protective rights. Not only that, but even in the case of regular employees there is often a gulf between rights and reality.

*From long-term to  
short-term and  
precarious employ-  
ment relationships*

### **Training and Further Training System**

South Korea has a relatively good school system that is structurally similar to that of the United States. As many as 72 per cent of all school graduates go on to further education, a proportion that even the OECD considers too high. This special focus on university education is partly attributable to South Korea's need for a large number of specialist workers for its economic catch-up policy, grounded on technology-based growth. By contrast the relevant training system remains rather undeveloped. Very few school graduates go into conventional training because a social stigma attaches to 'mere' training in a country with such a close-meshed university network. University graduates' lack of practical experience is a real problem. Many young people, even graduates, find it difficult to find a job on leaving education.

*Overwhelming  
importance of a  
university education*

The academic performance of South Korean schoolchildren is extraordinarily good by global standards. On the other hand, considerable pressure is imposed even on young children by the standardised tests that must be passed to get in to elite schools and universities. Education in South Korea is enormously expensive.

*High cost of  
education*

Tuition fees there are surpassed only by those in the United States and Israel. And that does not include the large sums spent on after-school tutoring. The high cost of education is one reason why many South Koreans choose not to have children, one reason why the birth rate is falling. The high financial cost of academic success also represents a major obstacle for the social mobility of socially disadvantaged children.

### Relations between Companies

The so-called Chaebols represent a vital component of South Korea's economic structure. These are large family-owned enterprises that, as conglomerates,<sup>20</sup> bring together a wide range of different firms and business models. The hierarchical structure of these conglomerates is a key form of business relationship in South Korea. The major families have no difficulty asserting their interests against economic competitors by means of mutual corporate holdings and ownership of conglomerates. The Chaebols have shown in particular that they are in a position to invest rapidly in highly promising new markets and, using their own financial clout, as well as the favourable conditions provided by the state, to drive innovative economic development.

This economic structure also harbours the potential for corruption and abuse of power, however. Although by international comparison South Korea is well ahead of other Asian states in this respect it falls short of most Western countries. The Chaebols have a poor reputation among the South Korean public. In response the owners make an effort to improve their standing with decent working conditions and social commitments.

Relations between suppliers and manufacturing firms in South Korea are characterised by long-term contracts and arrangements. The prevalence of the conglomerates also means that company relations tend to be stable and long-term.

### Evaluation

South Korea's managed economy with its socio-political top-down approach is strongly reminiscent of coordinated capitalism, even though more recently the country has leaned more towards the Anglo-Saxon/neoliberal model with its liberalisation, privatisation and deregulation. The welfare state remains comparatively underdeveloped. Because of the relatively egalitarian distribution of market income, however, income inequality is fairly well balanced even without

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20 Conglomerates are company groups which, through the ownership of various firms and affiliates, engage in activities at many points along the value creation chain, as well as in various sectors.

*Chaebol: the crucial  
importance of family  
owned firms*

*Coordinated  
capitalism*

major redistribution and is similar to that of Luxembourg. Market distribution is thus less unequal because the distribution of wealth is better than that in Germany, for example.

The assertive role of an authoritarian, non-democratic state played a central role especially in South Korea's economic catch-up process. Economic development was based on long-term planning, involving a variety of policy measures and a cautious exposure of South Korean companies to international competition. This successful strategy might also be attractive to other developing countries, but it requires a high functioning state administration to ensure that policy interventions and planning benefit overall development and are not confined to a few groups through corruption.

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*South Korea's  
development as  
a model for other  
developing countries*

South Korea		
<b>Gross domestic product per capita 2016</b>	51,599.9	GDP per capita in US\$ (Source: World Bank 2017)
<b>Average economic growth 2016 in comparison with previous year</b>	3.2 %	Average annual growth of GDP adjusted for inflation (Source: World Bank 2016)
<b>Government debt 2016</b>	41.6 %	Government debt as a % of GDP (Statista / Stata)
<b>Current account Q1 2017</b>	+3.70 %	External trade balance exports and imports of goods as a % of GDP (Source: OECD 2017)
<b>Employment rate Q4 2016</b>	76.4 %	Share of those in employment aged 15–64 in the total population (Source: OECD Outlook 2016)
<b>Harmonised unemployment rate January 2017</b>	6.8 %	Share of unemployed in total active population (Source: OECD 2017)
<b>Income inequality/ Gini coefficient 2010–2015</b>	27.3	Measure of income inequality, 100 = maximum inequality (Source: Human Development Report 2017, p. 206)
<b>Income inequality between men and women</b>	79 %	Earned income of women as a % of that of men (Source: Human Development Index 2015, p. 220)
<b>Poverty index (HDI) 2015</b>	0.913 (14)	The Poverty index is composed of various indices (inc. life expectancy, literacy rate, access to health care), Ranking worldwide: 0 = min. poverty, 1 = max. poverty (Source: Human Development Report 2017, p. 206)
<b>Tax ratios</b>	24.9 %	Taxes and social security contributions as a % of average gross wages (OECD/Taxing Wages 2017: 20)
<b>Trade union density 2013</b>	67.7 %	Share of active population organised in trade unions (Source: OECD 2016)

## 5.5. Sweden

*Erik Gurgsdies and Niels Stöber*

### **The Rehn-Meidner Model**

Economic policy in Sweden is based on the so-called Rehn-Meidner model, named after two trade union economists, Gösta Rehn and Rudolf Meidner. In 1951 they developed a macroeconomic model in which full employment is supposed to be compatible with a 'solidarity wage policy', without triggering inflation.

The basic idea was that permanent full employment cannot be achieved by means of a generally high level of aggregate demand, regardless of whether this comes from favourable global economic development or national economic stimulus programmes. Because different economic sectors grow at different rates, persistently high aggregate demand leads rapidly to the formation of bottleneck sectors. In order to maintain economic growth these sectors try to poach workers from other sectors. With full employment this is possible only by bidding up wages, leading to price rises in these sectors. The subsequent loss of purchasing power leads to wage rises in the other sectors. The upshot is price rises across the board and inflation throughout the economy.

### **Solidarity Wage Policy**

This situation was aggravated by the fact that after the end of the Second World War the Swedish blue-collar trade union pursued a so-called 'solidarity wage policy'. This has two main aims. On one hand, to implement the principle of 'the same wages for the same work' oriented towards the development of average labour productivity; and on the other hand, generally to reduce the wage gap between different occupations. Achieving these goals is conditional on prioritising centralised wage negotiations over lower levels.

In order to ensure that inflation does not erode the gains from a 'solidarity wage policy' the Rehn-Meidner model councils a tight fiscal policy to curb aggregate demand through budget surpluses.

This economic policy approach forces less productive companies onto the defensive on two fronts; on one hand, when demand is subdued they face flagging sales because of their poor cost and price structure; and on the other hand, the 'solidarity wage policy' exacerbates their already difficult cost situation and lack

*Full employment  
with a 'solidarity  
wage policy'*

*Tight fiscal policy*

*Pressure on less  
productive  
companies*

of competitiveness because wage demands keep in step with the development of average labour productivity in all sectors and all enterprises.

*Fostering more  
productive  
companies*

By the same token, highly productive companies enjoy a twofold benefit: on one hand, adequate demand because of their favourable cost situation and price formation; and on the other hand, the scope given them by their high productivity is easily sufficient to enable them to comply with wage agreements based on average productivity. These companies thus also receive a capital injection for the creation of new highly productive jobs.

*Unemployment  
approached pro-  
actively as a public  
adjustment task*

The losers from this combination of restrictive fiscal policy and 'solidarity wage policy' are less productive companies and their employees. The resulting unemployment was not regarded defensively as a public problem, however, but proactively as a public adjustment task. Accordingly a constantly upgraded and refined 'selective labour market policy' was developed. Comprehensive training measures and relocation assistance were deployed to train the unemployed and people entering the labour market for the first time or returning to it for productive and thus also well paid employment.

*Strong acceptance  
of the Swedish  
model*

Under the Rehn-Meidner model a restrictive fiscal policy, a 'solidarity wage policy' and a 'selective labour market policy' thus work towards the constant renewal and structural adjustment of the Swedish economy. This model operated as an economic framework from the 1960s onwards, with some ups and downs. Overall it conferred on Swedish economic policy »a conceptual coherence and political consensus that no comparable country even approached« (Scharpf 1987: 119), as Fritz Scharpf put it in the course of comparing the social democratic economic policies of Germany, the United Kingdom, Austria and Sweden. This judgement holds up even today. With its compact domestic market of just under ten million inhabitants Sweden was therefore able, despite the upheavals of globalisation, not only to hold its own with a competitive economy in global markets but even to increase its trade in goods and, more recently, services; half of GNP is now exported.

### **Financial System and Ownership Structure**

Corporate financing in Sweden is composed of a number of elements. Financing is based first and foremost on its developed system of house banks. There are also some elements of equity financing. The high degree of cross-holdings

*Not dependent on  
the capital market*



among companies in Sweden should be noted, however. Overall corporate financing in Sweden is characterised by a long-term perspective. The Swedish funding system resembles that of Germany, which for a long time was known as 'Rhenish capitalism'.

### **Training System**

Sweden recognised early on that in a globalised world economy the most important 'raw material' of a competitive economy is education. Swedish occupational training takes place at upper secondary level. Virtually all students participate voluntarily. Besides the academic pathways there are 14 national programmes offering specific occupational training.

It has always been a basic principle of Swedish training policy to avoid educational blind-alleys as far as possible. To that end specific occupational training is supplemented with more general content to such an extent that vocational qualifications also count as a school leaving certificate. In 2006 the comparable rate of attainment of school leaving certificates, for example, was 94.6 per cent.

Another key feature are the diverse options for recurrent training throughout a person's working life. As we have seen Swedish economic and employment policy is not aimed at protecting particular existing workplaces. Rather the idea is to enable people to take productive jobs most conducive to international competitiveness. In the education and training system therefore general and special curricula are merged for everyone.

### **Labour Relations**

When it became evident that the Social Democrats would not be driven out of government office for the foreseeable future the employers accepted the trade unions as full negotiating partners in the so-called Saltsjöbaden Agreement of 1938.

Based on this agreement the state was to stay out of labour market regulation as far as possible. This remained the case for a good 30 years. The labour market was peaceful and wage development was managed centrally by means of collective agreements. There was virtually no labour market legislation.

*Avoidance of dead ends in training*

*Trade unions and employers on an equal footing*

The period of cooperation was followed by a period of confrontation from the early 1970s to 1998. Centralised wage negotiations increasingly unravelled. In particular the stability constraints imposed in the wake of EU accession brought it home to the social partners that the collective bargaining system had to be re-established on a new footing. At the initiative of the Social Democratic government the main industrial trade unions and employers concluded the Agreement on Industrial Development and Wage Formation in 1998.

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*Conflict  
avoidance*

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The Industrial Agreement is based on the following basic pillars. First, a set of rules aimed at minimising periods without agreement, in which conflict was more likely. For this reason negotiations have to commence on a new agreement before the expiry of the existing one. Second, it relies on publically appointed and impartial arbitrators tasked with shepherding the negotiations in the direction of EU norms. Third and finally the idea that a wage benchmark should be set by the export-oriented industrial sector was revived. Key components of the Industrial Agreement were later taken over in the public sector.

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*Corporate  
cross-holdings*

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Trade unions in Sweden are extremely strong, with a high density rate currently over 70 per cent. It is therefore considered perfectly natural that the trade unions organise company codetermination. The duplication in Germany resulting from independent works councils is unknown in Sweden.

Also in contrast to the situation in Germany enterprise-level codetermination is not legally institutionalised. In Sweden the path chosen was to confer on trade unions the right to negotiate on all kinds of codetermination issues. In the event of conflict they have the right to strike even while the current collective agreement is still in place.

### **Relations between Companies**

In Sweden the employers' organisations also exhibit a high organisation rate. Strong partners on both sides was one of the key conditions underlying the success of the abovementioned agreements between employers and employees. Also characteristic of Sweden is the high level of cross-holdings between companies. Besides market relationships, finally, corporate information networks can also be brought to bear, whether for the provision of equity financing or for the purpose of technology transfer in cooperation between firms.

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*Companies  
closely intertwined*

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## Evaluation

Of all the countries examined in this book Sweden comes closest to the ideal type of coordinated market economy. The Swedish economy is characterised by the fact that employers and employees cooperate intensively in collective bargaining, both social partners are involved in the public endeavour of occupational training, corporate financing consists of a mixture of house banks, mutual shareholdings and corporate information networks as regards the provision of equity financing and these information networks are used for the purpose of technology transfer and also to foster cooperation between firms.

Sweden is noteworthy because it has been able to use its coordinated economic system and highly developed welfare state to combine a high level of economic growth, a fair distribution of wealth and low unemployment. In this way Sweden is perhaps the most successful embodiment of the aspirations of social democracy in comparison with the United States, the United Kingdom, Germany and South Korea.

*Close to the ideal  
type coordinated  
market economy*

Sweden		
<b>Gross domestic product per capita 2016</b>	27,538.8	GDP per capita in US\$ (Source: World Bank 2017)
<b>Average economic growth 2016 in comparison with previous year</b>	2.8 %	Average annual growth of GDP adjusted for inflation (Source: World Bank 2016)
<b>Government debt 2016</b>	38.55 %	Government debt as a % of GDP (Statista / Stata)
<b>Current account Q1 2017</b>	6.77 %	External trade balance exports and imports of goods as a % of GDP (Source: OECD 2017)
<b>Employment rate Q4 2016</b>	66.3 %	Share of those in employment aged 15–64 in the total population (Source: OECD Outlook 2016)
<b>Harmonised unemployment rate January 2017</b>	3.6 %	Share of unemployed in total active population (Source: OECD 2017)
<b>Income inequality/ Gini coefficient 2010–2015</b>	N.N.	Measure of income inequality, 100 = maximum inequality (Source: Human Development Report 2017, p. 206)
<b>Income inequality between men and women</b>	79 %	Earned income of women as a % of that of men (Source: Human Development Index 2015, p. 220)
<b>Poverty index (HDI) 2015</b>	0.901 (18)	The Poverty index is composed of various indices (inc. life expectancy, literacy rate, access to health care), Ranking worldwide: 0 = min. poverty, 1 = max. poverty (Source: Human Development Report 2017, p. 206)
<b>Tax ratios</b>	14.1 %	Taxes and social security contributions as a % of average gross wages (OECD/Taxing Wages 2017: 20)
<b>Trade union density 2013</b>	67.7 %	Share of active population organised in trade unions (Source: OECD 2016)

## 6. CONCRETE ECONOMIC POLICIES: PRACTICAL EXAMPLES

It was supposedly social psychologist Kurt Lewin who said »nothing is as practical as a good theory«. In order to bring out the practical relevance of the theories presented in the foregoing chapters to economic questions and issues of social democracy references to practice were provided throughout.

In this closing chapter these references are supplemented by practical examples from a number of controversial policy areas. The idea is to highlight how the basic values of social solidarity are reflected in everyday economic policy endeavours and how their economic policy principles are brought to bear.

These contributions are written by very different authors with diverse viewpoints. The examples cannot provide conclusive answers in constantly changing circumstances but rather aim to offer useful ideas and stimulate further thought.

**To complement this reader** further practical examples on the issues of the euro crisis, income and expenditure policy and privatisation are available at:

► [www.fes-soziale-demokratie.de/Lesebuecher/Mehrlesen.html](http://www.fes-soziale-demokratie.de/Lesebuecher/Mehrlesen.html)

### **In this chapter practical examples are presented that show:**

- how the energy transition can be achieved with a modern conception of the state;
- the challenges facing the economy and labour in the age of digitalisation;
- the relationship between debt and investment;
- why 'decent work' and codetermination go hand in hand.

## 6.1. Achieving the Energy Transition: An Entrepreneurial State for a Sustainable Electricity Market

*Carsten Schwäbe*

It is fair to say that the energy transition represents one of the most fundamental transformation processes imaginable in how Germany does business. The aim is to switch the entire energy supply to CO<sub>2</sub>-free and renewable production. In contrast to innovation processes such as electrification or digitalisation the energy transition will not involve the building of fundamentally new structures. Rather it will involve converting the existing structure of the energy supply to renewable energies, while ensuring at all times that supply is not interrupted. After all, energy is the fundamental factor without which our mode of production and way of life could no longer function.

### ► The Energy Policy Triad: Sustainability, Security of Supply, Affordability

The energy transition goes hand in hand with a number of concrete aims that no longer orient economic policy solely towards wealth creation but also towards the social challenge of sustainability. Top of the agenda here are ending energy production from nuclear fission and the use of fossil fuels. On one hand, the storage of residual nuclear waste that will remain radioactive for centuries constitutes too big a financial and environmental burden, quite apart from the destruction that would be wrought by a nuclear accident. This means that all Germany's nuclear power stations are to be shut down by 2020.<sup>21</sup>

On the other hand, the combustion of coal, gas or oil entails the emission of CO<sub>2</sub> and other greenhouse gases that boost global warming, thereby altering the earth's ecosystem in such a way that the polar icecaps are melting, raising the sea level and rendering some coastal areas and islands uninhabitable. Regions already afflicted by aridity will also be affected because global warming will exacerbate problems such as droughts and flooding. In future climate, change is likely to add to the causes of migration for many people.

In accordance with the Kyoto Protocol that many countries concluded at the end of the twentieth century Germany committed itself to a reduction of its CO<sub>2</sub> emissions by 40 per cent by 2020 in comparison with 1990 levels. In order to achieve this the German government has laid down multiple targets within the

<sup>21</sup> While other countries have opted to build nuclear power stations to achieve their climate targets Germany is striking out in a different direction with its energy transition.

framework of the energy transition aimed at making energy use in electricity, heating and transport emit less CO<sub>2</sub>. The Federal Ministry for Economic Affairs and Energy summarises these quantitative targets as presented in Figure 11.<sup>22</sup>

Within the framework of the energy transition the proportion of renewable energies in electricity, heating and transport energy consumption are to be increased, while energy consumption as such is to be reduced in all three areas. That means that energy efficiency has a key role in the energy transition. On the other hand, these sustainability targets are not to be achieved at any cost; that is why the energy policy triad of sustainability, security of supply and affordability are all on an equal footing.

In this section the focus is on the expansion of renewable energies in the electricity market. The Federal government has laid down a target of providing for at least 35 per cent of gross electricity consumption from renewable energies by 2020.<sup>23</sup> Given the constant growth in the share of renewable energies this target seems eminently achievable. In 2015 the share of renewable energies in gross electricity consumption already stood at 31.6 per cent.

Fossil fuels continue to account for the bulk of energy generation in Germany, however. Despite a slight fall in recent years the share of bituminous coal in gross electricity generation was still 18.2 per cent in 2015 and that of brown coal or lignite was 23.9 per cent. The running down of coal-fired generation to achieve ambitious climate targets by 2010 is still pending. Figure 11 presents the development of gross electricity generation in Germany from conventional energies in comparison with renewables.

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22 Federal Ministry for Economic Affairs and Energy (2015), Die Energie der Zukunft. Vierter Monitoring-Bericht zur Energiewende [The energy of the future. Fourth Monitoring Report on the Energy Transition], available at: <https://www.bmwi.de/BMWi/Redaktion/PDF/V/vierter-monitoring-bericht-energie-der-zukunft,property=pdf,bereich=bmwi2012,sprache=de,rwb=true.pdf>.

23 Gross domestic electricity consumption is given by adding together gross electricity generation and the balance of electricity imports and exports.





	2014	2020	2030	2040	2050
<b>GREENHOUSE GAS EMISSIONS</b>					
Greenhouse gas emissions, such as CO <sub>2</sub> (as against 1990)	<b>-27 %</b>	min. <b>-40 %</b>	min. <b>-55 %</b>	min. <b>-70 %</b>	min. <b>-80 to -95 %</b>
<b>RENEWABLE ENERGIES</b>					
Share of gross final energy consumption	<b>13.5 %</b>	<b>18 %</b>	<b>30 %</b>	<b>45 %</b>	<b>60 %</b>
Share of gross electricity consumption	<b>27.4 %</b>	min. <b>35 %</b>	min. <b>50 %</b> EEG 2025: 40 to 45 %	min. <b>65 %</b> EEG 2035: 55 to 60 %	min. <b>80 %</b>
Share of heating consumption	<b>12 %</b>	<b>14 %</b>			
Share of in transport sector	<b>5.6 %</b>				
<b>EFFICIENCY AND CONSUMPTION</b>					
Primary energy consumption (as against 2008)	<b>-8.7 %</b>	<b>-20 %</b>  <b>50 %</b>			
Final energy productivity (2008–2050)	<b>1.6 %</b> year (2008–2014)	<b>2.1 %</b> per year (2008–2050)			
Gross electricity consumption (as against 2008)	<b>-4.6 %</b>	<b>-10 %</b>  <b>-25 %</b>			
Primary energy demand buildings (as against 2008)	<b>-14.8 %</b>	 <b>-80 %</b>			
Heating demand buildings (as against 2008)	<b>-12.4 %</b>	<b>-20 %</b>			
Final energy consumption transport (as against 2008)	<b>1.7 %</b>	<b>-10 %</b>  <b>-40 %</b>			

Figure 11: Quantitative targets of the energy transition and the position in 2014



**Note:** The table presents the targets Germany has set for the reduction of greenhouse gases and the expansion of renewable energies. Interim targets were also set for 2050. (Source: BMWi 2015: 7)

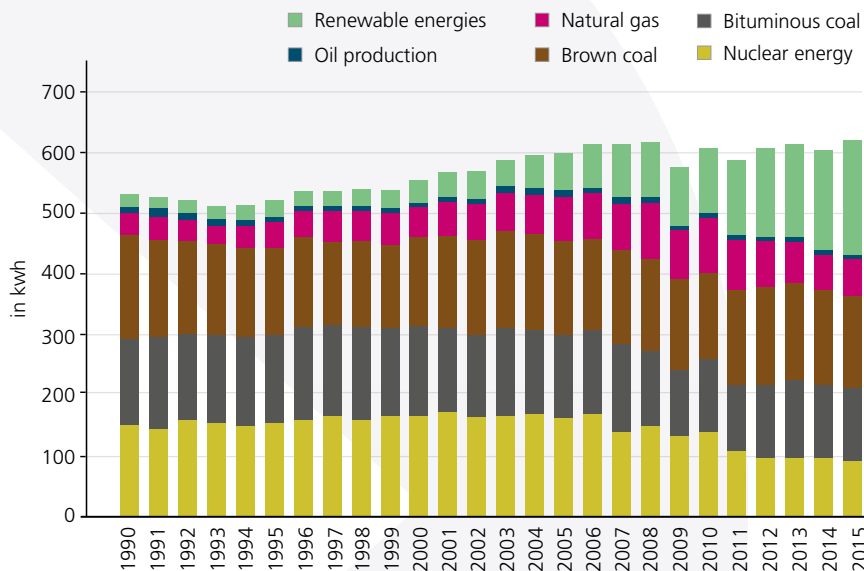


Figure 12: Gross electricity consumption in Germany from 1990 to 2015 in kWh  
(Source: Arbeitsgemeinschaft Energiebilanzen e. V. 2016)

**Note:** Figure 12 shows how much electricity was produced and from what sources during the period in question. The growth of renewable energies (green) and the reduction of electricity generated by nuclear power (yellow) are clear. There was no substantial reduction in power generation from brown coal (brown) and bituminous coal (grey).

### ➤ The Renewable Energies Act as Key Component of the Energy Transition

The Renewable Energies Act (EEG) represents a key component of the energy transition. Its initial incarnation was introduced by the SPD–Greens coalition government in 2000. It established fixed technology-specific payments for electricity generated from renewable energies that, as a kind of guaranteed demand,

established a strong incentive to build plants for the production of green electricity. This is in keeping with Mariana Mazzucato's finding that the state should not only make up for market failure but foster innovative sectors and markets. The EEG, for example, is aimed not only at coping with societal challenges such as the energy transition but also at realising new industrial policy prospects for exports through Germany's role as trailblazer in renewable energies.

While earlier economic-policy missions, such as civilian use of nuclear energy, were based on specific technologies the new 'mission orientation' as regards the energy transition is characterised by a more open approach in relation to technology. In the electricity market this means that not just one, but five renewable energy sources are to be considered as possible technological solutions: wind energy (land and sea), solar energy, energy from biomass, hydropower and geothermal energy.<sup>24</sup>

Since 2000 the government has introduced and further developed a number of support schemes to promote energy generation from these five renewable energy sources. Simplifying, the EEG operates in accordance with the following principles:

- **an obligation for the network operator to connect to the network:** network operators are required to connect plants for generating electricity from renewable sources and to expand the network for that purpose;
- **feed-in priority for electricity from renewable energies:** network operators are required to purchase, transmit and distribute electricity generated from renewable energies as a priority;
- **technology-specific feed-in payments:** the network operators are obliged to pay a sum defined by the legislator to the producers of electricity from renewable energies. This payment is fixed for 20 years for new plants. In the course of the expansion of renewable energies payments for new plants will be redefined and reduced on an annual basis.

The network operators would not be stuck with the additional costs of green electricity due to the fixed feed-in payments, however, but pass on the costs via the so-called EEG levy directly to the energy suppliers and ultimately to the end users. In order not to jeopardise the international competitiveness of energy-intensive industries in Germany they would enjoy special exemptions so that they would not have to pay the EEG levy.

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<sup>24</sup> Geothermal power stations aim to generate energy by drilling deep into the earth's crust to release geothermal energy.

Market formation via the EEG will shape the competition between conventional and renewable energies in such a way that the latter will be given the initial support they need to catch up with the efficiency level of the former. There are good reasons for this. Power stations were built on a large scale using the established technologies (brown and bituminous coal, gas and nuclear energy) and mass electricity production gives them economies of scale due to lower generation costs. Furthermore, long experience has yielded learning effects across the board that renewable energies will be able to achieve only in the course of market formation. Similarly the general framework – such as the energy network – is oriented more towards centralised electricity feed-in from power stations than towards decentralised feed-in from microgeneration units for solar and wind energy. The EEG levels out these competitive disadvantages to provide renewable energies with space to make their own efficiency gains through economies of scale and learning effects.

But why is a specific payment defined for each energy source and not one subsidy? From a regulatory policy standpoint this is problematic because it gives rise to competitive distortions between the different new technologies. For example, solar energy from photovoltaic cells for solar electricity always receives higher payments than wind energy. The reason for this is that innovation processes are still in their infancy for renewable energies. It cannot be predicted how costs will develop in the course of the first experimental installations and so all technologies are given the start-up assistance they need. In due course, however, payments will be adjusted so that energy sources with better cost structures and quality features will have a larger share of the electricity mix in the future. Others yielding poor results are likely to be phased out of the electricity mix.

### ► Development of the Expansion and Costs of Electricity from Renewable Energies

Since the introduction of the EEG in 2000 the production of electricity from onshore wind power and biomass has increased fourfold. The same applies to solar electricity from photovoltaic plants that have been part of the electricity mix only since the EEG came into force. Given geological conditions in Germany, however, hydropower has not been further developed. Since 2013, moreover, offshore wind power has established itself as an independent renewable alternative, which also receives an EEG payment. To date geothermal energy has remained confined to a few experimental plants and has made no significant contribution to the renewable energy mix.

Problems persist with the integration of electricity from photovoltaic and wind energy plants, however. In contrast to biomass or hydropower, which, as the need arises, can be converted into electricity as in the case of a large power station, in particular solar but also wind energy face the problem that they cannot generate electricity on demand. The sun shines during the day but electricity is also needed at night. Batteries and energy storage technologies are therefore key to the success of the energy transition. Furthermore, it is necessary to expand the network and improve infrastructure in order to better match supply and demand for electricity. That applies, for example, to the transfer of electricity from the windy north to the south of Germany.

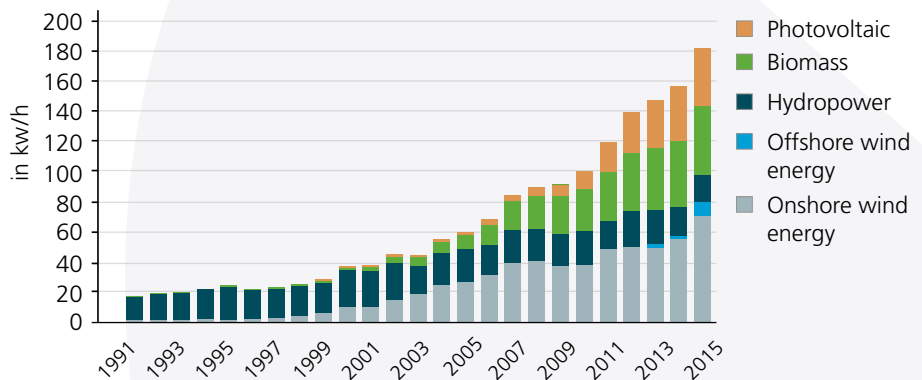


Figure 13: Gross electricity generation from renewable energies, 1991–2015

(Source: Arbeitsgemeinschaft Energiebilanzen e. V. 2016.)

**Note:** The figure shows how much electricity was generated from renewable energies in Germany during the relevant period. Since the entry into force of the EEG in 2000 there has been a substantial increase in electricity from solar plants (photovoltaic – yellow). The same applies with regard to biomass (green) and wind energy (light blue), which to date have proved to be the biggest sources of electricity from renewable energies in Germany.

As regards the costs of establishing green electricity plants, substantial cost reductions were achieved particularly with regard to photovoltaic energy in the form of learning effects and economies of scale. On the other hand, photovoltaic energy for a long time received particularly high EEG feed-in payments that

were lowered only much later. The upshot is a strong expansion of photovoltaic capacities in Germany, which has proved difficult to marry with electricity demand, given the more difficult distribution conditions for photovoltaic electricity. This oversupply has been accompanied by a sharp rise in employment in the photovoltaic sector that is likely to be hard hit as feed-in payments are substantially curtailed.

In order to coordinate the expansion of renewable energies with expansion of the network and the development of the necessary storage technologies the federal government has imposed a limit on the former in the shape of a 'flexible ceiling'. If capacity of a certain energy source is expanded beyond the prescribed ceiling feed-in payments will be substantially reduced for further installations. This measure will also restrict the dynamics of cost development as a result of the EEG. As Figure 14 shows, total tariff payments under the EEG increased from just under 1 billion euros in 2000 to around 30 billion euros in 2016. With a budget of 316 billion euros that corresponds to just under 10 per cent of the federal budget for 2016.

In order to ensure the affordability of the energy transitions further reform measures are under discussion under the aegis of the EEG. On one hand, the generous derogations have been criticised for companies in international competitive energy-intensive industries that are not required to pay the EEG levy, the upshot of which is that other companies and private households have to shoulder the cost. On the other hand, from 2017 the provision of support was set to change, with the government allocating fixed expansion quotas by competitive tender to interested companies. Companies requiring the least subsidy are likely to prevail. This boosts competition between companies and, at the same time, improves coordination of expansion. Competition in the renewable energies market will also be boosted because the promotion of this sector has fostered the development of strong companies better able to stand on their own feet. Critics regard use of the tender model as an unnecessary restriction on expansion of renewable energies, however, threatening the sector and its jobs.

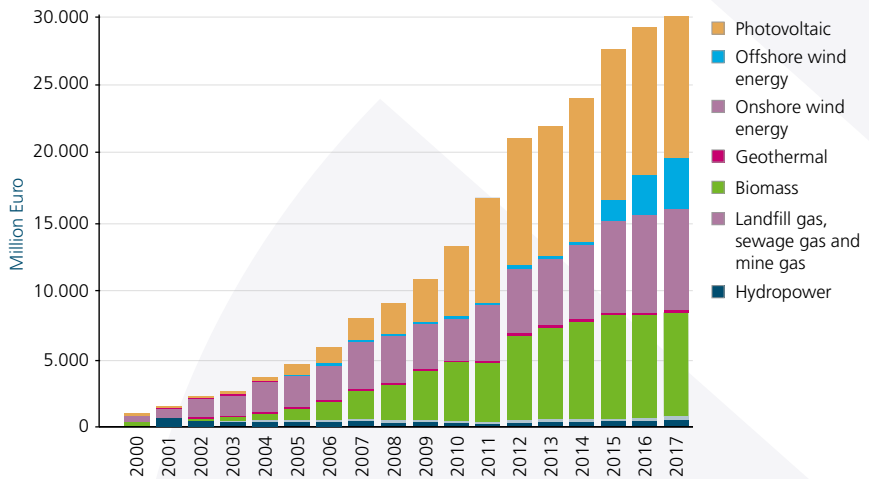


Figure 14: Total EEG payments in euros, 2016 and 2017 (millions)

(Source: BMWi 2016)

**Note:** The figure presents the total financial resources employed under the aegis of the EEG each year to promote renewable energies in the electricity market. Biomass (green) and photovoltaic energy for the generation of solar electricity (yellow) stand out here, while wind energy received lower funding.

### ► The EEG as an Instrument Necessary for Market Formation

The EEG has given a major boost to the expansion of renewable energies in Germany's electricity supply, forming a new market. From a regulatory policy standpoint, critics have identified problems with these technology-specific subsidies because they distort competition for the best solution between these technologies. The EEG's technology-specific perspective has made it possible, however, to evaluate technologies in terms of their economic development and to adapt support accordingly. Even though continuous reforms make long-term planning difficult such a dynamic and adaptable policy is essential to respond to the dynamics of innovation processes. This management via experimentation and adaptation is in keeping with an innovative entrepreneurial spirit that not only companies but the state needs in relation to such fundamental transformation processes.

Besides the further expansion of renewable energies the second energy-policy challenge in future years will be the exit from coal-fired power production. In 2015 Minister of Economic Affairs Sigmar Gabriel proposed that brown-coal power stations more than 20 years old must acquire twice as many CO<sub>2</sub> certificates within the framework of the European emissions trading scheme. This would make the operation of in particular older, high-emission coal-fired power stations unprofitable, while lower CO<sub>2</sub> gas-fired power stations would become more attractive again as a bridging technology. These plans were dropped however, because of strong opposition in the CDU/CSU and the SPD, as well as major protest actions on the part of IG BCE in Berlin. The focus here was on regions in North-Rhine Westphalia and Lusatia whose prosperity depends on coal and thus on coal-fired electricity generation.

Instead of shutting down older brown coal-fired power stations they were shunted into a so-called capacity reserve to cope with peak power demand. Although these are rarely used the costs involved are high. This policy is to the detriment not only of gas-fired power stations as a lower CO<sub>2</sub> alternative, but also of the regions themselves, as no substantive strategy has yet been developed to cope with the structural change away from coal-fired electricity generation coming over the next 40 years. Careful consideration must be given to the development of new economic activities in coal regions and the shaping of the transformation to cleaner energy in a socially responsible way.

## 6.2. The Economy and Labour in the Digital Age

*Carsten Schwäbe*

»The internet is a new country for all of us.« With these words uttered in 2013 Chancellor Angela Merkel caught the attention of the internet community. After all, for many people the internet and digitalisation are hardly terra incognita but everyday life. We receive information from the internet on a daily basis, whether from our smartphone, tablet or computer. We are becoming more and more connected at work and in private life in the digital world. So-called 'digital natives' were therefore slightly bemused by Mrs Merkel's assertion.

There is an element of truth in it, however. Even though we entered this new land a fair while ago now many far-reaching development steps are yet to be taken in internet use and digitalisation. Behind slogans such as 'Industry 4.0', 'Big Data' or 'crowdsourcing' lie new forms of production and ways of working whose eventual effects on the economy and labour in the digital age we are only dimly aware of. Many regard the digital revolution as an innovative process that will replace old technologies and ways of life as fundamentally as industrialisation. Economist Joseph Schumpeter saw this »creative destruction« as the essential core of capitalism (Schumpeter 1950). There is no doubt that this transformation will take place. Where this innovation process will lead us, however, is less easy to determine.

'Digitalisation' is a fairly vague term. It does, however, highlight a feature shared by all development processes linked to it: the common basis comprises digital information and communication technologies (ICT). Over the past few decades these have developed relentlessly. In the 1990s, for example, hard disks of 1 gigabyte were still enormous and expensive. Today 1 terabyte laptops are not unusual and even affordable for most people. Processor speed and data transfer have increased so much over the past decade that instead of storing huge amounts of data on our hard drives we have direct access to films and music on the internet, wherever we might be. Such developments enable digital ICT to penetrate more and more areas of the economy and society. And by enabling borderless communication, they represent the main driver of globalisation.

### ► The Digitalised Economy: Is Capitalism Still Dominant or Is It Sowing the Seeds of Its Own Destruction?

The internet and the new ICTs are creating new possibilities for the manufacturing and distribution of goods and services. 'Start-ups' – newly founded small companies with innovative business models – are sounding out which of these business models people will really want. Such firms are innovative not so much in terms of formal research and development, as is usually the case in, for example, big companies in automobiles, chemicals or pharmaceuticals. Most are based on ideas for new apps for smartphones or offer new services on the internet; for example, simple programs to develop video games or apps to organise fitness training, language learning or discover and rate new restaurants near where they live.



New user models are establishing themselves within the framework of the so-called 'sharing economy'. Instead of using their own cars many people in big cities use services through which they can hire a car quickly and easily, as the need arises. It's easy to find out where the nearest car is using an app. It can then be used and simply parked at the destination, from which the next user can pick it up. This kind of car sharing replaces ownership by providing the option of immediate access to a consumer good and is only one example of the digital 'platform economy' (Lobo 2014). Facilitation services such as Uber for transport services or AirBnB for short- and long-term rented accommodation present themselves as 'platforms' that bring together supply and demand. People can offer or use transport services or accommodation, with the platform taking a cut from each transaction. In this way, for example, AirBnB has become the world's biggest landlord without even owning the relevant properties.

Even though these new companies generally began as small start-ups, digital platforms in particular tend, after a competition phase, to become monopolies. This is evident not only in relation to AirBnB and Uber, but also the famous internet giants such as Facebook, Google and Amazon (Dobusch 2016). Market dominance arises from two advantages enjoyed by bigger platforms over smaller competitors:

- **Economies of scale:** operating costs for an internet platform are constant. New users do not entail new costs, so that more users automatically generate higher profits. When higher profits can be obtained as the number of users rises economists talk of economies of scale or scale affects.
- **Network effects:** The higher the number of users, the stronger the incentive for new users to use these platforms because, for example, supply and demand are greatest there. Facebook's dominance is due to the fact that most people visit it rather than other social networks.

Regulatory intervention is needed in response to the market dominance of many digital platforms, but as they operate internationally they can evade national law and even taxation.

### ➤ Shaping the Internet Economy in accordance with Social Justice

Even though we have already entered the new realm of the internet its regulation and the policymaking on digitalisation represent a major challenge to society.

Access to the internet is already one of the main prerequisites of social inclusion. In order to ensure equal participation for all in this advance net activists are calling for the implementation of net neutrality as a fundamental condition of a free and participatory internet. Net neutrality means that the providers of internet access always handle data on an equal footing.<sup>25</sup>

This concerns in particular the speed of data transfer. Net neutrality means that basically all customers and all possible internet service providers receive the same data transfer speed. Certain services or firms with deep pockets cannot buy particularly high data speeds, which would represent a massive competitive advantage over competitors without such resources. In this way the network and all services remain basically accessible to all.

Apart from a few exemptions in autumn 2016 the European Parliament adopted a regulation to anchor net neutrality.<sup>26</sup>

From an economic standpoint Dobusch (2016) advocates three starting points for regulating internet digital platforms that have a tendency towards monopolisation:

- Platforms with market power should open up their databases to third-party providers. For example, Google's search algorithm could be made available for a state-defined fee, so that new competitors do not have to invest enormous resources in constructing and further developing their own search algorithm. This would remove a crucial barrier to market entry.
- The program source codes of software-based platforms, such as Microsoft's Windows operating system or Apple's iOS should be disclosed so that competing alternatives can be developed for individual software packages on the basis of the operating system.
- Social networks such as Facebook should be opened up, making it possible to link up different providers in a given social network on the basis of mandatory compatibility. Customers could have certain services provided by alternative providers instead of by Facebook without leaving Facebook's network as such if they were able to customise their interface.

25 In Germany the blog [netzpolitik.org](https://netzpolitik.org) is one of the most important institutions for net policy and has always taken a firm stand in favour of the principle of net neutrality.

26 On this see, for example, <https://netzpolitik.org/2016/europa-sichert-die-netzneutralitaet-das-bedeutet-die-regeln-im-alltag/#comments/>. Detailed information and the latest research on the issue of net neutrality area available at [www.netzpolitik.org](http://www.netzpolitik.org), which also deals with other issues related to digitalisation, such as internet civil liberties.

## » What Are the Consequences of 'Industry 4.0' for the Capitalist Economic System?

Digitalisation is taking place not only through new internet-based business models. Traditional leading industries in Germany, such as the auto industry and machine building, will benefit from new opportunities, as well as needing to adapt. Developments towards the production of tomorrow are known collectively under the heading 'Industry 4.0':<sup>27</sup>

*»Industry 4.0 is a highly automated and networked industrial production and logistics chain. This merges virtual and real processes on the basis of so-called cyber-physical systems. This makes possible highly efficient and highly flexible production that incorporates customers' wishes in real time and enables a wide range of product variation.« (BMAS 2015: 15)<sup>28</sup>*

It is hoped that 'Industry 4.0' will make possible extremely high productivity gains. More and more activities and production steps could be taken over by intelligent machines, which will take other forms besides networked robots. Self-driving cars, intelligent heating and lighting systems for housing or watches that monitor health are only a few examples of the so-called 'internet of things', which harbours the potential for an unprecedented level of efficiency. This is because digitalisation is now taking place not only in smartphones or computers but practically everywhere.

According to economist Jeremy Rifkin (2014) the extreme productivity of the digitalised economy could call into question even our economic system. The automation of networked robots and production on demand will bring down marginal costs lower and lower. Only the fixed costs of factories or machines would remain substantial, says Rifkin. The variable costs, such as wages and material costs, which depend specifically on the quantity of goods produced, would be reduced to practically nothing as human labour is replaced and efficiency continues to improve.

27 While 'Industry 1.0' encompasses the first, steam engine-driven wave of industrialisation, 'Industry 2.0' refers to assembly line production. Computers were already part of 'Industry 3.0' in the 1970s, setting in motion the first automation processes. 'Industry 4.0' continues this process at a much more fundamental level as automation is now networked with humans and links machines and many production processes are now digital.

28 The white paper 'Arbeiten 4.0' (Work 4.0) of the Federal Ministry of Labour and Social Affairs (BMAS) contains an interesting overview of opinions concerning the digitalisation of the economy and labour in our society, as well as a discussion of and proposals for policy measures.

Because in a competitive market economy prices are based on marginal costs per product unit not only marginal costs but also prices would fall to nothing. For Rifkin digitalisation harbours the potential to overcome the key problem of mainstream economics, the scarcity of goods and resources. Constant productivity gains could thus remove the logic of capitalism from many areas of the economy.

A number of examples of this are already available. Additive manufacturing by means of 3D printers does not require human labour. Only electricity and material costs are incurred. Design is accomplished by the relevant cooperating internet community – also known as the crowd – itself. Designs for products to be printed can already be downloaded from the internet. And the essence of the economy that, according to Rifkin, will crowd out capitalism lies precisely in this form of cooperation. Analogous to the idea of the 'sharing economy' more and more collaborative common goods of this kind would be produced. For example, the Encyclopaedia Britannica would be accomplished with the participation of different actors on a voluntary, cooperative basis. Rifkin regards the monopolised platform economies, such as Facebook or Google, as a temporary phenomenon. Long term, people will want to assume control over these platforms and organise them jointly as collaborative common goods.

Whether and to what extent Rifkin's vision of the future will be realised and co-operation replace competition in the economy of tomorrow remains to be seen.

### ► Work 4.0 – What Activities Are Changing and Which Ones Are Disappearing?

Digitalisation is not only ushering in new production opportunities. Forms of working are also changing. For that reason the Federal Ministry of Labour and Social Affairs (BMAS) implemented a major discussion between 2015 and 2016 under the heading 'Work 4.0' and formulated a policy agenda for the digitalisation of work in response to the new development trend.<sup>29</sup> It is important to note that this is not occurring on the margins of the labour market, but affects the gainful employment of workers and the self-employed in general.

<sup>29</sup> The findings were presented in the white paper 'Arbeiten 4.0', which is available at [https://www.bmas.de/SharedDocs/Downloads/DE/PDF-Publikationen/a883-weissbuch.pdf?\\_\\_blob=publicationFile&v=4](https://www.bmas.de/SharedDocs/Downloads/DE/PDF-Publikationen/a883-weissbuch.pdf?__blob=publicationFile&v=4).

*»The deployment of modern information and communication technologies makes it possible to set work free from existing constraints, such as the spatial, temporal and organisational structures imposed by firms – with fixed working time and workplaces and a long-term tie between employees and the company – in favour of a new openness.« (BMAS 2015: 65)*

Digitalisation permits an unprecedented flexibility with regard to work. In many workplaces, for example, teleworking or mobile working are already common practice. This is still scarcely conceivable in relation to occupations that require personal presence, however, such as care work or education. Furthermore, for many employees these supposed 'new freedoms' do not confer greater leeway in organising their lives. Planning working time and leisure time has become more difficult, not least in the context of relentlessly increasing global competition. For example, the 'opportunities' offered by mobile working are rapidly leading to the expectation that workers can be reached at all times. New employment protection solutions must be found by the social partners and the government.

The new labour 'freedoms' in the digital age are also creating new work models. In the case of 'crowdworking', for example, companies give out smaller tasks to tender, such as research or services, via digital platforms. Members of the digital 'crowd' with the right skills then submit offers on a freelance basis. Because such activities can be performed worldwide there are many people who even take advantage of this kind of working not just to earn a living but to travel around the world. On the other hand, atypical employment relationships are on the rise precisely in occupations that provide services on demand.

Hand in hand with flexibility comes uncertainty about income and wealth, so that it becomes more and more difficult for people to plan their lives. The welfare state, what's more, faces the future challenge of integrating such 'self-employed' workers of the digital age in the social insurance system. At present they are scarcely able, for example, to pay pension insurance contributions or accumulate entitlements for old age. On top of that, the question arises of how people 'in the crowd' will be able to organise to articulate their interests over against those who commission their work. In particular in the area of online platforms for services discussions and possibly regulations are needed to counteract the tendency to exploitation.

Not only work is changing with the advent of digitalisation. The innovations accompanying digitalisation also harbour a strong potential for making obsolete all sorts of activities hitherto performed by people. According to a study by the Institute for Labour Market and Occupational Research (Dengler 2016) in Germany around 15 per cent of employees subject to social security contributions are at high risk and as many as 45 per cent at medium risk of being substituted by computers or robots. Both auxiliary and specialist occupations are equally at risk. Not only simple manual activities, but also the planning and precise calculations involved in building or machinery can already largely be performed by computers. Only an academic education leads in all occupational segments to a lower substitution potential.

Particularly affected by this are manufacturing jobs tasked with the concrete production of goods. But even activities such as the rudimentary correction or proofreading of simple texts or producing sports reports – for example based on the football results – could be automated. By contrast, teaching occupations or other social or cultural services have limited potential for substitution. It is still hard to imagine care work or education not being done by humans.

Given these developments the high substitution potential with regard to 15 per cent of employees subject to social insurance contributions hardly justifies talking of some sort of supersession of labour. Various kinds of work have been replaced many times in the past, but new activities always took their place. For example, even computer guided machines have to be developed and monitored. It is nevertheless important to raise the question, with regard to areas in which work is being replaced, of how the emerging efficiency gains will be distributed. Furthermore, accelerated technological change is constantly downgrading old skills. Changing occupations is increasing and thus the need for lifelong learning. In particular the skills required to cope with the new technologies and programs must be acquired and then constantly developed, if workers are to be able to keep pace with the digitalisation of the labour market. The political task will therefore be to organise lifelong learning of such skills both within companies and through state provision and incentives.

## 6.3. Budgetary Policy: Debts – Making – Growth

*Michael Dauderstädt*

Between 2007 and 2009, in the wake of the financial market crisis and the so-called 'Great Recession' public debt grew sharply throughout the world. On top of this comes a long-term trend of rising indebtedness in democratic capitalism, triggered by tax cuts for high earners and companies, as well as increasing welfare entitlements (cf. Streeck 2013). In many countries with growing inequality states – to put it in the terms of mainstream economics – borrow from (ever richer) savers instead of taxing them.

In the crisis even in Germany the state bailed out banks and launched economic stimulus packages (for example, the 'scrappage premium' for cars), thereby heading off an ever deeper crisis. German public debt rose from 1.6 trillion euros to over 2 trillions euros; that is, from around 64 per cent of GDP to over 80 per cent. In response to this massive debt increase the then government coalition (CDU/CSU and SPD) decided to insert a so-called 'debt brake' into the German constitution (the Basic Law). This sharply curtails the federal government's new borrowing, which is now restricted to 0.35 per cent of GDP and can be used solely as leeway for new investment. From 2020 the Bundesländer will no longer be able to engage in new borrowing. In fact, Germany has been able to consolidate the state budget. Debt has fallen slightly and the debt-to-GDP ratio had fallen back to 71 per cent by 2015 and looks set to be brought down below 60 per cent by 2020.

In other countries – especially in the euro zone – development has been less favourable. In 2010 news of Greece's new borrowing, which was higher than expected, triggered a panic on the financial markets for public debt. This panic also threatened to engulf Spain, Portugal, Ireland and Italy. Under German pressure the EU and the European Central Bank (ECB) refrained from halting the panic with immediate guarantees. Instead, reluctant bail-out measures were introduced – in the form of 'protective shields' and new funds – which required of all the countries affected that they introduce a debt brake and accompanying 'austerity' measures. As Mark Blyth (2014) has shown, this policy only served to plunge the countries in question even deeper into crisis. Their economies shrank, their debt-to-GDP ratios were ramped up and unemployment grew sharply. Even the IMF, which had been closely involved in the 'aid' programmes,

later claimed that it had grossly underestimated the negative consequences. Only ECB president Mario Draghi's declaration in 2012 that he would do 'whatever it takes' to maintain the cohesion of the euro zone stabilised the situation somewhat. But the economic and political damage was done and continues to hobble Europe to this day.

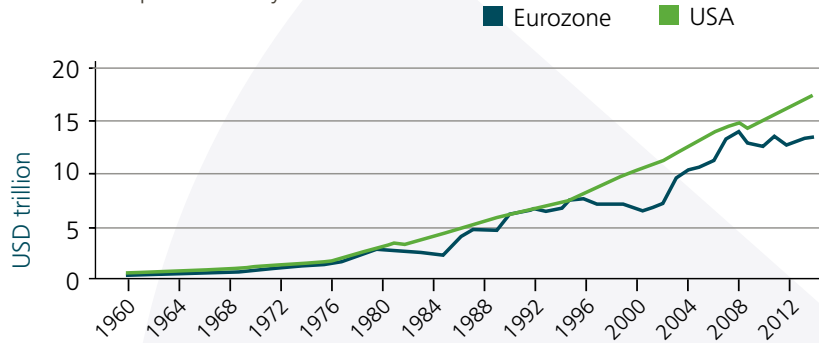


Figure 15: Development of GDP in the USA and the Eurozone at market prices (US dollars)  
(Source: World Bank.)

The budgetary policies of other countries have put more emphasis on growth. The United States, the United Kingdom and Japan allowed their public debt to rise. The two Anglo-Saxon economies – the models for market liberal capitalism – had similar debt levels to Germany's before the crisis (around 50 to 70 per cent), but in the meantime these shot up over 110 per cent. During the crisis their growth was well above that of the euro zone and unemployment fell more rapidly (see Figure 15). Japan's debt-to-GDP ratio has now reached the unprecedented level of well over 200 per cent without panic breaking out in the markets. On the other hand, its economy has shown only weak growth for decades now, albeit with low unemployment. In a study seized upon gleefully by opponents of borrowing and proponents of austerity (Reinhardt/Rogoff 2009), which had forecast growth problems for countries with public debt above 90 per cent, turned out to be based on computational errors.

### ➤ Growth and Debts

Obviously the relationship between growth and (public) debt is not so simple. A more systematic approach reveals that growth is hardly conceivable without debt. If the supply of goods and services in an economy is to grow, there must be corresponding demand. That entails more money in circulation: if the amount of money in the economy remains the same, the greater supply could be absorbed



only within the framework of deflation and falling prices. Deflation, however, stifles growth because buyers tend to hold out for even lower prices and investors can expect lower returns. And if, on top of that, households or companies in the economy wish to save, others have to spend more than they earn. The expansion of the amount of money in the economy and the absorption of savings thus require a readiness to take on debt.

According to mainstream economics, in the regular capitalist growth process private households save and private firms (if need be, also the state) absorb these savings. In Germany, for example, in 2012 private monetary wealth (in other words, accumulated savings) stood at around a net 3.3 trillion euros as against around 1.4 trillion euros in corporate and public debt (the rest was owed by foreign countries). Theoretically, the state could and should take on no more debt if the private sector was willing to absorb all savings. Unfortunately that is not always the case. In times of crisis firms hold back from investing. This entails the risk of a downward spiral if demand and growth decline, firms cut investment in response and this leads to unemployment and continued falling demand.

It was Keynes who recognised in the Great Depression (from 1929) that this vicious circle can be broken by debt-finance state spending. Additional state expenditure creates demand that is even higher than the public deficit because the income from state spending (for example, to construction firms) indirectly boosts further demand for investment and consumption goods (the multiplier effect). On the other hand, cuts in state spending shrink demand. It is this neglect of the multiplier effect that has led to such horrendous consequences as austerity policy has been imposed on southern Europe.

### ► How Much Debt Is Too Much?

Many people believe that high government debt is a big problem, as would indeed be the case for an individual or a private household. But the state differs from companies and households because it is permanent (even after 'bankruptcy') and can levy taxes by law. The very fact that many states have had high debt levels for long periods shows that a high level of government debt does not necessarily lead to panic on the financial markets. As long as a state's debts are in its own currency it can avoid panic with the help of the central bank. For that reason US, UK or Japanese government bonds are a safe bet. In the case of Greece (whose debts are in effect in a 'foreign' currency, the euro) the ECB should have issued a corresponding guarantee in 2010.

A state can run permanent budget deficits (and thus rising debt) without the debt-to-GDP ratio and corresponding interest payments rising without limit. As long as a country's GDP and thus its tax revenues are growing the debt-to-GDP ratio stabilises at an equilibrium value corresponding to the quotient of the deficit ratio and the growth rate. This model also underlies the EU's Maastricht Criteria, which lay down a deficit limit of 3 per cent of GDP and a debt limit of 60 per cent of GDP. In the case of a growth rate for nominal GDP (sum of inflation and real growth) of 5 per cent that works fine. Unfortunately, the deflationary EU of today (2016) is a long way away from that level of growth. Without deficits and new borrowing (debt brake) the debt-to-GDP ratio would slowly tend towards zero.

But even in the absence of market panic a government cannot be indifferent to the development of public debt. Although new debts create demand (which is generally useful) if there is no corresponding growth in supply inflation will be triggered. An extreme example is Germany's traumatic hyperinflation of 1923, in response to which German economic policy gave priority to price stability over growth. If the economy starts to overheat private demand outstrips supply and it is wise to implement a countercyclical fiscal policy, with the state 'saving' – in other words, running a budget surplus – and pay down debt (like Spain during the construction boom of 2005 to 2007). Furthermore, debts have to be serviced and rising debt means that an increasing portion of government revenues have to go to public debt servicing and are no longer available for other spending, such as social security, education or health care. Because interest flows to mainly richer creditors debts redistribute tax revenues to wealth owners. The benefits that accrue from debt-financed activities (public goods for all) can be restored through state redistribution, however.

Other arguments levelled against public deficits and debt, however, are more ill-founded. For example, public debt does not burden future generations because the latter inherit wealth as well as debts. No child will complain if they receive 1 million euros' worth of German government bonds. Also the idea widespread in mainstream economics that deficits do not stimulate demand because households cut their spending in the expectation of future tax increases to pay for current government expenditure (the notorious 'Ricardian equivalence') blithely ignores the fact that other households (those of creditors) can, correspondingly, count on future interest income and debt repayments.

Any adequate macroeconomic examination of public debt has to evaluate it in the context of private sector savings and investment behaviour. Private households save, for example, to provide for old age. They can pass on these savings – with the financial sector (banks or insurance companies) as intermediaries – to private companies or to the state. If firms invest too little and raise loans to absorb private savings then three possibilities remain: the state borrows or – in an open economy – the foreign sector or the economy contracts until the savings have decreased sufficiently.

For years the German economy has been unwilling to absorb household savings completely. Companies underinvest and/or are in a position to fund investment from profits. Because the state does not incur any more borrowing or even saves on its own account (because, among other things, it has curtailed public investment substantially) only the foreign sector remains. Germany loans the rest of the world the equivalent of 6 to 8 per cent of its GDP annually, which other countries can use to buy more German exports than they obtain from sales in Germany. That is the other side of Germany's current account surplus, namely the overhang of exports as against imports. Christian von Weizsäcker, a prominent, rather conservative economist is already talking about an investment crisis that requires a significantly higher level of public debt in order to offer savers low-risk alternatives.<sup>30</sup>

### ➤ Budgetary Policy for a Prosperous Future

Our future prosperity will not be safeguarded by piling up monetary wealth. Such capital is only worth as much as the investments it is used to finance. If it goes abroad we have to trust that the debtors there use it wisely and also in future will be willing and in a position to forgo their own consumption for our benefit. It is less risky if companies invest in their own country in order to create supply capacities and sources of income. The private economy's current reluctance to invest, however, show that even this option is fraught with uncertainties.

If the state takes up these savings it can invest to ensure our long-term prosperity. This includes infrastructure and housing, but also many things that traditionally do not count as investment but that sustainably boost the performance of the economy, such as education and training, health care and research and development.

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<sup>30</sup> Cf. <https://www.coll.mpg.de/download/Weizsaecker/Subsidiaritaet.pdf> (accessed on 12.10.2016).

## 6.4. Decent Work and Codetermination: The Policy of 'Decent Work'

*Wolfgang Schroeder*

Every society has its own understanding of the importance of 'gainful employment'. Answers to the question »what is decent work?«, however, not only differ between different societies, but also, because of an increasing pluralisation of societal employment and living conditions, are also contested within individual societies. In this sense the importance of work is at the centre of conflicts about market-economic participation and distribution. In democratic societies this goes beyond conflicts within the firm to include public controversies shaped by political parties and social movements, but also trade unions and employers. At present we find ourselves – together with the opportunities and risks that digitalisation offers in the form of the fourth industrial revolution – in a particularly uncertain environment with regard to the future importance and development of gainful employment.

In the debate on the consequences of accelerated digitalisation on the labour market far-reaching 'horror scenarios' concerning the loss of available employment are going around, which at the same time provide new nourishment to the thesis of the 'end of work'. Those who take this view traditionally argue that because of technological development modern societies are running out of gainful employment and that full employment is thus a thing of the past. On the other hand, it is argued that hitherto all technological innovations have led to more employment, even if the volume of work has fallen. In other words, to date more new jobs have been created as a result of technological advances than old ones have been lost (compensation thesis), as a result of which more people than ever before are involved in gainful employment. These new jobs, however, are often part-time. They are more 'flexible' and often more insecure, even precarious. These days fears are raised concerning a 'flexibilised hyper work-oriented society' than concerning the end of gainful employment.

### ➤ A Transformation in Work Organisation

Even though the shaping of gainful employment is the subject of broad social debate only in certain milieus, nevertheless it exerts a strong influence on employees' everyday lives. In the past industrial employment was closely interwoven with assembly line work, whose pace was dictated by machines. Although so-called Taylorist work organisation, characterised by standardisation, monitoring of individual

performance, selection of workers, social isolation and centralisation of company organisation, hand in hand with scientific work planning, did not encompass every-

The term '**Taylorism**' refers to Frederick Taylor (1856–1915). His aim was to organise work as efficiently as possible. His starting point was that workers function in accordance with the same principles as machines and he tried to structure operating processes in assembly lines.

one its decisive influence affected society as a whole. The history of the labour movement, too, especially the trade unions, is scarcely imaginable without Taylorist/Fordist work organisation and large enterprises, which gave impetus to trade union growth.

Car factories played a decisive role in establishing new and innovative forms of work organisation. From the 1980s onwards, a new and innovative organisational model developed alongside Taylorism and Fordism that one might call 'Toyotism', named after the work organisation practices pioneered at Japanese automaker Toyota, centred on team work. The aim was to break away from the drawbacks of the rigid and inflexible Fordist division of labour to provide stronger incentives to develop the capabilities of individual workers. At the same time, this form of work organisation was accompanied by the hope of creating a more varied, more interesting and more skilled working situation, in which employees are given greater individual leeway with regard to the disposition of their workload and participation in key decision-making. It seemed that team work would come to symbolise a new world of work, in which cooperation in the context of a group would go hand in hand with an upgrading of the individual in the production process. This concern also corresponded to the aims of trade union shopfloor policy.

The abovementioned new forms of organisation became relatively widespread in Germany, by international comparison, leading many to talk of a German 'Sonderweg'. The basis for this is provided by the particularly strong structure of qualified workers and the dual training system. The idea of harmonising humanisation and rationalisation is part and parcel of this, in turn furnishing a productive basis for the project of flexible specialisation in export-oriented industry. In the meantime a certain disillusionment has set in. Although team work has been extended, it has fallen well short of expectations concerning a far-reaching humanisation of the world of work. On the contrary, in many areas opportunities for employee self-determination in the workplace have been further reduced in favour of even greater standardisation.

With increasing globalisation and digitalisation – while at the same time traditional industrial jobs in large enterprises are being scaled back – a public debate on borderless, flexible and 'subjectivised' work is coming to the fore. These new forms of work are found primarily in services and small enterprises, frequently also in the form of a novel self-employment. These new forms of work are associated with the end of the established working time regime. The talk is of 'working without end'. For example, in the age of e-mail and mobile telephones many employees are expected to be permanently accessible, even beyond the legal requirements. On one hand, this can go hand in hand with more autonomy and improved reconciliation of work and private life, thus enabling more job satisfaction. On the other hand, it can lead to new forms of overload, resulting in stress and even exhaustion due to work. In this context the notion of the 'entrepreneurial employee' has been concocted, forcing workers to be responsible for their own employability. The emphasis here is on a process of development from the proletarian wage earner through the 'professionalised' worker to the 'entrepreneurial employee' within the firm. 'Entrepreneurial employees', who to some extent organise themselves under market-like conditions, have three main characteristics: individualised qualifications, systematic self-control over their work and constant risk of self-exploitation as a result of precarious social protection. Because the so-called 'entrepreneurial employee' is a social construct that allegedly corresponds to a new stage of the market-based economy, the sociologists Voss and Pongratz have come to the conclusion that a new kind of power relations have emerged within the firm: »The contradiction between capital and labour in capitalist firms does not disappear with the advent of the entrepreneurial employee, but is transformed into a structural contradiction between different kinds of entrepreneur« (Voss/Pongratz 2003: 32). Even though, as critics have rightly objected, this type is still a long way from dominating the working world the characteristics we have emphasised here are already widespread.

#### ► The Policy of 'Decent Work'

This is a good place to bring up the concept of 'decent work', which, on one hand, is linked to the project of 'humanising working life' pursued in the 1970s and 1980s, and on the other hand has been taken up by international initiatives, above all from the Nordic countries and the International Labour Organization (ILO). The ILO has developed a 'decent work' model. German trade unions adopted a more systematic reflection on the conditions and opportunities of a humane

working world at the DGB national congress in 2006. Accordingly the trade union and works council guidelines on 'decent work' are based on four pillars:

1. Decent work is well paid work.
2. Decent work is secure work (employment protection, reduction of temporary work, fixed-term employment and contract work).
3. Decent work is humane work (limitations on workload, reconciliation of work and family life and so on).
4. Decent work offers opportunities for social mobility and further training.

The concept of 'decent work' is understood as an alternative to neoliberal approaches in accordance with which only management and the market determine working conditions. Instead, 'decent work' is the cooperative outcome of the interaction of employees, management, employers' organisations, works councils and trade unions.

### ➤ Minimum Wages as Part of the Idea of 'Decent Work'

One of the main challenges for the policy of 'decent work' is the dynamic structural change in the labour market since the 1980s, characterised by flexibilisation, deregulation and diminishing security. This development was promoted by the SPD/Green government's 'Agenda' policy, which accelerated such processes (Trampusch 2009).

In the meantime the proportion of dependent employees in the low-wage sector has risen to around a quarter (see Figure 16). This is also a consequence of the erosion of binding collective agreements, which is particularly evident in smaller firms. Despite the rapid growth of the low-wage sector the option of a general statutory minimum wage only started to come to the fore from the early 2000s against the background of the Alliance for Jobs and the Hartz Commission. At this time a debate began – which was long bitterly contested – that finally led to a statutory minimum wage after a 15-year struggle between the trade unions, in public and in the parliament. Germany became the twenty second EU member state to introduce a general statutory minimum wage as recently as January 2015. Thus Germany finally caught up as regards the role of the state in wage policy. It is controversial whether this instrument is merely a supplementary building block within a path-dependent structural development of the welfare state or whether the path of free collective bargaining has been abandoned and a systemic transformation has taken place. The opponents of

a minimum wage among economic liberals and conservatives claim that it will lead to job losses. Existing evaluations have not confirmed this widespread fear, although it is at least conceivable in some instances. Particularly problematic is the specific structure of the low wage sector, which has made it increasingly difficult to escape from it. For social democracy 'decent work' is important for two reasons. First, bad work has to be humanised and second, those who work in the low wage sector have to be supported in their efforts to climb out of it again by improving their skills.

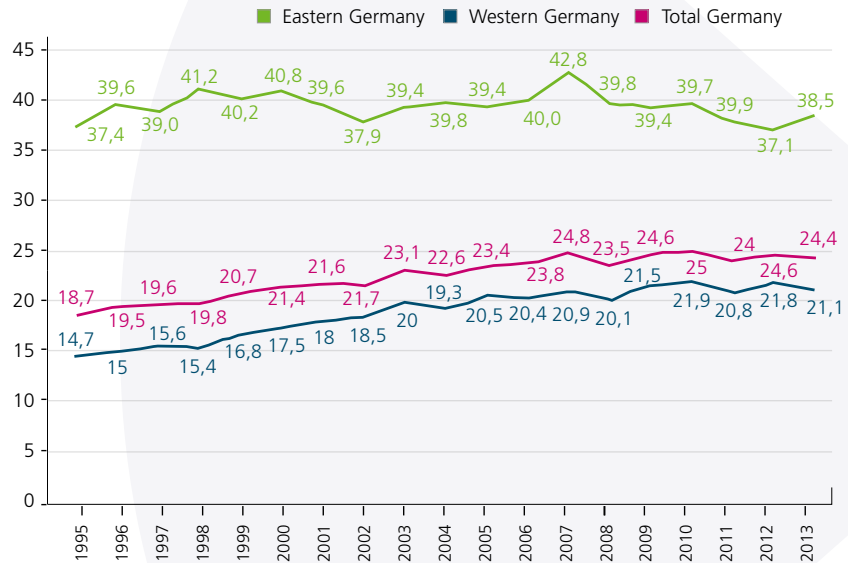


Figure 16: Proportion of low-wage employees

(Source: Kalina/Weinkopf 2015: 3.)

**Note:** The figure shows the proportion of low wage employees for eastern and western Germany and for Germany as a whole. In eastern Germany the proportion is much higher and remained at a similar level as in 1995 until a sharp rise in 2007. In the west, by contrast, low wage employment rose continuously, which is also evident from the figures for Germany as a whole.



Besides the low wage sector regulation of temporary employment, work contracts and employment on so-called 'platforms' (crowdworking) plays an important role in establishing standards for such insecure and atypical employment. Trade union pressure has pushed up protection standards in these areas and extended the rights of works councils. At the present time, however, questions concerning the regulation of work in the context of increasing digitalisation remain unclear. In particular the terms 'work' and 'firm' need to be adjusted to changing conditions as a result of spin-off and outsourcing activities. For example, economic activities that were once gathered together in one firm have become fragmented to be performed in many independent units without anything changing as regards ownership structure and the division of labour. On the other hand, work is outsourced in the form of 'works' and 'projects' in order to minimise costs and entitlements. Furthermore, in a digitalising world of work new demands are growing with regard to constant availability, data protection and so on. Questions of codetermination are thus central with regard to newly arising forms of work and organisation. These questions must be answered if the conditions for decent work are to be improved.

### ➤ Codetermination: Actors and Procedures

Not only individual but also collective codetermination is of crucial importance for the policy of 'decent work'. In companies in which no works councils or trade unions are active it is often highly unlikely that statutory or collectively agreed standards will be implemented. In this section therefore we take a close look at how Germany's codetermination model can be adapted to the changing circumstances of a flexibilised and deregulated labour market.

Besides peak-level organisations and the state, workplace actors represent the third key pillar of the German model of a negotiated 'decent work' policy. Up until the 1980s their activities concerned – within the framework of standards negotiated between companies or imposed by the state – central issues related to working conditions. To that extent Germany created a social order in the workplace oriented towards cross-company regulatory patterns, within the framework of which companies organise themselves. In this context, when it comes to personnel policy matters, top management has to take account of the interests of the staff and the works council, just as much as the provisions laid down in collective agreements and by the state at cross-company level. Conversely, the works council had to link its interest representation function as

regards the employees to co-responsibility for productivity and the business's economic success. The model of company codetermination and cooperation is formulated succinctly in the Works Constitution Act: »The employer and the works council shall work together in a spirit of mutual trust having regard to the applicable collective agreements and in cooperation with the trade unions and employers' associations represented in the establishment for the good of the employees and of the establishment« (§ 2 para 1 Works Constitution Act [*Betriebsverfassungsgesetz*]).

Germany's model of interest representation is formally divided between works councils and trade unions. Works council members do not have to be trade union members and the trade union has no direct and automatic influence over the works council. Given this formal separation it is one of the greatest achievements of the German model that the works councils and trade unions are not at daggers drawn but rather interlock on an everyday basis. For sixty years or so more than 70 per cent of all works councillors have also been trade union members and have prominent voluntary roles in trade unions. While the works council operates as a kind of 'borderland' institution between the workforce, the company management and the trade union (Fürstenberg 2000 [1958]) the workplace management oscillates between the workforce, the works council and the decisive interests and guidelines of the central management, as well as the employers' association. Conflicts of interest between the works council and the management are dealt with on a procedural basis, with open conflict very much the exception. The works council and the management are the main actors 'on the ground floor'. They have different legal characters and as a rule divergent power resources, so that generally speaking industrial relations actors are not on a level playing field. The actors in the workplace refrain from exercising rights of disposition within the framework of collective bargaining in favour of the higher decision-making level, under the aegis of historically developed institutions. Hitherto this has fostered a mode of cooperation that can be separated basically into political and economic components. This strict division of labour long ago shifted decisively in favour of company-level actors, however, a development that will presumably be further boosted by accelerated digitalisation.

### ➤ Challenges Facing Codetermination

The division of labour of company codetermination by works councils, which to some extent have a say in economic affairs through their own company rep-

representatives, as well as full-time trade union officials in the supervisory board, currently faces new challenges.

### **1. Declining number of works councils**

Only around 9 per cent of German private companies with more than five employees now have a works council. Even though around 40 per cent of all employees still work in firms that have a works council this number, too, is falling. The reasons for this include structural changes in company policies and a lack of participation on the part of employees, but also the stepping up of systematic and to some extent orchestrated obstruction by company managements. In order to ensure the vitality of Germany's codetermination model renewed efforts are needed to safeguard a comprehensive works council presence. One crucial measure would be a statutory duty to hold works council elections. This would not require a revolution, merely a transfer of conditions that have long prevailed in the public sector to the private economy.

### **2. Crumbling cohesion between levels of codetermination actors**

Company-level actors do not accept the supra-company level of decision-making on labour policy as a matter of course, but rather on the basis of practices that have been established over time. When company managements spy an opportunity to pursue their own collective bargaining path without jeopardising industrial peace and economic performance they will give it a try from time to time. In recent years, however, this has occurred more frequently. From the standpoint of social democracy, though, it is self-evident that employees' participation is not a matter for opportunism, but a basic and absolutely non-negotiable statutory right.

It is crucial for the legitimacy and acceptance of industry-level policymaking that the company-level actors see their influence and interests taken into consideration at peak organisation level. The peak organisations have to comply with this condition to maintain a high degree of loyalty and decision-making authority among their members. In the past, 'tradition' exerted a substantial binding force that shaped the political dimension of industrial relations. Since the 1980s, however, the peak organisations' ability to set standards has been progressively weakened. Management and works councils have increasingly gone their own way, publicly expressing their unease concerning industry-level decisions and refusing to fall in line. Furthermore, the establishment of industry-level associa-

tions not bound by collective agreements (*ohne Tarifbindung*) provided company-level actors with the option, besides the traditional employers' associations, of deviating from the institution of sectoral agreements.

### **3. The works council – contact partner and interest representative for all employees**

A key challenge is parallel interest representation for both core and marginal workers. In recent years companies' employment structures have changed substantially. The number of fixed-term employees, part-time employees, temporary employees and contract workers has shot up. This harbours considerable conflict potential as regards company codetermination, arising from problems of mediation and solidarity. The works council is confronted by a constantly changing workforce and at the same time has to act as mediating body between the interests of insecure groups of employees and those of the core workforce.

### **4. The codetermination model and works councils' 'remedial' role**

At the time the Works Constitution Act was brought into being company-level decision-makers were generally those who bore the economic risk. Although works council codetermination is limited to workplace organisation and personnel issues, economic decisions could nevertheless be discussed and sometimes, if appropriate, their effects moderated. Increasingly, however, due to internationalisation and the separation of ownership and company management economic decisions may be taken that go against the interests of the employees and even of the firm, and which company actors have no power to prevent. Often works councils are even denied key information on the future of the company, so that in many instances decisions are *faits accomplis*. The upshot of this is that the works council is often only in a position to try to ameliorate the adverse economic effects of decisions for the employees by negotiation. These developments and companies' financial market-oriented governance pose major challenges for the codetermination model. Codetermination actors therefore require more 'preventative competences'.

### **5. Closer integration of employees' individual participation and the collective codetermination institutions**

Innovative business and 'decent work' also require a change in corporate culture. More transparency and corporate communication, real participation for employees, more amenable management and broader participation in the value chain

are the necessary building blocks for innovation and successful company development. The focus here should be an approach to people that takes account of individual capabilities and fosters the strengthening of personal responsibility and respect for individual rights. Employees who merely have to do what they are told and are left no room for their own initiative will scarcely be motivated to pursue innovation in their daily work or develop a commitment to the firm. People tend to work well when working conditions are congenial; in other words, wages, their relationship with their workplace, work organisation, the usefulness of the product and their level of participation. Where robust control, self-responsibility and cooperation are required employees become a key factor in production. They are the real means of production and value creators.

In order to pursue these concerns the trade unions, the works councils and shop stewards will also have to further reform their own activities. Only in that way will they be able to respond more sensitively to employees' individual concerns. In the context of more decentralised working and decision-making processes employees' concerns have to be supported and protected more directly.

## **6. Internationalisation of companies demands the internationalisation of codetermination**

For a long time now value creation processes have spanned not only different sectors, but also different countries. By contrast, codetermination structures remain very much national in orientation. European works councils (EWCs) are the first important supranational institution whose competences have been used meaningfully. Nevertheless further improvements in the law are needed to enable employees' representatives to have a real say and on an equal footing. The European Company (SE) represents another arena for codetermination subject to international guidelines. Strategies and concepts have to be developed to enable people to seize the opportunities opened up in this way and to minimise the risks. The logic is simply: in order to ensure codetermination rights heightened European cooperation is needed, including a range of actors and levels. The more successful this is, the more satisfying the results are likely to be. Even though European Commission policy and the decision-making of the European Court of Justice remain sceptical of German codetermination institutions German actors must not withdraw within national borders but meet these challenges and fight for more economic democracy both in Germany and in Europe.

## 7. KEEP ON THINKING

The Social Democracy Readers offer a compass with which to navigate the basic questions of social democracy and orientation in the various policy areas. It is not their intention to offer final answers, however. The path of social democracy – as an idea and political action – must be constantly tested, adapted and reconsidered if we are to pursue it successfully.

This summary also takes up that baton and above all issues an invitation to keep on thinking, more specifically to reflect on how social democratic economic policy can work and what challenges it faces in the twenty-first century.

At present, the main challenge facing social democratic economic policy is the need to strike a new social balance between the state and the market. The SPD's Hamburg Programme offers a crucial impetus in this regard:

*»In our view, markets are a necessary form of economic coordination and superior to others. Untrammelled markets, however, are blind to social and environmental concerns and unable by themselves to provide public goods in sufficient quantities. To enable markets to realise their positive potential they need rules, a state with the power to apply sanctions, effective laws and fair prices.«*  
(Hamburg Programme 2007: 17)

Given these new challenges social democracy must constantly renew itself. It will manage to do so as long as it does not lose sight of its foundations and keeps reality clearly in view.

This applies in particular to social democratic economic policy. The aim of the present volume is to illustrate that social democracy can derive a clear economic policy profile from its basic values, as embodied in the UN covenants on fundamental rights, as well as providing a compass for a modern, value-oriented economic policy based on growth, social justice and sustainability.

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## Further reading:

*An introduction to all the important questions of economics and business news is provided by 'Das Wirtschaftslexikon. Begriffe. Zahlen. Zusammenhänge' (Economic Lexicon: Concepts, Figures, Contexts) by Volker Happe, Gustav Horn and Kim Otto (see p. 18).*

*The publications of the Friedrich-Ebert-Stiftung's Economic and Social Policy division deal with current economic policy studies and analyses:*

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# SOCIAL DEMOCRACY READERS



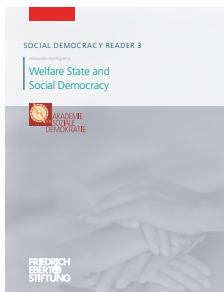
## **Reader: Geschichte der Sozialen Demokratie**

(History of Social Democracy),  
Michael Reschke, Christian Krell, Jochen Dahm  
et al. (2013), 3<sup>rd</sup> ed., Social Democracy Readers,  
Friedrich-Ebert-Stiftung, Bonn.



## **Reader 1: Grundlagen der Sozialen Demokratie**

(Foundations of Social Democracy),  
Tobias Gombert et al. (2014), 4<sup>th</sup> ed.,  
Social Democracy Readers, Vol. 1,  
Friedrich-Ebert-Stiftung, Bonn.



## **Reader 3: Sozialstaat und Soziale Demokratie**

(Welfare State and Social Democracy),  
Alexander Petring et al. (2012), 2<sup>nd</sup> ed.,  
Social Democracy Readers, Vol. 3,  
Friedrich-Ebert-Stiftung, Bonn.



## **Reader 4: Europa und Soziale Demokratie**

(Europe and Social Democracy),  
Căcilie Schildberg et al. (2014), 2<sup>nd</sup> ed.,  
Social Democracy Readers, Vol. 4,  
Friedrich-Ebert-Stiftung, Bonn.



## **Reader 5: Integration, Zuwanderung und Soziale Demokratie**

(Integration, Immigration and Social Democracy),  
Christian Henkes et al. (2011),  
Social Democracy Readers, Vol. 5,  
Friedrich-Ebert-Stiftung, Bonn.  
*Available only in German*



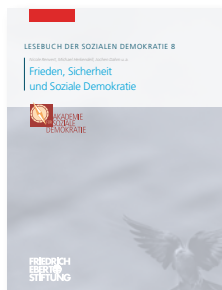
## **Reader 6: Staat, Bürgergesellschaft und Soziale Demokratie**

(The State, Civil Society and Social Democracy),  
Tobias Gombert et al. (2012),  
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Friedrich-Ebert-Stiftung, Bonn.  
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## **Reader 7: Globalisierung und Soziale Demokratie**

(Globalisation and Social Democracy),  
Michael Dauderstädt et al. (2015),  
Social Democracy Readers, Vol. 7,  
Friedrich-Ebert-Stiftung, Bonn.



## **Reader 8: Frieden und Soziale Demokratie**

(Peace, Security and Social Democracy),  
Nicole Renvert, Michael Herkendell,  
Jochen Dahm et al. (2017),  
Social Democracy Readers, Vol. 8,  
Friedrich-Ebert-Stiftung, Bonn.  
*Available only in German*

## 12 key terms:

### 1. Globalisation

(pp. 10, 56, 118, 140, 148)

### 2. Fundamental rights

(pp. 56, 68 f., 71 f., 75 f., 77)

### 3. Basic values

(pp. 68 ff., 75, 78)

### 4. Decent work

(pp. 78, 146 ff., 154)

### 5. Budget

(pp. 26, 34, 39, 85, 114, 148 ff.)

### 6. Capitalism

(pp. 17 ff., 22, 29 f., 34, 54 f.,  
56, 58 ff., 64 ff., 96, 141 ff.)

### 7. Market economy

(pp. 29, 36, 44, 57 f., 67,  
89 f., 93 f., 96 ff.)

### 8. Minimum wage

(pp. 98, 104, 149 f.)

### 9. Codetermination

(pp. 65, 98, 104, 120 f., 151 ff.)

### 10. Sustainability

(pp. 75 f., 80 ff., 82 f., 84 ff.,  
88, 90, 124 f.)

### 11. Social justice

(pp. 65, 68, 75 f., 78 f.,  
84, 90)

### 12. Growth

(pp. 38 f., 55, 57, 61, 75 ff.,  
84 ff., 88 ff., 141 ff.)

We invite you to participate in the debate on social democracy. The Friedrich-Ebert-Stiftung's Academy of Social Democracy provides a forum for this purpose. Nine seminar modules deal with the basic values and practical domains of social democracy:

**History of Social Democracy**

**Foundations of Social Democracy**

**Economics and Social Democracy**

**Welfare State and Social Democracy**

**Europe and Social Democracy**

**Integration, Immigration and Social Democracy**

**The State, Civil Society and Social Democracy**

**Globalisation and Social Democracy**

**Peace, Security and Social Democracy**



**Politics needs clear orientation.** Only those who are able to state their goals clearly can also achieve them and inspire others to do the same. In keeping with that, this Reader *Economics and Social Democracy* asks the following questions: How can a modern, value-oriented social democratic economic policy be successful? What principles underlie it? How can it be implemented in practical terms?

The topics of the Social Democracy Readers take their bearings from the seminars of the Academy for Social Democracy. The Academy for Social Democracy is an advisory and training body of the Friedrich-Ebert-Stiftung for people with an interest in politics and those who are already politically active.

**For further information on the Academy see:** [www.fes-soziale-demokratie.de](http://www.fes-soziale-demokratie.de)