

SOCIAL MARKET ECONOMY: AN INQUIRY INTO
THE THEORETICAL BASES OF GERMAN MODEL OF CAPITALISM

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ABSTRACT

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In this study, the concept of ‘Social Market Economy’ which was the leading idea in the post-Second World War economic order of Germany will be analysed. This analysis will also take into consideration the Economic School of Ordoliberalism which emerged in the inter-war period and greatly influenced the construction of the idea of ‘Social Market Economy’ with its theoretical principles. Some politicians and theoreticians in the post-war period also contributed to the development of the concept. Within this theoretical framework, the post-war economic policies and developments will be surveyed and the newly established economic order will be compared with the ideals of Social Market Economy theoretical programme. In particular, the impact of the Social Market Economy upon the evolution of German Model of Capitalism will be explored by taking into account the significant changes in the role of the state in the economy and the conduct of relations between the social partners especially since the 1960’s.

Keywords: Ordoliberalism, Social Market Economy, German Model of Capitalism

ÖZ

SOSYAL PİYASA EKONOMİSİ: ALMAN KAPİTALİZM MODELİ'NİN TEORİK TEMELLERİ ÜZERİNE BİR İNCELEME

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Bu çalışmada, İkinci Dünya Savaşı sonrası Federal Almanya'nın ekonomik düzeninin oluşumunu etkileyen Sosyal Piyasa Ekonomisi düşüncesi incelenecektir. Bu inceleme, iki savaş arası dönemde ortaya çıkan ve Sosyal Piyasa Ekonomisi düşüncesinin oluşumunu etkileyen Ordoliberalizm Ekonomi Okulu'nu da kapsayacaktır. Savaş sonrası dönemde bazı politikacılar ve teorisyenler de bu teorik çerçevenin gelişmesine katkıda bulunmuşlardır. Bu teorik çerçeve içinde, savaş sonrası dönemin ekonomi politikaları ve gelişmeleri betimlenecek ve yeni kurulan ekonomik düzen Sosyal Piyasa Ekonomisi programının idealleriyle karşılaştırılacaktır. Bu bağlamda, Sosyal Piyasa Ekonomisi kavramının kökenlerinin incelenmesi, 1960' lardan itibaren özellikle devletin rolünde ve sosyal düzenlemelerde gözlenen değişimler ışığında, bu kavramın Almanya'ya özgü bir kapitalizm modeli oluşturulmasına olan etkisini ortaya koyacaktır.

Anahtar Kelimeler: Ordoliberalizm, Sosyal Piyasa Ekonomisi, Alman Kapitalizm Modeli

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CHAPTER 1

INTRODUCTION

German economy was historically described as a distinctive economic style compared to other Western countries. Germany was regarded as a late comer considered in terms of its industrial development. In the late nineteenth century, after national unification industrialization process gained speed in Germany. In contrast to other European countries, Germany lived this process in a short period of time. In the aftermath of unification, a rapid capital accumulation took place which gave way to an industrialization process mainly directed to the export markets. Protectionism of the state and development of the corporatist tradition led to the emergence of a distinctive style of capitalism. In the German Model, rather than applying free trade and free competition mostly propagated by the Anglo-Saxon countries, markets were largely regulated and for organizational and national reasons, cartels became the dominant mode of organization for competing in external markets. Thus, instead of applying the classical liberal concept of market economy and competition, capitalist relations were organized from a national perspective. In that period, military, political, economic and social interests were closely interrelated and the national economic expansion in a catching-up process became the main priority for which all the national instruments were mobilized in a corporative framework. Various classes through their organized groups actively involved in the regulation of markets in a framework which was supported by the state.

The main institutions of German capitalism came into being in his early industrialization period. Generally, a social welfare system introduced by Bismarck, the establishment of strong industrial interest groups and close state-industry and industry-banks relations have been the results of this process. Consequently, the

emergence of German capitalism with its distinctive practices and institutions was distinguishable. However, liberalism was not a dominant ideology either in political arena or in the intellectual sphere. 'German Historical School' was the main economic school which supported the cooperative structure and cartelization in German Economy.

After First World War, during Weimar Republic, Germany experienced a prolonged economic crisis. This period was characterised by a hyper-inflation process. Later the effects of Great Depression led to the further deterioration of economic conditions. In this period, the institutional structure of German capitalism did not change greatly. However, a democratisation process was set into motion both in the political sphere and the industrial relations. The effect of labor unions was more profoundly felt and authoritarian elements in industry relatively diminished. The most outstanding characteristic of the period was the strength of organized groups in affecting the state's policies and the corresponding rise in state interventionism. Cartelization process did not stop and Germany was regularly called as the 'land of cartels'. In the early 1930's, deteriorating economic conditions were combined with a political crisis which resulted in the totalitarian rule of Nazi domination which would continue until the end of Second-World War.

After the war, German economy virtually collapsed and German society was faced with the occupation of Allied Powers. The period between 1945 and 1948 was associated with economic scarcity and political uncertainty. Beginning from 1948, Germany began to take the opportunity to choose its new economic order and relevant economic policies which would set forth its economic reconstruction. Actually, previous national experiences and external and internal political forces became decisive in determining the future road of the German economy. Firstly, 'command economy' was rejected on the basis of the recent experiences of Nazi economy and its repressive stance against major social, economic and political freedoms. Indeed, recent political and economic catastrophes were mentally connected to the administrative modes of previous periods. On the other hand, while the introduction of market economy became a viable alternative, the question was what kind of a market economy is necessary which will satisfy both the concerns of political forces and the requirements of an economic reconstruction. The option of 'laissez-faire' policies

were discarded as the historical experiences proved that freeing of market forces without creating a social and legal framework is very capable of bringing disastrous results. Taking into consideration the traditional social and economic relations of German society, 'Social Market Economy' represented the German economic style in the post-war period as well as the theoretical concept which gave inspiration to that style.

In Germany, market economy came about not as a result of an evolutionary process but political forces became influential in its dominance in the post-Second World War economic order. The U.S support for market economy in Germany was an integral part of its containment policy of the Soviet Union. However, in choosing the kind of market economy and economic policies to be applied, domestic political forces became decisive. After 1948, Ludwig Erhard, Economic Minister of CDU government, with its Social Market Economy programme made enormous impact on the economic reconstruction of the German economy. Economic policies implemented between 1948-66 created the institutional basis of the German economy although there were also some particular policies specific to the reconstruction period. For this time period, it was generally accepted that the Social Market Economy as a concept became the leading idea in the economic policies of central administration and in the minds of productive forces of German society.

The basic aim of Social Market Economy was to combine freedom in markets with social equality or equilibration (Ausgleich). Social Market Economy as a leading idea served for the acceptance of market economy in Germany. Its stability oriented approach which prescribed the institutional framework for the markets and its emphasis on the social protection made the market economy more acceptable in the German society. The economic policies of the period such as the monetary reform and further extended initiatives to private agents fostered the relations of market economy. In this period, apart from these changes in the institutional framework, German economy entered into a growth process based on an export-led strategy. This process was called as the 'German economic miracle'. Rising wealth combined with high growth rates and the mobilization of productive forces for national recovery strengthened the institutional framework provided by Social Market Economy. In fact, all the economic policies implemented in this period were formulated to sustain high

growth rates mainly by encouraging the private initiative without direct interventions in the market process.

What Social Market Economy has achieved with great success was a ‘social’ consensus among major economic and political actors of the society. Within the special circumstances of reconstruction, the conflict among diverse interests of social and economic groups were suspended for a period and economic forces were mobilized for the economic expansion within the foundation of market economy order. There was a consensus between capital and labor, among political parties and major social groups and among economic policy actors. The distinctive feature of Social Market Economy was the gradual institutionalization of a consensus regime with a long-lasting character of social and economic integration which was not special to the reconstruction period.

The first aim of the thesis is to figure out the theoretical foundations of Social Market Economy. ‘Ordoliberalism’ will be investigated as the main theoretical background of the economic policies in post-war German economy. Ordoliberalism was commonly defined as the German neo-liberalism which came about in the years of Weimar Republic. After the Second-World War, its economic programme based on the institutional framework of market economy influenced economic policy makers who intended to set up a new economic order. Ordoliberalism represented a liberal critique of interventionist policies of Weimar state which was vulnerable to the manipulation of the organized group interests of that period. While Ordoliberalism took a strict opposition to any kind of collectivism and interventionism, it did not approve theoretical implications of classical liberalism which led to the implementation of *laissez-faire* policies either. For Ordoliberalism, it was crucial to create the legal framework and institutions for a market economy rather than leaving market to its own forces. These theoretical principles more or less made reflection on the establishment of post-war economic order.

In this period, German economy was often called as a functioning ‘market economy’ like U.S.A with high growth rates. In contrast to the other European countries, planning instruments were not used and Keynesianism was not applied. Most of the market economy proponents evaluated the condition of German economy as the success of market economy. The role of the ‘Social Market Economy’

programme in that economic success is what will be analysed in the following chapters.

However, German economic order did not remain same. Beginning from the 1960's, in parallel with the changes in international economic environment and domestic evolution of the economic system, some traditional aspects of German capitalism was restructured within the new system. An expanding social welfare system, labour market regulations with the high influence of organized groups and state's growing role in economy were associated with that development. In the 1980's, especially in the hey-day of neo-liberalism, it was alleged that the economic institutions developed within the framework of Social Market Economy constituted institutional rigidities which led to the low competitiveness and low economic growth rates of German economy. For most neo-liberals, while 'Social Market Economy' in first decades of West Germany represented a free market economy with high economic growth rates, later changes turned German Social Market Economy into a stagnating economy due to its institutional rigidities. Hence, for them, it is imperative to dissolve these institutional foundations to increase efficiency and adjust to international competitive markets. On the other hand, another line of writers opposed to such an institutional dissolution as these institutions provided the unique social conditions on which capitalist relations in Germany operate. For them, Social Market Economy with its dense institutional network managed to achieve market efficiency and social cohesion at the same time. For that reason, German capitalism created its own style of economic organization in which institutions were densely interrelated to each other for the survival of the system in which the abolition of one institution could bring the end of an overall economic order. For Maurice Glasman (1997), Social Market Economy achieved both social equity and competitiveness through its regulated markets and provided an organizational alternative to global deregulation. Michel Albert (1992) claimed that German economy as the most outstanding expression of 'Rheinish Capitalism' was superior to the Anglo-Saxon Capitalism by its social and economic qualities. Although it is not easy to make strict division between various capitalisms, German economy with its unique institutional design seemed distinguishable. Hall and Soskice (1999) described Germany as an example of 'organized market economies' which had 'non-market coordination' mechanisms

provided by the traditional institutions of German markets. These conditions created market relations which were embedded in the social structure of German Economy. However, these were not only the results of structural development of German economy and society but also of the theoretical principles associated with those developments. While German economy and other Western liberal economies had a variety of institutional differences in their concrete structures, the theoretical base of German Capitalism mostly expressed by Ordoliberalism and Social Market Economy has also greatly differed from other western liberal economic schools. .

It is interesting to note that German economic order was usually called as Social Market Economy. It indicates that the original principles inherent in the concept made a deep impact on the organization of German economy. However, both the concept and the concrete economic order called as Social Market Economy evolved in time, thus, it seems crucial to describe their evolution within their own interaction. Thus, the relation between the concept of Social Market Economy and these institutional developments is crucial to understand the evolution of German capitalism in post-war period.

The main purpose of the thesis is to describe the post-war institutional development of German capitalism with the Social Market Economy as the leading idea. Rather than concentrating exclusively on the processes of German capitalism, the study will focus on how the principles of dominant economic programmes and relevant economic policies have affected economic processes in Germany and what kind of institutions were brought about out of this interaction. When considered the traditional characteristics of German capitalism, what kind of changes in economic relations were observed with the introduction of market economy and which previous social and economic practices endured in the new period are the questions that will be answered in the thesis. To ascertain the divergence or convergence between the theory and practice of Social Market Economy is also crucial to understand the place of Social Market Economy concept within the long-term development of German political economy.

CHAPTER 2

ORDOLIBERAL ROOTS OF SOCIAL MARKET ECONOMY

In this chapter, I will concentrate on ‘Ordoliberalism’ as a liberal economic theory which was first constituted in Weimar Period of Germany and further developed in the Nazi-period. Ordo-liberals were also called as German Neo-Liberals and their activities first intensified in 1920’s mainly as a response to the political and economic crisis situation in Germany. Among these liberals, there appeared an agreement on the reasons of this crisis and their proposals for relieving this situation greatly overlapped. Although they expressed their ideas more personally in 1920’s, Ordoliberalism as a distinct economic theory came about as a result of the works of Walter Eucken and Franz Böhm in Freiburg University beginning from the early 1930’s and extended its sphere as far as other same-minded liberals contributed to the ideas of Ordoliberalism such as Alexander Rüstow and Wilhelm Röpke. Ordoliberals’ vision of economic order largely shaped by the experiences of German economy in the period of Weimar Republic and Nazi domination, provided the theoretical basis for the post-Second World War economic order of Social Market Economy.

In the first part of the chapter, I will indicate the common line of thought of German Neo-Liberals with regard to the major problems of the economy in Weimar Republic and how the first elements of Ordoliberalism appeared out of the common criticisms of Weimar State and the conducted economic democracy in that period. In the second part, I will put out precisely from which political and economic concerns, Ordoliberalism was firmly constituted by the works of the ‘Freiburg School’ and from which economic schools they were influenced. I will particularly bring attention to the effects of German Historical School and Austrian School. By making explicit the differences of Ordoliberalism from those influential schools, it will be clear that

Ordoliberalism intended to follow a distinct road regarding their theoretical aspirations for a liberal economic order and the formulation of economic policies in that way. In the third and fourth part, specifically the works of Walter Eucken and Franz Böhm will be in focus and how the basic principles of Ordoliberalism was expressed in their works will be indicated. Walter Eucken's theory of economic order will be complemented by his economic policy recommendations. Lastly, Franz Böhm's legal theory will be assessed as an indispensable part of the Ordoliberal thinking on economic order.

2.1 German Neo-liberals In Inter-War Period and Emergence of Ordoliberalism

To ascertain the standpoint of German liberalism in inter-war period and its policy implications for the major problems of German economy it is crucial to understand the economic and political concerns of Ordoliberal programme. Liberalism in Germany did not gain a dominant position in society as in Anglo-Saxon countries until the end of Second-World War. Its causes can be sought in various facts like late industrialisation of Germany or in the style of its industrialisation in more state-supported corporatist forms. Yet , Germany has witnessed a kind of economic liberalization between the period of Napoleonic conquest and the unification in 1871 (Nicholls, 1994:7). German liberals then believed that the unification of country will bring about the abolition of restraint on industry and trade. However, after Bismarck came to power, German economy increasingly implemented corporatist methods in the industrial relations making emphasis on more organic elements in society and state's involvement in the economy in collaboration with the major economic powers. It meant that liberal principles were set aside and Bismarck proposed 'a form of corporate representation of German economic interests' inspired from the idea that 'corporations would knit the community together, whereas parliamentary liberalism divided it'(Nicholls, 1994:8). In such a preference, it was also effective that in order to compete with other industrialized countries, the industrialization should be accelerated and this could only be achieved by a strong relationship between the major economic actors and the support of a state paternalism (Nicholls, 1994:16). In 1879, German

commercial policy replaced its free trade policies with protection by putting duties on grain and iron imports and protectionism continued in an increasing manner (Nicholls, 1994:17). On the other hand, in the second half of the nineteenth century, a trend of cartelization was seen in the economy which was not counteracted by state, rather it was encouraged. Also this fact was legalized with the decision of German supreme court in 1897 which announced the cartel contracts legal (Nicholls, 1994:18). In consequence, the illiberal elements were incorporated into the German economic life. Especially the rules decided by large entrepreneurs and 'Junker' landowners became crucial and the state was reduced to an instrumental role in maintaining that rules and further pursuing the interests of that dominant classes. The Reich Economics Office agreed on a kind of 'managed capitalism (Gemeinwirtschaft) in which state officials cooperate with the big business to control the economy (Nicholls, 1994:21).

After the First World-War, two important events became effective in configuration of liberal ideas. First one was the post-war economic crisis in Germany mostly reflected by hyper-inflation and the second one was the Great Depression which influenced all of the world and gave way for protectionist reactions in various countries. The liberals in that period mainly focused on the possibilities to solve the problems that created an inflationary environment in early 1920's and the ways to overcome the crisis situation in the economy. However, there was wide belief that 'capitalism and the anarchy of the market' were responsible for the depression (Nicholls, 1994:61). In inter-war period, there was a tendency to appreciate the economic policy options from a nationalist point of view. Pure liberal solutions were hence not considered even in the agenda of liberals.

We will basically concentrate on the ordo-liberal thought and its policy recommendation in 1920's and 30's. Indeed it is crucial to give the common points of the liberals in that period and their standpoint to other systems of thought. In the literature, the liberals of inter-war period were called as neo-liberals as they did not wholly embrace the thoughts of classical liberalism and its practical results. Yet, the previous liberal idea on the absense of activism in regulating the economy which led to laissez-faire liberalism was left since after the recent catastrophic events it became clear that the markets should not be left to their own forces but be reconstructed with a sound institutional and legal basis which prevents any development in markets which

was contrary to the principles of market economy. Among liberals, there was a wide belief that what is needed is not a complete overthrow of liberal principles by looking at its failures in reality but to redefine it in a new context and with new instruments to give functioning to the market and broadly to the socio-economic order.

First common point of neo-liberals was that they did not accept the nationalist understanding of economic problems and did not approve the protectionist policies which were commonly implemented after Great Depression (Nicholls, 1994:44). On the other hand, it was accepted that 'laissez-faire liberalism' could not be an answer to the economic difficulties and at the opposite, a kind of collectivism or a system for large state intervention was naturally seen by neo-liberals as totally incompatible with the liberal principles. In that way, they wanted to establish the liberal order relying more on the social question and the protection of rules of competition in market. Most neo-liberals believed that economic crisis of 1920's was largely the result of policies of previous periods in the form of cartelization of the economy and state interventionism controlled and directed by 'vested interests'. For that reason, the problem was perceived as the violation of principles of market economy and state's contribution to that violation. In inter-war period, there was an agreement among neo-liberals for the need of a 'strong state' for the protection of competition; not necessarily for directing or regulating the economy but settling the rules of the market and the control mechanisms against any attempt of violation of those rules (Nicholls, 1994:47).

What differentiates the neo-liberals from classical liberalism was the knowledge that free mechanisms of market do not necessarily lead to a natural competition order (Reuter, 1998:71). For Alexander Rüstow, the rules of the game could be guaranteed only by a strong state which lay beyond the interests of the major economic groups. The claim for a strong state was common in liberal economic theories of Germany and has been revealed in the lecture to the German Association for Social Policy (Verein für Socialpolitik), which was organized by Rüstow in 1932 (Nicholls, 1994:47). Rüstow, in this meeting, clearly rejected 'monopolies and cartels, pluralism, and planless government interventions' and stated that government interventions should be in conformity with the economic process rather than in the direction of pressure group interests. He envisaged a 'strong and independent state

which must be vigorous, independent, neutral and powerful not by coercion and imperative control but rather by its authority and leadership' (Megay, 1970:426).

The other important work of neo-liberalism was the article of Walter Eucken in 1932 called as 'Staatliche Strukturwandlungen und die Krisis des Kapitalismus' (Changes in the Political Structure and the Crisis of Capitalism). For Eucken, the state influenced by economic groups had the characteristics of a 'Wirtschaftsstaat' which was not a sign of a 'strong state' but of its weak form (Reuter, 1998:72). In this article, Eucken stated that the problems of market economy did not result from the economic field but mainly from the political field (Pies, 1998:108). He assured that the 'politicization of the economy' necessarily strengthened the influence of interest groups on government and these led to the 'incoherent and contradictory interventions in the economic process (Megay, 1970:426). Bad economic conditions until that time was the outcome of the limitations to competition which was associated with the lack of appropriate political regulations. Hence, for Eucken, we should look at the framework which covers the free play of the actors in order to understand the undesired results of interventionism (Pies, 1998:108). Both Eucken and Rüstow stressed the necessity of reducing the extent of the governmental activities to essential tasks and ,thus, sought to give it an increasing authority on its major areas and independence from the interest group pressures.

On the other hand, Franz Böhm's work of 'Wettbewerb and Monopolkampf' in 1933 supported the view of neo-liberals on the concentration of power in both public and private sectors. Böhm criticised the economic block of private power and showed the insufficiencies of classical liberalism about that subject (Reuter, 1998:73). Böhm argued that competition order should be established and guaranteed by state. The rules of the game should be secured by an 'open law order' at a constitutional level. At that aspect, the state should not only be strong but also be immune to any kind of ideologies. Böhm put out the role of state as the 'protection of capitalism against capitalists' in a manner of preventing rent-seeking and concentration of power (Reuter, 1998:74).

Consequently, the 'strong state' of neo-liberals did not imply a 'strong totalitarian' state but a guarantor for the free play of the forces in market. It is understood that 'paleoliberalism' which envisaged a 'night-watch' and minimum

state and failing regulations in market did not bring an optimum for a competition order. The arising social question and abuses of competition in the market was conceived by neo-liberals as the result of failure of the laissez-faire policies and instead of them growing interventionism. For neo-liberals, spontaneous political and economic processes are necessary for the extension of freedom in market but it should be complemented by a 'Rechtsstaat' which required the superiority of law in the enforcement capacity of the state and its relevant regulations if it is intended to fight against monopolism and collectivism which came into being as a response to 'social question' (Gutmann, 1998:55).

For Megay, German neo-liberalism stood between laissez-faire and welfare liberalism and gave more importance to the social question than the classical liberalism did (Megay, 1970:427). Eucken believed that market economy with its organizational advantages is conducive to the solution of social problems but it was not enough. For him, social measures should not be an appendage to the economic policy but an integral part of economic order whose structure should also serve for the 'trans-economic values of a political, social and cultural nature'. Rüstow also emphasized the necessity of governmental action for the attainment of social goals and values as far as these are not distortive to the development of market process. Especially, Wilhelm Röpke, another ordoliberal economist, claimed that the extension of the mass society created a moral vacuum which was partly caused by the inability of laissez-faire liberalism to give an answer to social question and intended to be responded by the growing effect of collectivist ideologies. For this reason, Röpke proposed that an economic order based on liberal principles should be constructed not only by pure economic reasoning but also other sorts of cultural and social values which stand 'beyond demand and supply'.

German neo-liberals, particularly Ordoliberals, while analysing the causes of the economic crisis, referred to the effect of the pluralist Weimar State in deteriorating condition of the economic order. For Ordoliberals, the integration of the societal interests into the powerful interest associations, the continuation of the corporatist relations inherited from the Bismarckian welfare state and the manipulation of the state activities by the dominant interest organizations were at the center of the crisis. Eucken argued that 'democratic parties that organize the masses

and the interest groups exert an increased influence on the government and thus on economic policy'. This meant that the activities of these parties contributed to the 'growing disorganization of the economy by the state' (Manow, 1999:7). Accordingly, Ordoliberalism saw the cause of subordination of the state by pluralist interest politics and its results in the 'inconsistent and incoherent state interventions' which eroded the possibility of state's independent policy making for the economic order. It was their view that organized interest pursued their particular goals and this consequently prioritised the private interests over public interest (Megay, 1970:433). Especially Röpke made an emphasis on Rousseauian idea of common good by saying that 'originally democratic doctrine was monistic' and the idea common good did not require the pluralist penetration of interest groups (Megay, 1970:434). Although Ordoliberals did not exclude use of democratic mechanisms in shaping the economic policy, they implied that common good or public interest does not arise as the result of competition between particular private interests and emphasized the necessity of creating a different sphere of expression of the public interest which lies beyond and above the particular demands of the interest groups. However, they were far from giving an adequate, sound criteria for the determination of common good.

Such a conception of public interest necessarily called for a 'strong state' whose functions should be clearly separated from the effect of 'parliamentarianism and partisan politics' and when it was done, the state should be assigned to protect the economic order within the limits of legal framework based on the liberal principles and its relationship to the market in terms of necessary interventions should be compatible with the rules of the market. For this argument, the strength of the state came from its capability to act as a neutral enforcer of the market rules and a continuous preserver of that order against major threats as if it has a will beyond the 'short-sighted' particular political interests. This role attributed to the state, in contrast to its minimal role in laissez-faire liberalism, required an active place for the state in the issues of maintaining economic order which does not necessarily imply 'government interventionism'. However, such a picture of 'strong state' raised questions about how the state's position will be vis-a-vis the major economic and political power dispersion in that society.

Manow claimed that Ordoliberal's attempt to 're-establish a strict boundary between the state and society' by a 'strong state' had highly authoritarian elements. Especially Rüstow made reference to Carl Schmitt's notion of the 'total state' and proposed a 'radical liberal interventionism' which required state's power to establish sound liberal institutions. On the other hand, Manow made citation from Herman Heller to indicate that Ordoliberals legitimised to use anti-democratic means to 'de-state the economy' especially from the interference of the corporatist Bismarckian welfare state which supported the 'corporatist complex as the institutional and regulatory framework in which German employers and unions pursued their interests' (Manow, 1999:8). Heller pointed out that these features made 'radical liberalism' an 'authoritarian liberalism' which aimed at demarcating the clear boundaries between state and economy by de-politicising the state and giving it a power with which it could stand and act against the pressure of political demands.

Interestingly, Manow argued that 'Ordoliberalism was a child of Protestant anti-liberalism and anti-pluralism' (Manow, 1999:11). He again stressed on Rüstow's thesis which claimed that economic liberalism is derived from the Calvinist work ethic and in the societies where Calvinism is not dominant, liberalism is bound to be distorted. It implied that in Germany where 'Lutheran state paternalism and orthodox parochial Protestantism' dominates, people did not tend to believe that free market will eventually bring prosperity to all but when faced with the 'unfavorable market outcomes', they applied to the state to intervene in the market process (Manow, 1999:12). For Rüstow, classical liberalism with its laissez-faire attitude ignored the religious basis upon which a functioning liberal order should be established and believed that the victory of liberalism as an economic doctrine will come without support of 'social, religious or political factors'. In Germany, with a Lutheran tradition, liberalism did not become dominant by itself, but by the outside support of the state. Manow argued that for that tradition, the state was assigned to protect the economic liberalism and provide an 'economic 'Schutzraum' or protected domain' in which free market processes occur with a guarantee of the state (Manow, 1999:13). For Manow, 'authoritarian' elements of the Ordoliberal thinking were taken from the 'Protestant conception of the proper role of the state'. He especially referred to the Lutheran-Protestant thinking in which the 'individualism and private religious beliefs were

combined with 'state paternalism towards the Protestant Church'. State's attitude towards the religious sphere could also be seen in its attitude towards economic sphere inspired by the Lutheran doctrine which 'represented a peculiar combination of spiritual freedom and rigid order. Manow essentially supposed that German Protestant liberals prioritised the role of the state over the effect of the demands of the 'civil society' and claimed that Ordoliberalism's roots could be found in the Lutheran-Protestant conception of the state-society relations. For him, the position of Protestant liberals in 'Kulturkampf' era 1871-1878 in favour of 'vigorous state interventions' greatly resembles the Ordoliberal call for 'strong state' in Weimar Period. Manow's quotation from the Protestant historian Heinrich von Treitschke writing in 1879 on 'Kulturkampf', seems very interesting: "For us the state is not , as it is for the Americans, a power to be contained so that the will of the individual may remain unhibited, but rather a cultural power from which we expect positive achievements in all areas of national life" (Manow, 1999:14).

The statement given above underlines the constitutive role of the state in Germany in the establishment of the major economic, social and political institutions. The assignment of the state to implement various tasks raises questions about to what extent and by what kind of functions should the state act and what does the state's action imply for the state and society relations. In order to clarify Ordoliberals' call for the 'strong state', it should be questioned that for which goals state was mobilized and which means were allowed for the actions of the state.

Ordoliberals mainly dealt with the issues of freedom and power in economy and society. Freedom was conceived as the main motive which identifies the essence of the economic activity in a decentralized exchange economy and its preservation was crucial for a functioning economy. Although Ordoliberals did not give a clear definition of freedom, it was thought as a concept of 'freedom from' rather than 'freedom to'. It meant that the existence of freedom in its utmost sense depended on the 'minimization or absense of subjection to the power of others rather than on the actual exercise of power' (Megay, 1970:429). In that way, for Ordoliberals, freedom in market could only be maintained through eliminating the power locations which restricts the freedom of the individuals who will act with a 'minimum power'. Eucken determined three threats to freedom: "the private power of the other party in

economic relations, the power of the leaders of associations over their members and the power of the state which has allied itself with private centers of power” (Megay, 1970:428). Classical liberalism saw the main danger to the individual freedom in state’s extended power in the economic process and for their view, private power emerged as a result of the state’s interference , not as a natural outcome of the market. However, although Ordoliberals recognized the threat of state interventionism, they indicated the emergence of private power locations as an expression of the natural propensity in the market towards monopolization which also made use of the public channels to support its position. Thus, the danger to freedom was rooted in the market mechanism itself . Ordoliberal’s argument is that this situation provided the necessity for an outside intervention to prevent the inherent tendency in the market to restrict the freedom of individuals. The address for that task was necessarily the state which would counteract the construction of the power positions, not particularly the abuse of the existing power positions. For Megay, Ordoliberalism fell into the ‘neo-liberal dilemma’ which ,on the one hand, saw the power of the state as a major threat to the individual freedom, on the other hand, recognising that ‘power can be controlled only by power’, they employed state’s power inserting ‘public interest over and against private interests’(Megay, 1970:432). This dilemma is greatly related with the distinctive neo-liberal perception of the state which does neither foresee a ‘weak state’ which was under the influence of political demands of the interest groups nor authoritarian or totalitarian state which imposes its power to all other segments of the society. Ordoliberals supposed that state, within its constitutional limitations, will act against all the power concentrations in the society without extending its power in a hazardous way to the individual freedom. In that state, the role of the interest groups will be limited to express their interests and opinion but not beyond that; making demands for their interests. Thus, state will be open to the political demands but not dependent to them. For Megay , this concept of state logically necessitated ‘some elite of disinterested, benevolent, expert and courageous men enjoying tremendous public support’ who will come as a result of an electoral process but will act independently for the public good beyond the particular private interests (Megay, 1970:439). Ordoliberals highly trusted in the existence of a political elite with the support of a competent bureaucracy and their capacity to act ‘on their own behalf’ for the common

good and when it is necessary against economic and political trends if these trends developed contrary to the efficient functioning of the economic and political order.

Ordoliberalism believed in the possibility of emergence of such a state conception in liberal democracies but did not give the clues for how to construct it in a designed manner and guaranteeing that the political elite will act with a consciousness attributed to them by Ordoliberals. While trying to avoid from the political pressures of the interest groups, the problem emerged when it came to limit the arbitrary use of power within that state. Thus, this state conception needed clear mechanisms which will make the state's position via other power locations more concrete and restrict its activities to the predictable and comprehensible tasks which were integrated to the legal framework. Consequently, Ordoliberals' call for 'strong state' without giving implications how to limit it have led to various interpretations of Ordoliberal state conception. Although Alexander Rüstow's understanding of state resembles with an authoritarian state, it could not be assumed that Ordoliberalism supported an authoritarian state or accepted to use authoritarian means to conduct their 'strong state' and the liberal economic order. Rather, their displeasure with the Weimar state led them advocate the return of the state to its essential tasks like the protection of the freedom of individual units from the excesses of power. This goal provided the state a legitimate tool to fight against private power locations but not tolerated an arbitrary use of state power beyond that aims.

2.2 The Place of Ordoliberalism In Economic Theory

Ordoliberalism as a distinct variant of liberalism came as a result of the works of economists in Freiburg University in 30's: namely Walter Eucken, Franz Böhm, Friedrich A. Lutz and Fritz W. Meyer. Later Hans Grossmann-Doerth joined this working group. They were called as 'Ordo-circle' or 'Freiburg circle or School'. Their works were published in the journal of 'Ordo' which still serves for extending the Ordoliberal thought. Eucken's economic order theory and Böhm's legal theory provided the most decisive arguments in the ideational direction of Ordoliberalism. During the Nazi domination, they took an anti-Nazi stance and the crisis situation of 20' and 30's and repressive political system after the Weimar period have greatly

affected their formulation of the economic order. Their view of a liberal order saw the two extreme cases as a danger to a 'functioning market economy': the laissez-faire liberalism which ignored the necessity to complement the market processes with a continuous institutional support and underestimated the emergence of the power positions contrary to the principles and good functioning of a market order. On the other hand, deficiencies in market processes which produced socially and economically negative results led to an increasing tendencies for government interventionism and centrally administered economies. For Ordoliberalism, these two extreme cases posed equally a threat to the basic principles of a liberal economic order.

Three representatives of Freiburg School began to edit a series of publication called as 'Ordnung der Wirtschaft' and produced the anonymously written essay of 'Our Task' in 1936 as the first publication of the series. These gave the first and basic elements of Ordoliberal thinking and stated that against which common trends in economic thinking they have formulated their ideas and which schools they explicitly criticised.

First, the major economists of the school saw the collaboration of law and economics as inevitable in order to fully understand and direct socio-economic phenomena (Böhm et.al, 1989:16). According to Ordoliberals, political economy and law as formative sciences lost their status and their spheres of influence became dominated by the political interests. They implied that, on the one hand, the facts relating to the economic life were relativized in the direction of particular interests and this made impossible to make claims for objective scientific truths. As these facts were greatly relativized, political economy and law were no more the essential center providing the reliable scientific facts which would be the only guide for the economic policies but , contrary, the common understanding dictated that the development of law and political economy in concrete life at a given time should be superior to the distinct and autonomous logic of this formative sciences. This common attitude emptied the inherent mechanisms of sciences and made them subordinate to the changing value judgements of the political and economic events. For Ordoliberalism, this transformation was greatly caused by the common attitude in scientific and non-scientific thought in 19th century called as 'historicism' (Böhm et.al, 1989:16). Later

in this chapter we will look at the effect of the historicism to the major economic schools in Germany.

On the other hand, for them, this relativization of the scientific facts and the successive arbitrariness in policy making led to growing fatalism for economists as they have lost their scientific criteria for assessing economic development. This fact necessarily brought about the self-affirmation of historical trends and economists confined themselves to only observing this phenomena. Ordoliberals gave the example of Friedrich von Savigny's legal fatalism which prescribed that the political-legal task of science is to define exactly what happens in economic and political sphere and all the content of law and economics should be subordinated to this situation. For this idea, 'the idea of law followed the substance of law' (Böhm et.al, 1989:17). However, according to Ordoliberals, the law itself with its strict rules should be the only criteria to assess the events, not the viseversa.

On the other hand , Ordo economists suggested that Karl Marx's thought also contributed to the strenghtening of fatalism . Ordoliberals's statement is that this predeterminateness of the process of capitalist development in the theory of Marx narrowed the sphere of human action and will to intervene in that process and direct this trend in favour of deliberate design of economic and political order. This theoretical implication has made a considerable effect even in non-Marxist circles. Werner Sombart also stated that 'course of economic development could not be directed by political intervention, it has its own unique dynamic whose direction could not be changed by political power (Böhm, et.al 1989:19). Ordoliberals claimed that this common idea of economic development implied the irreversability of historical processes and theoretically ignored the effect of political and intellectual power to that process. In contrast to the economic determinism embodied in Marx and Sombart, Ordoliberals gave some examples as for the role of the political power in the direction of economic development and greatly relied on the power of influence of intellectual thought on the political and economic history which was perceived as missing in other contemporary economists. The economic and political experiences of Germany taught that simply pursuing the economic trends and making *ad hoc* economic policies with regard to those trends resulted in a chaotic situation. For that reason, Ordoliberals

attempted to find the ways to conduct their vision of economic order based on the scientific knowledge of law and political economy.

In the following part, the influence of the German Historical School and Austrian School on the general orientation of German economic thinking and particularly on Ordoliberalism will be taken up.

2.2.1 The Influence of German Historical School

The common attitude in older Historical School in economic analysis was the historical specificity (Hodgson, 2001:59). Instead of building universal theories, they mainly tried to develop particular theories depending on the data taken from ‘the simple description of specific phenomena’. This kind of method of analysis was called by Menger as ‘empirical realism’(Hodgson, 2001:60). Knies, who is a representative of the older Historical School, envisaged that ‘the economic phenomena of national life are historically bound to the collective existence of nations (Hodgson, 2001:62). Within the influence of increasing nationalism at that period, they took the national economy as the decisive unit which provides the environment in which individual economic relations occur. The representatives of Historical School applied an ‘organist ontology’ to the economic analysis which presumed the society as an organism in which the economic relations were directed with the dominant guidance of the spirit (Geist) of the time and nation. It meant a ‘dependence of the individual upon the whole’ in which unification of individuality around the concept of ‘Geist’ was maintained through the organic relations of individuals. Hodgson stated that “‘socio-economic system was analysed as if it had a singular will and mind of its own: surmounting those of the individuals comprising it, just as the brain and nervous system of an organism transcend its individual organs and cells”’ (Hodgson, 2001:63). Rather than giving implications for a general theory, in the perspective of historical specificity, they supposed that ‘different types of socio-economic system require different theoretical categories and principles (Hodgson, 2001:78)

The younger Historical School became effective especially at the period of late nineteenth century and Gustav von Schmoller was the most important representative of that tradition. He, in parallel with the older school, criticised methodological

individualism as he took the individuals under the influence of historical and cultural circumstances (Hodgson, 2001:114). Though Schmoller considered the individual economic relations as a part of the whole, as different from the older school, he focused on finding out the real causes of this unity and analyse the relations between ‘actor and structure’ which was not necessarily realised before in German Historical School (Hodgson, 2001:116).

From the beginning of the 19th century an observable trend was seen in favour of using historical methods in scientific investigations. History provided enormous empirical material in explaining the economic phenomena in different times. However, historicism does not mean merely using the historical facts for the theoretical aspirations but more than that, it saw the historical knowledge as a precondition for the scientific analysis. The historical investigations revealed that “cultural institutions are in a process of development” and “within a continuous change of the institutions, different institutional forms replaced one another in the historical development” (Wittkau-Horgby, 2000:539). Especially Schmoller placed emphasis on the necessity to use historical methods as all the economic and cultural institutions were seen as the outcomes of the specific historical processes and , thus, they should be understood as historical entities. Such a perception of the economic development led Schmoller to take the result that ‘a proper understanding of the economic phenomena’ and the analysis of the institutional development should be based on ‘the historical analysis of their cultural context’ which was thought as the most decisive factor in the direction of the economic processes (Wittkau-Horgby, 2000:543).

Karl Popper defined historicism as ‘a doctrine alleging that history is directed by underlying currents, trends, laws and movements which are independent of human purposes’ (Chimielewski, 2000:515). He referred to two kinds of historicism: pro-naturalist and anti-naturalist. Pro-naturalist understanding of historicism recognised the existence of ‘ever-lasting’ trends in history which , in a process of development, survive in different historical times and such a continuation of the trends implied that there are some common elements between natural and social sciences. Thus, for the pro-naturalist historicism, there appeared the possibility to use the empirical facts in the historical trends to make explanations for the historical momentums and

predictions for the future course of the events like in a natural science (Chmielewski, 2000:519).

On the other hand, anti-naturalist historicism clearly separated the social sciences from the natural sciences since it believed that it is impossible to make experiments in social life because it is impossible to conduct the conditions in a social field in a same manner. The continuous change in social processes necessarily brings the complexity in social life which does not allow for the 'isolation of the experimental situations' (Chmielewski, 2000:516).

Historicism implied the impossibility to make objective claims for truth in social matters since 'social scientists are a part of the domain they investigate' and their values and preferences are an obstacle to reach the objective knowledge in social sciences. This historicist assumption is the one mostly criticised by the Ordoliberalism as historicism degraded the role of the formal and theoretical science and the general laws which make science an independent unit whose norms relating to the truth does not change according to the changing trends in economic and social life, hence, could not be relativised according to the historical context.

Naturally, historicism contributed to the holistic understanding of the society and economy. Such a conception of historicism came about from an understanding of economic phenomena emphasizing the dependence of economic events on the 'common spirit of a time and of a people'. Historicist view implied that individuation, as the appearance of an economic phenomena, is 'not only derived from the singular position of a culture in space and time but also from its singular relationship to the spirit of a time and a people (Koslowski, 1997:515-16). The main argument of historicism is that rather than giving an absolute and universally valid identity to the Spirit, it 'assumes an individuality of the spirit in the different peoples and in the spirit of the different times', 'Volksgeist' and 'Zeitgeist' (Koslowski, 1997:516). Historicism built up a relation between the universalism and particularism in such a way that a particular culture could not confine itself to its individuality only but entails an assimilation of 'universally valid powers and principles as the emergence of Volksgeist, the spirit of the people. However, universal principles were highly relativised and do not represent an absolute truth or a means to that end. For

Koslowski, 'the criterium of truth for historicism can only be the historical idea of fruitfulness' (Koslowski, 1997:518).

Ordoliberal thought, as against historicism, underlined the necessity of creating 'a non-doctrinaire and truly universal view of history which will serve the intellectuals to bring the criteria for truth by which they will affect the economic events rather than perceiving them as inevitable (Böhm et.al, 1989:20). Rejection of the historicism did not mean that Ordoliberals did not regard the historical facts but what they complained about was the common tendency among economists to use historical methods.

On the other hand, Ordoliberals blamed Gustav von Schmoller for his attempt to 'make political economy into a moral science as a result of which, for them, political economy lost its power as a formative science. Although Schmoller did not totally discard theoretical assumptions in economic analysis, his starting point was the concrete, particular economic phenomena which will lead to the theoretical result if all the necessary data for it were available. Ordoliberals mainly dealt with the policy implications of this assessment of the economic object which was directed to the needs for social reform and state intervention. For Ordoliberalism, Schmoller's concentration on the specific problems and its *ad hoc* solutions (Punktuelles Denken) without systematic thinking was far from understanding the whole scheme of the economy and give appropriate answers to the theoretical questions originating from 'abstract thinking apparatus of political economy' (Böhm et.al, 1989:20-1). Consequently, Ordoliberals believed in the certainty of scientific and theoretical knowledge, not 'the quality of probability' in Schmoller's terms and received this knowledge as the basis for the guidance of the economic policies. As a result, these provided them a reliable and powerful source to counteract historical trends they saw as reversible. From that standpoint, Ordoliberalism tried to overcome the problems arised from Schmoller's economic analysis and general results which leads to a relativist and historicist understanding of the economy.

2.2.2The Effect of Austrian School:Menger and Hayek

Carl Menger, as the most important representative of the first generation of Austrian School, debated with Schmoller the methodology of economics known as 'Methodenstreit' in 1880's. Menger tried to differentiate theoretical economics from the history of economy and attempted to apply 'deductive and abstract theory' to economics (Hodgson, 2001:82). He applied 'methodological individualism' in economic analysis and put the individual who pursues his self-interest into the focus of theoretical research. Menger challenged the concerns of Historical School about historical specificity by emphasizing the effect of the 'individual' on the economic transactions with his interest-induced motivations and economic rationality which has some features that could not be relativised to the changes in time and society. Moreover, Menger also undermined the historicist understanding of economic phenomena by putting forward the thesis that 'socio-economic systems throughout history have had a set of common and typical institutional foundations (Hodgson, 2001:84)

While Historical School dealt with the 'particular concrete phenomena' as the most important subject for economic analysis, Menger, in his 'Investigations of 1883', took 'analytically conceived economic world' as the basis for its 'exact orientation of the theoretical research' (Yagi, 1997:240). Menger's attempt was towards ascertaining universal principles which characterises economics as a neutral science to political interventions. Menger opposed to the historical research which assessed the economic phenomena through its 'realistic-empirical orientation' while he proposed to apply a theoretical research through the 'exact orientation' in order to find out the 'exact and universal' laws of economic actions (Yagi, 1997:242).

On the other hand, Menger questioned the 'organic view of national economy' of Historical School by saying that 'national economy' consists of 'a complex of individual economies' and a 'Geist' or a social will above individual economies as an independent factor could not be taken as the determinant of the economic processes. Thus, the attempts for 'exact theory' should take the individual behaviour as the starting point for explaining other economic phenomena, not the organic unity around the concept of 'Geist'. However, Menger did not deny the existence of organically-related social structures and institutions. As different from the Historical School, he did not view the social institutions as a product of the 'spirit of nation' (Volksgeist)

but as the last point of an evolutionary process which was derived from an 'organic origin' which came about and developed according to the needs and interests of individual interactions. He distinguished two approaches for the development process of institutions: pragmatic approach and organic approach (Yagi, 1997:245). The first one considered the intentional effects for the establishment of institutions and the second one drew attention to the spontaneous processes that contributed to the emergence and evolution of social institutions. Although Menger recognized the influence of both approaches, he gave a more weighted role to the understanding of 'organic origin' as he relates such spontaneous processes with the creation of money or the process of price formation. This emphasis on the spontaneous processes as the most reliable and valuable factor for the establishment of institutions largely stemmed from the belief in 'the rationality of the behaviour of individuals' whose evolution would be assumed to bring the 'most efficient selection of the ends-means relation' for individual behaviours (Yagi, 1997:246).

Such an evolutionist stance for the creation of social institutions was further developed by Friedrich von Hayek who was the most prominent representative of the second generation of the Austrian School. He basically concentrated on building a 'theory of spontaneous order of markets' as the main reference point for 'freedom and rule of law' (Witt, 1994:178). This was not only an economic theory but also a social theory which provides Hayek with a social basis for his economic policy implications.

Hayek's starting point for his social philosophy and economic theory was the 'incomplete and imperfect' knowledge of individual in the market. Individuals entered into interaction with other individuals through impersonal forms which provided the transmission of 'incomplete' knowledge of the individuals. These interactions, as a result, created an 'impersonal system of rules of conduct' like the creation of price mechanism. This system contained very complex relationships which could not be fully understood by human reason and could not be result of humans' deliberate intentional arrangement. Thus, individuals acted in a framework of rules of conduct, spontaneous order, which facilitated their actions but also contained the possibility of creating unintentional results (Witt, 1994:179) For Hayek, the rules of conduct were not automatically directed to the 'foreseen benefits of particular people' but provided

‘multi-purpose instruments’ in order to deal with various kind of situations (Fleetwood, 1995:151).

In Hayek, we can observe an over-emphasis on the market as an evolving order rather than an end-state order. For him, ‘it is by a process of evolution, not conscious reason, that mankind has developed what Hayek has called the ‘extended order’ or civilization’ (Barry, 1994:149). This statement was based on the belief that a spontaneous order within its complexity could create a much better organized order than anyone created by deliberate arrangement. Hayek used the concept of ‘catallaxy’ instead of ‘economy’ to define a ‘special kind of spontaneous order produced by the market through a ‘multitude of agents’ acting within the rules of law, of property, tort and contract (Fleetwood, 1995:148). On the other hand, he opposed the neo-classical equilibrium model where equilibrium represented an end-state position that does not match with the processes of market. Instead, he proposed a ‘transformational conception of socio-economic order’ as this order implied ‘a continual process of reproduction and transformation with no termination point’ (Fleetwood, 1995:137-141).

Hayek saw ‘rational constructivism’ as the main danger to spontaneous order. For Hayek, this was caused from an over-emphasis on human reason and its combination of romantic ideals which created the ‘synthesis of constructivist illusions and socialist ideas’ (Witt, 1994:181). In the ‘Errors of Constructivism’, Hayek’s definition of constructivism rested on the idea that ‘since man has himself created the institutions of the society and civilisation, he must also be able to alter them at will (Fleetwood, 1995:147). This trust on the constructivist reason justified state interventions which, for Hayek, distort the spontaneous processes of market and its solution-finding mechanisms in the case of disorder. A disequilibrium in the market calls for a state intervention into the market for a constructivist, for Hayek it was a normal situation in the transformational process of the market from which the ‘rules of conduct’ change and evolve by self-correcting mechanisms. Thus, involvement of the state in the catallaxy does not cure the situation but aggravates it. For this reason, he prescribed a ‘limited state’ which was confined to its role as the ‘neutral enforcer of the rules of just conduct’ (Barry, 1994:156). The limits of the governmental activities should be put and guaranteed by the law so that it will be immune to the effect of

pressure groups. Instead of 'teleocracy', in which there is the direct influence of citizen's political aims, Hayek insisted on the 'nomocracy' which regards the superiority of rule of law as the main determinant for the actions of government (Streit and Wohlgemuth, 2000:238).

Hayek distinguished private law, concerning 'rules of conduct', and public law, referring to the 'rules of organization of government' (Tomlinson, 1990:33). For him, the rules of government in time superseded the private law and the public plans under the effect of legislation penetrated into the sphere of spontaneous order (Barry, 1994:153). Hayek favoured an 'evolutionary jurisprudence' basing its idea on the assumption that there can be no such 'legislative mind' that can comprehend all the knowledge of human circumstances in order to ascertain the rules for an extended order (Barry, 1994:152). Although Hayek recognized that as 'law-making is a rational process, a matter of maintaining the consistency of law', it must not be subjected to the 'constructivist rationalism' (Tomlinson, 1990:32). Again in parallel, activities of government should be restricted by law and discretionary decisions should be kept in minimum. Hayek's main point is that 'the appropriate sphere of government should depend on its lawfulness rather than its consistency with some rationalistic criteria' (Barry, 1994:154).

According to Hayek, the extended order consisted of a 'complex arrangement of rules and institutions' i.e. 'rules of just conduct' that provide the individuals with the predictability and certainty in the market. At that point, rationalism does not foster certainty but disturb it in the long-term 'either through politics or by a kind of intellectual osmosis, competing and rival research programmes' (Barry, 1994:161)

As we look at the relations of Ordoliberalism with the thought of Hayek, we can find some converging points among them but also major differences. First, Hayek and Ordoliberals believed in the strength of market economy as the source of individual freedom and social order. As a result of a reliance on the mechanisms of market economy, the rules that organize the market and their relations to the individual behaviour in market became crucial. In a general sense, the importance of the legal order that provides the framework for the market was emphasized by both schools of thought because (1) through this, the limitation of public policy and political activism was respected (2) the 'appropriate' rules for the market stability and certainty were

brought in (Streit and Wohlgemuth, 2000:240). As the most important common point between Hayek and Ordoliberalism, they both were strictly against state interventionism in the market process as it is certain for them that the direction of market process by the state will disrupt the own mechanisms of the market. For that reason, any kind of collectivist tendency should be opposed and rules of the market should be strictly defined and implemented.

In the article of Streit and Wohlgemuth, three major differences has been identified for the relation of Hayek and Ordoliberalism (Streit and Wohlgemuth 2000:242). First, the view of competition in Hayek diverged from the one in Ordoliberals. Hayek assessed competition not as an end-state situation in catallaxy but as a part of a 'transformational process' in spontaneous order, thus, he rejected the neo-classical equilibrium model. Hayek defined the equilibrium as a 'rationalist delusion' since, for him, equilibrium model hides an 'implicit normative' statement that when there is a diversion from the equilibrium situation, state feels obliged to intervene to correct the inefficiencies in the market, thus, equilibrium analysis implicitly calls for intervention in the market and assumes the possibility of 'complete knowledge' in the market. On the other hand, Eucken used the concept of 'complete competition' (vollstaendiger Wettbewerb) which is similar to the 'perfect competition' but it mainly refers to a 'consumer-oriented economy in which the social and political problem of economic power is solved' (Streit and Wohlgemuth, 2000:243).

Most importantly, Ordoliberalism was against spontaneity in determining the rules of the system. This was also the basic point where Ordoliberalism differed from Austrian School. Hayekian conception of market economy greatly relied on 'a spontaneous order of economic actions, called as catallaxy, as well as to the rule of law, the nomocracy. While Ordoliberalism believed in the existence and credibility of market coordination in a spontaneous order, they did not agree to leaving the whole economic activity to pure spontaneity. For them, to build an economic constitution is so vital for an economic order which could not be left to the forces of spontaneity. While Streit called Hayek an evolutionist, Ordoliberalism stood in a more middle condition, having a more constructivist stance, though they are strictly against state interventionism (Streit and Wohlgemuth, 2000:246). Their constructivist elements come from their insistence on the establishment of the rule of law and the dominance

of legal rules in a functioning economic order and the use of constructivist means to establish the 'desired liberal economic order' anchored in law which could not be merely a product of purely spontaneous processes.

The third difference between Hayek and Ordoliberalism is their degree of emphasis on the 'Social Question'. In accordance with the theory of societal evolution, Hayek was against the concept of 'social justice', since to the catallaxy we could not attribute purposes which were arbitrarily incorporated to the 'rules of conduct'. Hayek mainly dealt with the content of the 'rules of just conduct', not with the results of it. His adherence to the 'unplanned and purpose-free order of 'catallaxy' led him not to make an ethical assessment on the result of the market process. However, Ordoliberals, to give an appropriate response to the historical pressure of 'Social Question, tried to reconcile the market order with the some common principles of social justice and proposed that 'a well functioning competitive market order' is the most crucial means to overcome the 'Social Question' (Streit and Wohlgemuth, 2000:251). Ordoliberals also accepted that there could be some unintended social results of the market process and this couldn't be always solved by self-correcting mechanisms of the market. This statement opens the way for the expression of constructivist elements in Ordoliberalism which does not cover an extensive sphere of intervention but only allows for market-conforming policies in order to eliminate or prevent the undesirable social outcomes of spontaneous processes of market. In Hayek, we can neither find an argument on the compatibility of market process and social justice nor any one in favour of the attempts to correct the results of the market as the individuals or state has no 'complete knowledge' of the market in order to intervene in for the attainment of particular purposes.

In order to sketch the difference between classical liberalism and ordoliberalism, Norman Barry's distinction between 'procedural rules' liberalism and 'end-state liberalism' seems relevant (Barry, 1989:111). 'Procedural rules' liberalism bases its argument on the quality of exchange process in market, irrespective of the concerns about the results of this exchange. For this idea, as far as the individuals acts within a free sphere of action, the results could be socially undesirable or destructive to the competition at the end. In this situation, procedural liberalism evaluates the disequilibrium in the market or the emergence of monopolies not as a need for the

intervention by the state, but as the particular phases within the self-correcting mechanisms whose rationality could not be fully comprehended. On the other side, 'end-state' liberalism presumed a specific form of competition order which was assumed to provide the best means for the enhancement of the major principles of liberalism and emphasized on the need to set up the institutional conditions which will mostly promote the free competition in market. From this perspective, although competition order has some unique mechanisms which were integral to its operation, the free interaction of individuals within it may result in a situation which is contrary to the intrinsic principles of liberalism. Such a vulnerability of the competition order to the results of its own mechanisms necessitates, for 'end-state' liberals, a continuous protection of the market order and a reconsideration of its rules. They even envisaged the restriction of individual freedoms within the market for the eventual sustainment of the 'appropriate' market order and, thus, made a normative statement for an active protection of competition rather than viewing it merely as an instrument for diverse ends of the individuals.

Ordoliberalism was called as an 'end-state' liberalism by Barry (1989:112) since the maintenance of economic order, and particularly market order was for Ordoliberals an essential task to achieve whose rules should be consciously shaped and the most 'appropriate' framework for the market order should be established. In addition, the 'Social Question' made difficult for them to solely rely on the exchange relations within a purpose-free competition order. It was certain that market order should be constructed with organizational principles and institutions in the way that it provide a 'functioning' competition order and it will automatically lead to the mitigation of socially adverse effects of market, for Ordoliberal thinking.

In Ordo Manifesto of 1936, they made clear that all the scientific knowledge should be utilised, as in law and economics, in order to appropriately set up the economic constitution which indicates the working principles of the whole economic system. As a second perspective of their programme, their aim of analysis respected all units and processes of economic interactions as 'constituent parts of a greater whole'. They argued that the 'treatment of all practical politico-legal and politico-economic questions should be directed to supporting the idea of economic constitution' (Böhm et.al, 1989:23-4). For that reason, the collaboration of economics

and law was conceived as inevitable to Ordoliberalism, first, to correctly analyse their economic life and, second, they endeavoured to establish an economic programme which will make a practical influence to the settlement of an economic order to give an integrated response to the contemporary questions of economic life which was largely ignored by economists in previous decades especially as a result of common historicist attitudes.

2.3 Ordoliberal Theory In Walter Eucken

2.3.1 Economic Order Theory (Ordnungstheorie)

Eucken published his 'Foundations of Economics' in 1940 and presented his essential theoretical aspirations in this work. His main aim was to overcome the 'Great Antinomy' in economics which came about as the conflict between theory and history. He began his work by criticising the dominant economic schools that previously tried to picture the economic process and responded to the problem of 'Great Antinomy'.

At the beginning, he criticised mainstream 'formalist' economics because of its over-emphasis on the concepts in economics. For him, these economists, first of all, were devoid of the analysis of real economic life, second, their theoretical aspirations are without basis due to their 'self-evident' concepts. Eucken believed that economic reality could not be understood without a theoretical analysis. However, for him, formalist economists did not provide that theoretical basis as they dealt more with the concepts than the facts (Eucken, 1950:54) Especially he underlined the increasing sectarianism in economic analysis which proposed a variety of arbitrary definitions that distorted the existence of objective knowledge in economics.

As relating to 'Great Antinomy', Eucken pointed to Menger's emphasis in his 'Investigations' on a commonly-made distinction between historical economics and theoretical economics. According to that, historical analysis focused on describing the 'concrete' phenomena and their individual relationships while theoretical economics aimed at finding out the 'laws or the general nature of exchange, price, rent, supply and demand (Eucken, 1950:55). For Eucken, most economists pursued clearly this separation and historical and theoretical economics were viewed as irreconcilable

spheres of analysis. Eucken argued that “in so far as this division between historical and theoretical economics is seriously carried out, the real problems of economics are left unsolved and the science completely loses its way” (Eucken, 1950:56) In that way, he criticised both the theoretical economists and the proponents of Historical School for ignoring the way of the economic analysis of the opposite side.

Eucken especially criticised Schmoller’s methodology which was stimulated by an empiricist realism. For him, the real world could not be understood without asking appropriate questions regarding to the reality and trying to answer them in a formulation of definite problems (Eucken, 1950:60). Historical analysis neglected to use such tools and confined itself to describe the concrete, particular phenomena without making necessary connections between the parts of it. Although Schmoller did emphasize the importance of theory, his analysis did not start with theoretical tools. On the contrary, he believed that only after the concrete, particular phenomena were described with its all causes and effect, one could be work towards a theory. This idea is clearly rejected by Eucken and proposed that ‘purely empirical economist of any type, even the statistician, is bound to fail to understand concrete economic life and its relationships’ without recognizing the ‘Great Antinomy’ and understanding ‘the purpose of genuine theoretical analysis’ (Eucken, 1950:63).

In another part of ‘Foundations of Economics’, Eucken concentrated on the assessment of ‘stages’ and ‘styles’ of economic development which was commonly elaborated by Historical School. For the early proponents of Historical School, the main aim was to understand the successive stages of economic development which assumed the economic reality as a process of development, however, in twentieth century, the crucial driving point for historical economists was not ascertaining the sequence of the stages but ‘capturing the different characteristics of the economic life of each stage’ (Eucken, 1950:65). It was envisioned that an historical theory should be constructed for every ‘stage’ or ‘style’ and this was called by Salin and Spiethoff as ‘intuitive’ or ‘descriptive’ theory (*Anschauliche Theorie*) (Eucken, 1950:67). This project assumed that by ‘constructing cross-sections of economic history, a theoretical analysis could be brought for each stage and through that, the ‘Great Antinomy’ between theory and history could be solved.

Eucken both opposed to the 'stages of development' and the 'styles of development' and, as contrary to Spiethoff, he argued that this kind of an approach could not 'portray the real world in all its essential variety' (Eucken, 1950:90). First, they generally tried to grasp the 'essential' and 'normal' in economic reality so as to give the basic characteristics of a 'style' within a specific period. For this reason, it could not give the complete picture of economic reality. Secondly, the 'construction of 'stages' and 'styles' of economic development necessitates an over-simplification of economic phenomena by confining the variety of economic relations strictly to a single type. Lastly, such a kind of theoretical building will largely ignore the relations of economic phenomena with its historical whole in which they occur.

On the other hand, Eucken questioned the use of the concept of 'capitalism' in describing the processes of economic reality. For him, capitalism was generally regarded as 'an active formative being, real and alive' which is decisive for the direction of the economic events. Such a kind of conceptualization had two major deficiencies for Eucken. First, the emergence of capitalism was attributed to a development of history but its further life with its death and effects was separated from its historical origin as if it survived as an independent unit. Secondly, Eucken argued that 'because the concept of capitalism says nothing definite about the structure of the economy, it can not suitably be used for describing economic reality since the economic systems in the 'capitalist' countries are so various and complex to be embodied as the parts of a single concept of 'capitalism' (Eucken, 1950:95-100). As a result, according to Eucken, 'capitalism' and other cross-sections, 'stages' and 'styles' of economic development 'does not provide any precise manageable set of characteristics' and is unable to transcend the 'Great Antinomy' in economics (Eucken, 1950:101).

Eucken put the emphasis on the existence of different economic systems in history and expressed that 'the economic process goes on always and everywhere within the framework of an historically given economic system' (Eucken, 1950:80). He made a general distinction between two kinds of economic system: one that 'grew' and one that 'created'. Many economic systems before industrialization came about as a result of historical growth without 'any comprehensive systematic plan'. Before eighteenth century, it is not possible to catch an economic system built up by a

rational will imposing constitutional principles. From that time, economic systems based on an economic constitution became visible. Economic constitution implied the 'decision as to the general ordering of the economic life of a community' (Eucken, 1950:83). Inspired from the ideas of classical economists, the governing principles for most of the modern economic constitutions became 'private property, freedom of contract and competition'. However, Eucken observed that 'actual economic systems supposedly based on such an economic constitution diverge more and more from these principles' and, thus, the economic system could not be simply equated with the economic constitution (Eucken, 1950:83). In accordance, the legal system and economic system are not completely converging units.

The task of scientific economist was determined by Eucken as to 'describe precisely the individual parts of a system and show how these partial systems fit together'. Such a kind of attempt for scientific investigation necessitated the 'knowledge of different kinds of economic systems' in order to picture economic reality in its variety (Eucken, 1950:89-90).

Eucken put out two elemental forms of economic structure: 'the centrally directed economy and the exchange economy'. Centrally directed economy had two appearances: The first one was 'simple centrally directed economy or independent economy; second one was 'much larger centrally administered economy'. In modern times, the latter one was commonly seen and subdivided into three categories: (1) 'the totally centralised economy characterized by the prohibition of all exchange (2) the centrally directed economy with free exchange of consumer groups (3) with consumer's choice (Peukert, 2000:108). On the other side, exchange economies were classified according to the planner's decision whether or not to take the prices as the major criteria and Eucken differentiated twenty-five possible form of markets for exchange economies. "An almost unlimited variety of actual economic systems can be made up out of a limited number of basic pure forms" (Eucken, 1950:109).

As for the market forms, Eucken argued that throughout the history basically two different kinds of supply and demand became dominant: 'open' and 'closed' (Eucken, 1950:133-34). He insisted that a scientific analysis should focus on the economic plans of individual unit as the main object of investigation. In that way, he put out that as the economic plan depends on the planning data and as the economic

actions of the individual economic unit when supplying and demanding depend on the economic plan, the forms which supply and demands takes are only to be understood if one starts from the differences in these planning data (Eucken, 1950:136). In this context, the planning data could not be analysed by a strict logical analysis. Data was perceived as the ‘facts which determine the nature of economic world without being economic facts’. In that sense, economic theory should grasp the ‘necessary interconnectedness’ between the ‘given’ data in order to enlighten the economic facts without being able to understand how this data come to exist (Peukert, 2000:111).

The individual unit could act in his economic plan with diverse motives and criteria which indicates the existence of a variety of market forms. In the first case, the economic unit may take ‘the expected reactions of his customer as a datum in his economic plan. A monopoly of a supplier and demander is an example for this case. In the second case, price was conceived as the datum for the economic behaviour. The price setting and the relationship of individual firms with that price takes different forms. However, among them, the condition where the ‘supplier and demander takes the anonymous price’ is the most outstanding one in which competition dominates.

Eucken’s conceptualization of competition does not depend on the common understanding of competition in which the result of any individual behaviour could not cause any change in the price. It could make a change but for Eucken the decisive factor in competition is not ‘the actual reactions resulting from an individual conduct’ but the individuals tendency to neglect any possible reactions of his economic plan in the price mechanism and only take price as ‘a planning datum’ for his actions (Eucken, 1950:140). In this situation, competition does not exactly provide perfectly elastic demand curve for supplier which would not fit to the real economic conditions, however, the supplier bases its actions on an economic plan in which perfect elasticity of demand is given, not alterable with the size of his supply. As a result, Eucken’s competition does necessarily contain elastic demand curve, homogenous products or an indefinite number of firms. For Peukert, ‘Eucken’s competition is not a ‘night-watch competition’ inspired from the formal economic theory based on abstract models but prescribes a real condition in which ‘firms may innovate, differentiate their products, advertise’ (Peukert, 2000:113) It meant that similar market conditions for the individual units do not bring about the same results which could range from

competitive to monopolistic one. In that sense, Eucken's understanding of economic processes is not deterministic and recognises diverse conditions of real economic life which can change *via* the limited knowledge and the personal preferences of the actor (Peukert, 2000:114).

Although he avoided from the static understanding of competition and monopoly, he emphasized on the necessity of a sound differentiation between the two forms of market. He said that there is a tendency among the economists to deny the distinction between competition and monopoly. Although there are some signs for competitive behavior in monopolistic markets and some latent monopolistic tendencies in competitive markets, the distinction between them is crucial in the sense that they are contradictory forces in the market. Eucken argued: 'From the formal mathematical point of view, monopoly is a limiting case of competition, or competition a limiting case of monopoly. In the actual economic world, monopoly is something quite different from competition (Eucken, 1950:145). As the economic analysis should focus on the economic plans and data available to economic unit, it should be kept in mind that competition and monopoly require entirely different economic plans and ,thus, different market actions.

As a third form, for Eucken 'in its economic plan the individual economic unit may take as given neither the prices to be paid, nor the price to be received , nor yet the reactions from the other side of the market. It may reckon with the two factors together: that is, with the expected reactions of the other side of the market and of its competitors' (Eucken, 1950:146). This condition generally refers to the oligopolistic market forms.

To the standard classification of market forms as competition, monopoly and oligopoly, Eucken added new pure market forms as partial monopoly, partial oligopoly and collective monopoly and insisted that these forms are not the mixture of first three standard forms but exists as the 'basic forms of demand and supply complete in itself and not further subdivisible' (Eucken, 1950:150-51). This result was largely driven from the procedure that requires the working of actual conditions 'from below' rather than relying on the necessary results of formal a priori assumptions made 'from above'. Eucken's methodological choice to concentrate on the economic plans and data to typify market forms led him to select the 'multiformity

of conditions' for the basis of his theoretical construction of forms (Eucken, 1950:152).

Although struggles for economic power before were hidden behind a veil of diverse purposes including religious and ideological sentiments, for the problem of economic power Eucken argued that economists should be able to understand what lies behind the veil as for the actual struggles for economic power (Eucken, 1950:264). Eucken believed that 'economic power is not something irrational or mystical but is comprehensible and accessible to rational analysis (Eucken, 1950:p.272). For that purpose, it is necessary to deploy the morphological and theoretical analysis which he used in analysing the market forms. The totally centralized economy contained the realization of 'maximum concentration of power' in which all the economic plans of the individuals were controlled by the central authority. In case of exchange economy, the expression of economic power became different because the individuals make their economic plans and actions according to the market. It occurred among the rival powerful groups and the position of an individual economic unit in market determined its power against other competitors. Some market forms like monopoly had more concentration of power compared to other forms. Moreover, the power positions were more easily established on either side of the market, when the market is closed and generally the importance of the market became effective in ascertaining the power position of an economic unit (Eucken, 1950:266).

For Eucken, the one market form where the economic power is at minimum, is perfect competition. In this form, the economic plans took price as a datum and no individual unit is dependent on the power of others in the sense that it is clear that no supplier or demander has a power to influence demand, supply or price apart from to calculate the reactions as a result of their particular actions. It refers to a form of market where each unit has a small influence on the economic processes and altogether with their actions, unconsciously, determine the price. Perfect competition requires small power positions of the individual units without any concentration of power, thus, any personal economic dependence (Eucken, 1950:270).

Eucken argued that after morphological analysis was used to determine 'the degree of economic power in a particular case', it is possible to reach the theoretical

propositions about the more precise understanding of extent and effect of economic power. Additionally, he underlined the mutual support of political and economic power and proposed that only the combination of the historical perspective with morphological and theoretical apparatus could clearly explain this collaboration and reach the exact ‘sources and effects of different power positions of economic power’ (Eucken, 1950:272).

2.3.2 Economic Order Policy (Ordnungspolitik)

Hans Otto Lenel, a representative of the second generation of Ordoliberalism, briefly reviewed the economic order theory of Eucken in his article of ‘Evolution of Social Market Economy. He clarified two appearances of the economic system. First one is an individual, positively given fact (Lenel, 1989:18). He described this as ‘ the totality of the realised forms in which, at a given time, the daily economic process takes place in concreto’. It built up the concrete economic structure which would be analysed by the economists. On the other hand, second aspect of economic system related to the question that whether the concrete conditions in the first aspect provide an ‘appropriate and effective’ whole for the economy, if not, how could it be achieved? (Lenel, 1989:19). This statement revealed that the task of the economist is not only to define a ‘given economic structure’ but also to find the ways to improve it.

The term ‘economic order or economic system’ was the central element of Ordoliberal thinking and provided the theoretical base on which economic policy decisions should be made. Economic order contained ‘typical structure of economic activities and its systematic examples or all the regulations characterizing economic process in a specific economic order (Vanberg, 1998:3). Eucken argued that economic order should be evaluated with respect to its economic constitution which reflected the basic principle upon which the economic order was conducted. His morphological scheme in order theory provided him with the tools to classify different economic orders. For Eucken, the variety of economic orders could be explained by a variety of ways in the organization of the following principles. 1) ‘decentralized coordination of economic activities in the framework of general rules 2) ‘sub-coordination of the actors with a control of a central governing system’ (Vanberg, 1998:3). Eucken stated

that the first one provided an appropriate instrument of coordination for the economic activities and a dynamic basis for a workable system. However, it is true that a centrally organized coordination could also satisfy these two conditions required for an efficient economic system. Ordoliberalism's choice for a decentralized economy depended on the existence of 'freedom' in this system and respect to 'human dignity'. Decentralized economic system provided the individuals to freely act in the market for their own purposes as far as they remained within the rules of the system. Thus, the system gave the individuals the chance 'to develop their powers' and created the necessary incentive for them in the economic process which situation eventually served for the working of the system (Lenel, 1989:27). Ordoliberalism mainly analysed the forms of market orders depended on the decentralized coordination and concentrated on the investigation of what kind of a general framework of the rules could best sustain the 'decentralized coordination of economic activities'. Eucken took 'competition' as the principal element of the economic order and competition order was conceived as the most free and efficient order which constituted the basis of the economic constitution.

Eucken claimed that a society can choose its own system from a range of economic systems. This was also a claim that was against the belief in the 'pure spontaneity' in the emergence of the economic institutions. On the other hand, it implied that constitution of the economic order is open to political choices and does not evolve only by its own mechanisms.

Eucken's understanding of economic system was clearly against the Hayekian thesis on the development of the economic systems. Spontaneous processes could contribute to the emergence of the economic system, but a workable and efficient economic system could not come only as a result of the evolution of the markets. This statement is a normative one and includes important implications for an economic policy which tries to conduct a sound basis for a functioning economic order. Reliance purely on spontaneity abolishes the necessity to make an economic policy as it was thought that the traditional 'rules of conduct' should be respected and the outcome of the market processes, whether it is positive or negative, should be unquestionably accepted. However, Eucken proposed that an economic order is something which should be constructed and shaped by a political, social and legal

order in order to guarantee maximum freedom in the market and an efficient and functional system which could not be thought purely in market terms and left to its spontaneous processes. Consequently, the elements of 'freedom' should be complemented by the elements of the 'order'.

On the other hand, Eucken's view is also different from the view of Historical School. Although Eucken viewed the economic order as a whole, it was not a holistic understanding. For Historical School, markets have no logic of their own and are 'merely' 'a set of institutionalized rules' which were characteristics of that society (Peukert, 2000:110). So there are parts of that system which were hanged to each other by organic relations and their actions were determined by the meaning of the 'whole'. However, Eucken made a 'bottom-up' analysis and focused on the relations of autonomus individual factors and their coordination mechanisms. The result was that every economic order has a steering mechanism for its functioning and composed of complex relationships which should work on the basis of important principles. This view implied that economic orders in general and markets in particular have a distinctive logic (obviously manifest in economic constitution) which should be respected if it is intended to establish a workable economic system. As a consequence, for Eucken's view, to understand the economic order with its all inherent relations and its relations with the other orders of the society is crucial to make an economic policy on that basis.

Eucken's basic question was that 'How is the economic process with its far-reaching division of labour controlled in its entirety, so that everyone comes by the goods on which his existence depends?' (Lenel, 1989:24). And to give an answer to the question that how the economic activity will be directed and controlled in industrial society, any economy should determine its 'scarcity gauge' which will indicate the goods in short supply. For Eucken, the price mechanism is the best criteria for a 'scarcity gauge' which was seen as the integral part for a coordination in economy (Lenel, 1989:28).

Eucken stated that in an economy based on the division of labour in our modern age, interdependence is inevitable between economic actors (Eucken, 1989:27) and implied that all economic activities and the regulation relating to those activities are linked to each other (Eucken, 1989:29). To be a part of a whole

economic system, all individual decisions should be in a proper coordination with others in order to build the efficiency of the system and a more sound control of economic activity. Every single economic activity has a meaning within the framework of the whole economic system and its meaning can change within different frameworks. On the other hand, the interdependence of the actors was not confined to the mechanisms of economic order in Eucken but he also showed that there is an interdependence between various orders of the society (political, economic, social , spiritual). This fact created the possibility that these orders could be ‘antagonistic’ to each other or to the whole system. For this reason, the components of the economic order should be compatible with each other and to the general logic of the system if it will function appropriately (Schiller, 1964:41).

The interdependence of the orders is crucially related to the ways of economic policy making. For that reason, it is crucial that the steering mechanism, important principles of the economic order and any economic policy measure are compatible with each other and they together should be in conformity with the economic system (Lenel, 1989:25). Lenel claimed that ‘any pragmatic economic policy’ which aimed at only fulfilling economic interest of the majority demand and ignoring the particular functioning of the economic system is bound to fail or lead to a less efficient economic system.

Eucken made an important distinction between the two spheres of the economic system: ‘economic order’ representing ‘the legal and institutional framework of economic activity and ‘economic process’ representing ‘the daily transactions of households and businesses’ (Karsten, 1992:113). This differentiation was also indicative for the direction of the economic policies envisaged by the Ordoliberalism. They have clearly rejected the interventionist policies distortive to the ‘economic process’ but not abstained from using constructivist means to enhance ‘economic order’ within which economic processes occur. This choice greatly determined the way of implementing economic policies in Ordoliberal thinking. For Ordoliberalism, the aim was not to regulate or to steer the market as government interventionism prescribed but how to create the legal and economic basis on which any economic order or market economy can flourish.

‘Ordnungspolitik’ –economic order policy- mainly dealt with that issue and Ordoliberalists tried to confine all the economic policies to Ordnungspolitik in order to avoid from any disruptive effects of direct interventions (Schiller, 1964:67). Ordnungspolitik concentrated on how to construct and develop the organizational forms and the institutions of the economy in such a way that it will take care of the institutional framework of the economic order and contribute to the easy functioning of the economic processes. On the other hand, ‘Ablaufspolitik’ dealt with the economic process itself which have required the interventions in both the microeconomic (prices and production quantities) and macroeconomic (employment, investment, national income) relations in the market and took a ‘quantitative’ stance with regard to the economic policy. Original Ordoliberal thought clearly rejected the ‘Ablaufspolitik’ as this meant a direct intervention in the market processes where only the decision and the purposes of the autonomous actors should be decisive in creating the market results and not the steering of the process by governmental agencies for some pre-determined goals. Ordoliberalism advocated a ‘qualitative’ economic policy making which confined itself to the improvement of the institutional frameworks. Ordoliberalists’ motto regarding economic policy was ‘planing of the forms by the state’-yes; ‘planing and steering of the market process by state’-no (Schiller, 1964:42).

Eucken, in his ‘Principles of Economic Policy’ in 1950, tried to express his views about the possibility of an appropriate economic policy which should be developed from the theoretical results derived from his economic order theory. He explicitly criticised the laissez-faire policies which characterised the economic policy implications of classical liberalism and were commonly used in 19th century in liberal economies (Peukert, 2000:119). The reason for that was that laissez-faire policies neglected ‘the drive to power’ in market processes and did not formulate economic policies actively directed to prevent the private concentrations of power. For Eucken, ideal form of market order was full competition which mostly minimised the power positions in the market and guaranteed the freedom of the individual units. From this choice of market order as the most suitable one for the aims of an economic order i.e. furthering the freedom, Eucken stated that it is a ‘competition order’ which should be built up and supported by the compatible economic policies. He revealed the ‘constitutive and regulating’ principles he thought as necessary to conduct and

preserve a functioning market order. Eucken's constitutive and regulative principles could only function on the precondition of full competition in that economic order.

1. 'Freedom in markets' is the primary principle in a market economy. Individual freedom should be provided and protected in a legal and economic framework so as to guarantee the initial motive for the market economy and discard any possible centrally imposed regulations. Also this is a principle which will function only with the motive of competition. Additionally, in drawing the boundaries between state and individuals in an economic system is crucial. As Eucken put it, there is wide belief in Ordoliberal thinking on the assumption that private initiative will lead to the best overall performance and 'socially beneficial increase' in performance (Lenel, 1989:29).

2. 'Price mechanism' serves as the main device of coordination in a competition. Zweig argued that price mechanism has a paramount importance which should be respected in all areas of economic policy in the sense that any attempt 'to control or subsidise prices and wages and interfere with the interests or imports' should be avoided (Zweig, 1980:22).

3. Another component of the system is 'the freedom of contract'. It is one of the most important principles which make individual exchange and transactions possible between persons with equal rights on the basis of contract. However, there is always the danger of the misuse of the freedom of contract in the direction of restricting competition. For that reason, cartel agreements directed to the restriction of freedom of contract should be prevented. 'Universally acceptable laws' should give the ground for a proper settlement of contract (Lenel, 1989:30).

4. 'Open markets' were seen as the precondition of a 'full competition' by Eucken. He implied that partially closing of the market could exist with competition, however, this leads to the monopolization and disturbs functioning of competition order. This closing could be implemented either by the state or by the private power (Peukert, 2000:122). For that reason, in order to achieve full competition, it is crucial that the legal system guarantee the 'open markets' against the possible disruptions of the markets through closing acts..

5. 'Private property' is another formative principle of Eucken's economic system which was mainly characterized by liberal elements. Liberal thinking locates

private property to the system by defining its functionality for the working of the system. Private property was not conceived as the mere extension of natural rights but as a means to fight against the power problem in economy (Peukert, 2000:123). Lenel also favours private property for its close relationship to and inseparability from the concept of 'human dignity' (Lenel, 1989:30). For the functioning of private property as a safeguarding mechanism of freedom, private property should be widely dispersed. On the other hand, private property provides sufficient stimulation for private capital accumulation and voluntary savings. These factors, in any way, gave a dynamism to the market through strengthening private initiative. Lenel argues that 'a well-constructed system of ownership creates more security and facilitates the resolution of conflicts of interest (Lenel, 1989:31). However, this argument has some controversies, as the existence of private property does not exactly facilitate the resolution of conflict but, in most cases, it intensifies conflicts. To combat with such a possible outcome, Lenel saw the safe conduct of competition as the preventing factor of a huge concentration of private power which leads to a 'more widely redistribution of property' . Private property is indispensable to the working of the system in the condition that it was conducted into a competitive order which has enough constraint to a probable private concentration of power and provide enough incentives to the private actors to accumulate capital and target more productivity and efficiency.

6. Eucken's another formative principle is 'monetary stability'. According to Lenel, price formation could work as a coordination mechanism as far as there is a monetary stability in the economic system (Lenel, 1989:34). The stability of the value of currency is crucial for providing the certainty and predictability in the market. For Hamm, competitive regulations could be successful if currency stability was secured, inflationary policies were avoided and uncertainty about the inflation rates were eliminated (Hamm, 1995:109). This principle is called 'primacy of currency policy' by Eucken. The fulfillment of this policy should be primarily dealt with as the stability of the overall economic order is largely based on a sound monetary system.

7. Other constitutive principle is 'synchronization of control and liability'. This principle implied 'the private bearing risk' which provided a kind of equity and efficiency to competitive system (Möschel, 1989:154; Zweig, 1980:24). Eucken referred to 'the problem of 'companies with limited liability' and the problem of

limitations in standard contracts (Möschel, 1989:155). Private liability is indispensable to market economy in the way of combining freedom and personal liability.

8. 'The constancy of economic policy' constituted another formative principle of Eucken's economic order. An economic system that desires to make its working permanent should ensure that the direction of economic policies is certain, have a logical consistency and continuity. The constancy of economic policy is important because it allows the individuals to make more healthy plans and give more clear individual decisions as they could always predict the content of economic policies and its possible impact on the market relations.

Eucken also emphasized four additional regulative principles. These were 'monopoly legislation, incomes policy, environmental protection and the determination of minimum wages' (Möschel, 1989:155). For Eucken, setting up an appropriate market system is not possible with only constitutive principles. The State should establish the necessary framework within which the market will efficiently function (Zweig, 1989:25). Especially monopoly and competition legislation are crucial to prevent the monopolization tendency in market economy. Eucken said that 'Monopoly control should be exerted by a public monopoly control agency. To make it independent of the dangerous influences of the interest groups, it should be an independent agency which is only subject to law'. The aim of the agency should be 'to dissolve monopolies as much as possible and to control those which cannot be dissolved' (Peukert, 2000:125-26).

2.4 Franz Böhm and The Concept of 'Private Law Society'

Franz Böhm, as another representative of Ordoliberalism, was a jurist. He worked as an official in the Ministry of Economics of Weimar Republic in late 1920's. Also in parallel with his experiences in the ministry, he mainly concentrated on the problem of concentration of private power in economy through cartels and monopolies and the ways of preventing them through legal means.

Cartellization of the German economy gained momentum especially after 'the protectionist turn of economic policy in 1878/79 and from there on, the existence of

the cartels was commonly accepted in Germany and widely encouraged by the state and public as the main expression of German organized capitalism. Knut Wolfgang Nörr (2000) put out the reasons why the cartellization beginning from the late 19th century was actively pursued.

First, the 'stage' theories of Historical School supposed that there is a continuous development from one stage to another and the last stage is superior to the previous one. According to this logic, free market and free competition is inferior to an organized economy with cartels as the latter one represented the last stage of the economic development and, thus, had a higher rank over the former one (Nörr, 2000:149).

Secondly, collectivist tendencies in German society greatly overlapped with the idea of cartels. In this time, any institutional emergence of co-operative societies was supported by the public and the collective organizations were respected at the face of declining individualism. In that issue, also the moral concerns of the society became effective and cartels were regarded as socially and economically beneficial factors contributing to the common good (Nörr, 2000:150)

Finally, cartels were seen as the representatives of national economic and political power. In the direction of the dominant power politics (Realpolitik) at that time, cartels were the symbol of a strong national economy and used as a weapon against the foreign competition. For that reason, cartels were actively supported by the state to reach its national ambition. It is interesting that while Realpolitik took hold, the idea of law declined and became unable to impose its standards. This prevented any type of questioning of cartels in German public (Nörr, 2000:151-52).

In his monograph of 1933 on competition and monopolies, Böhm embraced the classical economic philosophy. Rather than regulation of the markets through monopolies and cartels, he proposed that 'free competition based on performance' should be established in order to increase national product. His conception of 'free competition' did not refer to a chaotic condition in the market, on the contrary, it built up an order based on 'legal rules and regulations' (Nörr, 2000:156). He used the term of 'economic constitution' to characterise the functioning of the market. From that standpoint, competition was not only seen as the instrument for the market interaction but also as the main constituent element of the economic order (Nörr, 2000:157). For

him, competition is rooted in the society itself as a coordination mechanism based on cooperative relations rather than coercion. For that reason, it did not refer to state or to individual but it represented the cooperative relations within a community. Because of its central position to the community, for Böhm, competition should be the main principle which should regulate the market processes.

Böhm gave two economic reasons for the 'legal prohibition of cartel contract'. 1) He believed that it destabilized market, especially if market tended to collapse 2) There were no risk benefits for all market participants (Tumlir, 1989:130). According to Böhm, the choice of the rules of the game at the constitutional level could not be changed in sub-constitutional level through private contract in the direction of private interest. So the involvement of the private pressure groups should be prevented in determination of 'Ordnungspolitik' which greatly depended on the superiority of the rule of law (Vanberg, 1998:7). As a consequence, the freedom of contract should not be misused in order to put restraint on competition through private contract. Since changing the 'rules of game' is totally incompatible with the idea of 'conformity with the general economic system', Böhm assessed cartel agreements as contrary to economic constitution based on competition. Additionally, he was against the self-determination of the rules by the private groups (Selbstgeschaffene Rechts der Wirtschaft), because he believed internal rules determined by private groups within their interaction is largely based on the interest drive motives, hence, incapable of being transformed into general law for the economy. These rules determined by interest groups could not be in conformity with the general political-constitutional choice of the society (Vanberg, 1998:8).

In his later article of 'Private Law Society and Market Economy' in 1966, Franz Böhm stressed the the evolution of Private Law in Europe and its indispensable role to the coordination of the activities within community. He argued that there was always a private law in western societies that implicitly regulated relations of private actors. However, for him, with the French Revolution, private law extended its sphere and began to dominate also the public sphere by its own distinct kind of relations which came about as a result of the evolutionary process of the community. Private Law Society referred to a society where 'everyone should have the same rights and status, namely the status of a person under private law'. For Böhm, private law

contains a social system combined with the control of the society of free and independently acting individuals and of the companies and corporations of private law established by them on a voluntary basis (Böhm, 1989:47). Due to these features of private law, he underlined the necessity of building free competition on the basis of a 'private law society'. As private law served well to the society by its coordinating mechanisms, Böhm implied that a society which was organized by the rules of the private law is the most appropriate one to a free competition order. For this reason, the sphere of private law in the social relations should be preserved in order to conduct the necessary conditions of free competition.

First of all, regarding state and society relations, Böhm advocated that any social order should presuppose state and society as two distinct entities. He defined the state as the social organism, which socially and politically has a controlling function and society contained the rest of them. In such a distinction, 'the administration of the means of control was attributed to the state with the exclusive task of 'the protection and preservation of the society' (Böhm, 1989:47). The bounds of competence which indicate the scope of the authority of the state was determined by its special relationship with the society including the co-determination of the member of society through its representatives. This kind of a relation between state and society was called as 'constitutional' (Böhm, 1989:48). Böhm asked that while state is able to express its will through its institutions, how can society express its will? According to law, society is not a legal entity as only the individuals can have some rights (Böhm, 1989:49).

However, he did not exclude society from his analysis. Böhm did not believe that the French Revolution saved the individual from society but it left the individual within society. He assessed the outcome of French Revolution as a transformation from 'a feudal society of privileges' into a pure 'private law society'. Individual has get rid of his dependence on the privileged people and was bound to the private law society which provided all with legally equal status and private autonomy. Thus, it gave way for new kind of relations greatly dependent on the rules of private law. The private law society did not represent the aggregate of unconnected individuals but a community whose main relations were coordinated and organized according the rules of the private law. So the contractual relationships were regulated by private law.

However, it had implications beyond private law also in public sphere providing individuals with an ‘extensive freedom of movement, a competence for planning and a status within the private law society. All these rights were not naturally given but constituted social civic rights (Böhm, 1989:50).

Böhm’s main argument was that ‘private law society could not function without authority’ and stated that ‘with abolition of feudal society the activities of state covered the content of private law society with its attempt to construct legal order which regulates the transactions of the individuals (Böhm, 1989:51). Böhm argued that ‘the individual is bound to his state through ‘the medium of private law society’ (Böhm, 1989:50). Thus, the interaction between individuals on an equal basis constituted a legal entity which makes the connection of the individual with its state. In a way, as Böhm argued, the private law society complemented the functions of the sovereign body in its relationship with private law subjects , hence, individuals.

Böhm speaks of private law society as a coordinated system rather than having relations of coercion. He defines ‘social cooperation’, based upon a coordination between autonomous but not self-sufficient individuals as a ‘signalling system’ (Böhm, 1989:52). In that way, private law society fulfills its coordinating function by influencing ‘the selection of individual plans, their content and their accommodation to the plans of others’ (Böhm, 1989:53). In this relationship, a private law society while providing social cooperation and coordination with its legal provision, also served as an instrument of social control. Böhm gave the exchange agreement as the main indication of the cooperation between independent traders with equal rights and puts out that ‘the private law system is involved in controlling free market processes’ (Böhm, 1989:53).

For Böhm, French Revolution led to the ‘the establishment of private law society, the transfer of executive power to the members of private law society in their entirety, a drastic easing of the burden of the task imposed upon the executive power’ (Tumlir, 1989:134; Böhm, 1989:57). In the new society, the activities of government were limited to making regulative framework and the influence of the government was rendered neutral. In Böhm’s words ‘the role of the state in the overall enforcement of the system would be so constituted that it would severely limit political discretion (Böhm, 1989:63). However, there is always the threat of the

involvement of pressure groups in political processes and the role of state as defined after the French Revolution should be guaranteed against the penetration of the political interests of pressures. Therefore, Böhm stated that ‘a defence mechanism’ which strictly determines ‘the role and duties of the government, the task of the legislator and the principles by the courts would interpret the law’ should be conducted to protect the special relation of the state with the private law and its connection with the individuals (Böhm, 1989:63).

Böhm distinguished between the ‘normative force of *de facto* occurrences and the exact and proven legal phenomena’. For him, legal principles emerged as a result of a long evolution and this feature made it more reliable with regard to their normative influences (Böhm, 1989:67). Böhm saw the tendency in society to take the normative effects of political and economic events as the guide for their actions. However, for Böhm, ever-lasting legal principles should be the only source of interpretation of the social phenomena. For that reason, the system of private law is crucial for avoiding ‘the normative force of actual events’ in a way that the stability of the rule of law and its institutions became dominant and ‘legal standards govern the events’ (Böhm, 1989:67). This idea of Böhm greatly resembled Hayek’s view on law.

The concept of private law society served for excluding the factors of ‘power’ from the regulation of economic interactions by the separation of itself from the state and providing the legal rules necessary for its functioning under the protection of the rule of law. Böhm thought that a market order based on the free competition as the economic constitution could only function in a framework of a private law society. This vision could also be viewed as a legal complementary to Eucken’s design of economic order in the sense that both theories emphasized which institutions should be supported to enhance the freedom of the individual against the threat of big power concentrations.

CHAPTER 3

SOCIAL MARKET ECONOMY: THEORY AND PRACTICE

Social Market Economy indicated both an ‘economic order concept’ and the realization of its principles in the economic restructuring of the post-war Germany. Although greatly inspired from the Ordoliberal concept of economic order and the ‘Ordnungspolitik’ of Ordoliberalism by taking a general non-interventionist stance, Social Market Economy as a theory had some distinctive qualities differed from Ordoliberalism in some issues. Despite the fact that it embraced the Ordoliberal tradition, Social Market Economy did not only deal with economic order problems but also had socio-political implications by proposing a national model which wanted to reconcile the market economy with the intrinsic political, social and economic values of the German society. In this sense, Social Market Economy implied a comprehensive order within the framework of its general principles but as a theory, it did not impose a strict regulation of society according to some predetermined rules. Social Market Economy as a theory provided the ‘ideological basis’ upon which the Social Market Economy as a concrete realization of order would be constituted. Post-war development of German economy and society was greatly influenced by the Social Market Economy as a leading idea. Therefore, the analysis of that period is crucial to explain how far the German socio-economic order converged with or diverged from the original concept of Social Market Economy and in which direction it evolved within a framework of market economy.

In the first section of the chapter, general theoretical implications of Social Market Economy will be explored. While embracing the principal elements of Ordoliberalism, Social Market Economy did not confine itself to the limited scope of competition order. It was perceived as a ‘comprehensive order’ which built up an

‘organic whole’ out of the various orders of society. Social Market Economy attempted to create a social consensus between various groups in society with conflicting objectives. It was an attempt to reconcile these conflicting positions widely accepted as antagonistic under the framework of Social Market Economy. The social and economic premises of Social Market Economy were a mobilizing factor for the large segments of society in post-war era.

Most of the second chapter will be devoted to the post-Second World War analysis of the German economy. The focus will be on how the market economy was constituted as a crucial part of Social Market Economy in post-war Germany. Particular economic policies of central administration which led to the institutionalization of market economy will be mentioned and the spectacular growth process called as ‘German economic miracle’ in that period will be analysed with all its determinants keeping in mind that the level of economic performance and its quality was highly interrelated with the nature of economic policies

The role of monetary policy and its institutionalization in post-war stability and the development of fiscal policy constitute the distinctive characteristic of economic policy in Germany. The standpoint of the macro-economic policy making in Germany was not in line with the general trends in macro-economic theory as shown by the absence of Keynesianism. Although some Keynesian elements were introduced by the ‘Stability and Growth Act’ in late 1960’, there appeared a continuity in macro-economic policy-making in Germany. Concrete role of the state with its increasing or decreasing involvement in market relations in post-war Germany enabled us to appropriately compare it with the tasks attributed to the state by the theory of Social Market Economy.

In the last part of the chapter, another important area, i.e competition order in Germany will be questioned. The Ordoliberal conception of competition and the contributions made by Social Market Economy will provide the basis for the evaluation of competition policy in Germany. The ‘Law Against Restraint On Competition’ in 1958 and its further amendments will show the scope of competition legislation in Germany.

3.1 Social Market Economy As A Leading Idea

Alfred Müller Armack is the person who first used the expression of Social Market Economy as to represent an economic order. Although he had written on the economic problems in 1920's and 30's, his proposal for Social Market Economy after the Second-World War became decisive in the establishment of the liberal economic order of Bundesrepublik. In 1946, he expressed his programme on the Social Market Economy in his book of 'Wirtschaftslenkung und Markt-Wirtschaft' ('Planned Economy and Market Economy'). With this book, he put out the basic principle upon which Social Market Economy should be conducted and gave the clues for the future economic policy making in the new economic order. In 1948, he worked in the 'Scientific Advisory Board to the Federal Ministry of Economics. In 1952, he was appointed to the 'Head of of Central Policy Unit at the Federal Ministry of Economics. From this time on, he actively involved in economic policy making in accordance with his theoretical understanding of Social Market Economy.

Social Market Economy represented an idea of social and economic order which is prescribed to be established by the theoretical basis and its practical reflections shaped by the leading idea of Social Market Economy. Armack defines Social Market Economy 'not as an exclusive competitive theory' but as an ideological concept aimed to create and sustain relations of cooperation and coordination between different spheres of society including different class formations (Armack, 1998:258). In that sense, this idea of order targeted to achieve peaceful socio-economic relations within the complex nature of society, by an 'irenical' formula which will serve as the leading and guiding idea for all sort of interactions of social and economic actors. In Armack's terms , Social Market Economy is a 'strategic idea' which promotes 'genuine cooperation' of different social groups identified by different and conflicting objectives (Armack, 1998:261). 'As a comprehensive conception of Social Market Economy', it does not only refer to an economic order functioning by the coordination of markets but it settles and aims to reach some social objectives for the working of the whole economic order (Armack, 1998:262).

This idea stems from the main argument that 'market economy and social security did not exclude itself' but 'the market and social protection are indispensable

and support each other'. First of all, Social Market Economy as a theoretical concept and as a leading idea signals an attempt to combine the outcomes of market economy with social progress in society and proposes that only such an order as a product of that attempt could lead to 'the efficient production of means of material well-being and personal freedom in a socially balanced society. Armack pointed out that the main goal of Social Market Economy as an economic order is to reach the objectives of personal freedom, economic and social security and economic growth, called as 'magic triangle' by Armack (1998:264).

Social Market Economy as seen in Armack is not an 'apocalyptic' vision or an utopian design which intends to set up an order with pre-fixed principles and aims (Zweig, 1980). Rather, its main aim is to turn the cooperation of economic forces into 'a workable and realistic harmony' and reach to a compromise by which the conflicting interests in the society were integrated to each other. Social Market Economy does not imply a closed system with a fixed organizational content valid for all the times but is open for revision and continuous renewal in its application and basically serves as a leading idea indicating the generally defined road in reaching the 'magic triangle'. In that sense, Social Market Economy is not an order based on a single value system but contains the co-existence of different kind of systems under a cooperative framework whose formula should be revised in accordance with the changing necessities of time.

Rather than being exclusively a theory of competition, Social Market Economy is a theory of 'wirtschaftliche Gesamtordnung'(comprehensive economic order) which analyses the economies from the perspective of the 'totality of the social and economic order' (Koslowski, 1998:81). Bearing in mind the Ordoliberal assumption that there is an interdependence between different orders of the society, economic and social orders and the policies relating to them should not be analysed separately. They are in a continuous interaction that illustrates that Social Market Economy is firstly a social order combining different spheres of society rather than concentrating only on the economic dimension of it. Koslowski argues that 'Armack's theory of Social Market Economy is a theory of the totality of the social order, of the style of the living (*Lebensstil*), of the common form of style (*Stilform*) of an economy and society (Koslowski, 1998:87).

First of all, market economy was conceived as the best means for maintaining efficiency and freedom in the market and the most appropriate basis for social progress. Ordoliberals agreed on the superiority of the market economy compared to other economic orders in the sense that it provides the most optimal allocation of resources in a guaranteed efficiency and most suitable basis for social measures. Armack stated that market economy system is superior to other alternatives by its capacity to generate high productivity and general welfare (Watrin, 2000:207). However, although Social Market Economy presumed the market economy as the best means to achieve its social and economic goals, market processes were not viewed as an autonomous interplay of market forces whose results for the economy and society should be unconditionally accepted. They saw that market order could only function with the collaboration of other orders of society. For that reason, the aim of public policy could not only be the free realization of markets but should also provide that the values and aims of the other orders of the society are compatible with market logic. For Social Market Economy theoreticians, the market order is open to some 'market conforming corrections' aiming at counter-balancing negative market effects. Social Market Economy viewed the competition order as a 'mechanical process indifferent to values and goals and emphasized on the 'technical and partial character of market system' (Armack, 1998:263). This was not seen as a pure spontaneous order which leaves no place for outside steering mechanism. In contrast, since competition order was seen as an artificial order which does not come about purely spontaneously but is consciously constructed, it opened the ways for some corrections in conformity with the system as far as there is always the possibility of market failure or market insufficiency and the pressure of social requirements of society. It does not change the fact that 'market economy is characterised by the coordination of the decentralized planning entities' and the aims were pursued by individual entities. However, this situation, first, brought the space for an 'Ordnungspolitik' dealing with the improvement of the general economic order and, second, the possibility of affecting the market processes for some particular objectives of society. This economic policy did not confine itself to preserving only the competition order, but attempted to protect the whole social order with its interdependencies. In that direction, it became a necessity to supplement economic equilibrium with a social equilibrium for the

general order of society. For this reason, the system of market economy is not the only and the best means of coordination within society which should have a priority over other orders of society.

Armack and Ordoliberalists agreed on that economic policy should be directed to building the general framework for the 'appropriate and effective coordination' of decentralized planning entities. However, Armack did not see economic policy choices limited to making market economy regulation, rather he introduced some constructivist elements different from the Ordoliberal view. It meant that rather than creating merely a market economy with an appropriate legal basis, there should be a deliberate attempt to affect the market processes in such a way that it will bring socially positive results and complement it with necessary social policies. Armack intended to set up a 'multiform and complete system of social protection on the basis of market economy' with the pre-assumption that social protection is not incompatible with the market economy, contrary, they supported each other (Zweig, 1980:36). We can put the subject differently by saying that Armack tried to establish a totality of social and economic order in which social security is essential and in conformity with the functioning of market economy. As a consequence, he did not only criticise the 'idea of total economic planning' but also 'the idea of a totalization of the market as the only means for co-ordination in the social order' (Koslowski, 1998:80).

The theory of Social Market Economy puts emphasis on the necessity to socially counterbalance or equilibrate the negative market processes by creating 'an institutional framework for 'social equilibration of capitalism' without breaking with the general idea of capitalist order but by defining it new in the light of social interpretations (Koslowski, 1998:82).

First of all, Armack claimed that 'capitalism is an open system whose future development cannot be anticipated and is, therefore, unpredictable' (Watrin, 2000:197). Rather than concentrating on analysing capitalism by the guidance of some pre-determined laws of historical development, Social Market Economy relied on the possibility of changing the capitalist order which brought about the possibility of 'goal-oriented actions for the purpose of influencing and controlling social and economic developments'.

On the other hand, the theory of Social Market Economy was greatly influenced by the younger generation of German Historical School which was generally directed by historical and sociological studies of Spiethoff, Sombart and Weber. Having rejected materialist theory of history depending on laws for economic development, they indicated the importance of 'mental, social and religious factors' in the economic events while analysing economic history. For Koslowski, these theories provided 'a more realistic analysis of motives and functions' which, in a dynamic process, gave direction to economic events and directed the attention of Social Market Economy to the 'totality of economic style of an epoch, a style in which mental, economic and political factors form a synthesis' (Koslowski, 1998:76). Though Müller Armack argued that Social Market Economy is a kind of capitalist order, mainly it concentrated on the insufficiencies of the capitalist order by thinking that social equilibration is inevitable for the working of the system.

Another aim of Social Market Economy is to combine ethics and economics in the idea of economic order. Otto Schlecht proposed that the idea of Social Market Economy was also influenced by 'humanist and socio-Christian principles' by the way that it constituted a 'liberal and human alternative' both to laissez-faire capitalism and state-controlled command economy (Schlecht, 1998:276). Derived from an ethically-directed reasoning, Social Market Economy gave great importance to ethical elements in economic order rather than merely trusting in market processes. Armack argued that market economy could function better when it was encountered with humane objectives which were also helpful for mitigating negative consequences of market processes. Also Röpke emphasized on the mismatch of humane requirements with the modern mass society. He proposed a 'double path' to proceed: 'humanizing the environment; giving the individuals the chance to develop and apply their full potentialities' and enhancing social responsibility (Zweig, 1980:38). In this way, Social Market Economy tried to set up a market economy which was combined with the 'socio-ethical objectives'.

3.2 Role of The State In Social Market Economy

State had an important place in conducting Social Market Economy as an economic order and developing it by the appropriate economic policies. Not only for competition policy but for other areas of economic order, state's involvement was presumed as the integral part of the theory of Social Market Economy in various policy initiatives. However, the problem began when it comes to determining the extent of state's involvement in the market processes.

Ordoliberals were strictly against government interventionism. In Ordoliberal thought, state should concentrate on how to improve the economic order rather than directly setting in the market process to steer the market. The idea of 'a strong but limited government' was also accepted by Ordoliberals by a statement that there is a decrease in state authority as far as there is an increase in the extent of state activity. Eucken proposed that state should restrict itself to only making 'economic order' policies (Ordnungspolitik) in order to make itself more efficient and functional (Kloten, 1989:72). From the Ordoliberal point of view, public sector should take a secondary role in participation in the economic process. If the state will act in market process, first, it will be 'bound by rules of conduct and appropriate assessment criteria; second, the intervention will be in conformity with the market mechanism. The second principle was also used by Armack in referring to a criteria allowing state intervention. Ordoliberals put the limit for the state intervention to the point where 'the disruption of the overall market mechanism' begins.

This view greatly differed from laissez-faire liberalism and the thoughts of Austrian School. For instance, Hayek clearly rejected any attempt by the state 'to take rational and purposeful actions' which were conceived as destructive to the spontaneous functioning of the markets (Streit and Wohlgemuth, 2000:246). While Hayek thought that the reason of the market failure is such rationally organized, governmental actions, Ordoliberals thought that these resulted mainly from an existence of a 'weak state', which could not guarantee efficient functioning of the market. Although Ordoliberals highly trusted in the market coordination as a result of 'spontaneous interaction' of individual actors outside the effect of the state power, state was thought as crucial in making and enforcing institutional framework of general rules of the market, hence, the economic constitution.

On the other hand, Armack gave a more extensive role to the state since the Social Market Economy as the idea of a socio-economic order should fulfill a great task in achieving its objectives including social ones which go beyond solely maintaining a competition order envisaged by Ordoliberalism. Armack defined market economy as an 'artificial order', a machine in need of 'rational human control and steering' (Watrin, 2000:210) that indicated that a liberal assumption stressed on only market economy principles and spontaneous actions of private actors is bound to fail. Missing social dimension was interpreted by proponents of Social Market Economy as harmful to the long-term functioning of the system itself. As the basic objective of Social Market Economy is to combine 'economic freedom and social security', this situation called for a considerable involvement of governmental action for regulation of the economy for a 'socially-balanced market economy'. Armack also took the view that state's interventions should be compatible with market economy mechanism and be 'socially justified'. One example for such an intervention could be given by putting 'minimum wages below the level of equilibrium wage' which was not seen to the detriment of efficient resource allocations of the economy (Watrin, 2000:211). However, 'fixing prices or directly involvement in the process of price building' was conceived as contrary to market mechanism and it was rejected on that basis. In consequence, Social Market Economy argument considering the role of state is that socio-political aims could be achieved both by state interventions within the rules of the market and by the efficiency of market allocation of resources by private actors.

While Social Market Economy favoured a strong state and its involvement in various fields, the problem appeared as how to limit this 'strong' state. For that problem, Rüstow proposed that the state should function as a 'neutral entity detached from the interplay of the groups'. Freiburg School claimed that 'economic order policies' should be implemented 'impartially and without exception' which implied that the concept of 'Rechtstaat' emphasizing on the superiority of rule of law should be decisive in the content and scope of the state's role. So, the 'automaticity and predictability' of governmental action with the inspiration of 'Rechtsstaat' should be secured against the possible effect of pressure groups in 'economic order policies' (Barry, 1989:117)

In fact, Ordoliberalism did not make a clear formulation of the state organization with its tasks and responsibilities and not give the exact boundaries between state and market. The reason for this was that they generally dealt with the micro-economic relations in the market by making use of static equilibrium analysis (Kloten, 1989:72). In the context of this way of analysis, it was thought that state under the control of the law will contribute to the good functioning of the market economy and serve as a guarantee against any interventions from private and public sector. The role of the state was designed as complementary to the market relations and the market process gained ascendancy over the effect of public sector as envisaged in 'subsidiary principle'. This principle assured that 'effective competition and private initiative' could provide better results in the market than the government involvement would bring. According to 'subsidiary principle', government intervention should be called for when market mechanism failed or the result of that process is contrary to the common social interest. Then the state provided the 'second best solution' to stabilise the market and get involved in services where the private initiative is insufficient (Stockmann, 1991:55).

While the 'principle of subsidiarity' determined whether the state will intervene or not, the 'principle of conformity' restricted the degree of that intervention. Although 'conformity principle' revealed a useful criteria for assessing market interventions, it did not provide a clear-cut separation of state's activities from the market relations and provided a 'scope for discretion' (Kloten 1989:78). The effects of market interventions of the state could not be easily measured. The limit to state activities was generally put at the point where this extension of the activities seriously challenged the market processes. However, there will be certain cases where there will be diverging views on whether a specific state intervention is destroying the market process or not and this will give the way for market interventions subjectively justified.

On the other hand, it is not possible to divide all the economic policy into market-conforming or non-market conforming categories. There will be some interventions that was directed to correct the market processes and contribute to the functioning of market. This represents a modest type of intervention. However, the kind of intervention that stands at the boundary of destroying the market process does

not imply a governmental action which aim the correction of the market processes from the start, but it extends its sphere having a neutral effect in market process as far as it does not cross the line where market processes began to be harmed. Therefore, it creates a large sphere of state influence where the state interventions neither attempted to correct the market process nor seriously challenged the dynamics of the market economy, at least perceived as so.

On the other hand, there is no exact limit of the size of the public sector *via* private sphere. This problem was generally held within the framework of ‘principle of subsidiarity’ and the growth of the public sector was seen as a danger to the market economy. However, this only provided the general assessment criteria and did not put out ‘to what extent and for which purposes’ the public sector should expand (Kloten, 1989:78).

3.3 Competition Policy In Social Market Economy

Ordoliberal concept of ‘competition’ was largely shared by the theory of Social Market Economy . Ordoliberalism saw competition as the main regulatory factor in the coordination of the market supplying the best means for individuals to fulfill their self-interest. Böhm said that competition is not only an incentive mechanism coordinating a free market economy, but also a device which limits power (Vanberg, 1998:8).The first goal of competition policy is to secure individual freedom of action and the protection of individual economic freedom was conceived as ‘a value in itself’ which should be maintained against any restraint of private or public power (Möschel, 1989:146).

In Möschel’s terms, Ordoliberal concept of competition is derived from ‘an appreciation of law and justice based on contract’ (Möschel, 1989:148). He connects this feature to the tradition of idealist German philosophy embodied in Immanuel Kant and classical English moral philosophy (Möschel, 1989:149). Ordoliberal competition policy differed from *laissez-faire* concept of competition which implies ‘the uselessness of competition law’ (Möschel, 1989:147). *Laissez-faire* conception was strictly against any attempt of governmental intervention as this was contrary to the general rules of competition and they believed in that competition order emerges

and functions spontaneously much better than in any kind of outside intervention. However, Ordoliberalism saw the danger and tendency of monopolization or any economic concentration which distorts competition and this problem could not be solved by the purely market processes. On the other hand, Marxist theory evaluated it as an inevitable development of competitive capitalism into monopoly capitalism and Galbraith saw monopolization as a product of 'technological and innovative superiority of modern industrial structures' (Möschel, 1989:147). Both views implied 'the impossibility of competition', because of inevitable development of capitalism in reverse direction. However, Ordoliberalism believed that concentration of private power and the limitation of competition by private means is not an irreversible process and stressed on the necessity to pursue competition policy against these threats.

Ordoliberals were aware of the fact that in reality it is impossible to realise perfect competition but the idea of competition could be held as the guiding principle, as a criteria for the private individual's acts or economic order policies. For this, Eucken used the idea of 'vollständige Konkurrenz' (full competition) which should not be equated to perfect competition (Vanberg, 1998:9). He stressed the tendency of private power to affect the political and legal processes in order to legalise the restraint of competition whose prevention should constitute the content of any 'Ordnungspolitik' and this principle of competition should be integrated into rule of law in the way of creating a sound legal framework for market relations.

First, competition policy in Social Market Economy derives its effect from an over-emphasis on the rule of law which is greatly directed by the content of economic constitution. Then legal principles stemming from the 'general idea of competition' should be decisive in construction of the legal framework of economic order. According to Ordoliberals, the first objective of competition policy should be the maximum preservation of individual freedom in the market, thus creating the conditions of 'full competition', and, in this way, the prevention of any governmental or private attempt to restrict the freedom of the competitors to the advantage of some special interests and groups. This could only be achieved when the content and scope of competition policy was clearly incorporated to the legal framework.

It was stated that while the governmental power was restricted by constitutional mechanisms, private power concentration should also be restricted by the legal principles. Möschel proposes that the the regulation of competition should not lead to the increasing role of the state nor be left to self-regulation of private power. He uses the concept of 'functional differentiation' in defining the conduct of competition policy (Möschel, 1989:152). It necessitates a certain demarcation of state's relations with the society and the regulation of the economic relations within the society. This meant that the legal framework for competition should exactly be determined in a way that 'a distribution of competence between society and state' will be put in clear lines and 'a method of solving the private conflicts' should be incorporated in competition law. Thus, the scope of government policy should be exactly determined by the rule of law in the way that it does not allow any discretionary decisions to be taken by the political power.

Armack argued that the realization of a competition order should be taken as a task of legal and governmental action and to constitute the legal order of market competition is within the competence of political power. He said that a government should pursue an anti-trust policy against misuse of economic power and conduct the necessary legal institutionalization for such a policy initiative. The task of the government is to set up the competition order in which the guarantee of individual's profit seeking in the market will eventually serve for the 'common good' of the society which was equated with 'fair conduct of rules' (Watrin, 1998:18).

Social Market Economy handled the competition not as separately from other parts of economic and social order. Taking into attention the interdependence of political and economic processes, misinterpretation of the term 'strong state' could lead to an idea that state should take an extensive role in regulating competition which could create a kind of 'rent-seeking society'. For that reason, competition policy was integrated into legal system, 'thereby embedding competition policy into the economic order of free society' (Watrin, 1998:18). Separating competition policy from discretionary political decisions, Watrin states that 'the protection and enforcement of workable competition' largely depended on a 'creative legislation' which should not be motivated by merely political interests. This argument could be interpreted as a indicator of the need for a political attempt to make economic

constitution based on competition dominate market relations. In consequence, since ‘proper’ legislation relating to competition is dependent on the political action which would create a politically neutral legal framework, the problem evolved around the question of what will be the exact method in regulation of competition by law. Streit and Wohlgemuth implied how this process will be put into effect. For them, a ‘double task’ should be implemented: first; ‘to grant independence to those who are entrusted and legitimised to make laws and to govern’, second; ‘to provide a sophisticated combination of checks and balances’ (Streit and Wohlgemuth, 2000:233).

3.4 German Post-War Growth and Macro-Economic Management

3.4.1 Economic Condition during 1945-48 Period

After the Second-World War, Germany witnessed a major economic collapse. In this time, economic activity greatly stopped. Although the Allied Powers did not absolutely destroyed the capital stock, the ‘damage was distributed unevenly’ and ‘suppliers of the essential inputs’ were largely destroyed by the Allied bombings (Giersch et.al, 1992:17). Transport network lost its functionality and most of the residential buildings were out of use. In addition to these, there appeared a migration from the eastern side of the country to the western part. These conditions made difficult to manage the economic processes and hindered the necessary reconstruction of economy.

However, Allied Policy did not primarily deal with the question of expanding industrial production or stimulating the export activities needed for a economic recovery. Their policy vision in Germany was shaped by the ideas of Henry Morgenthau, US Secretary of Treasury, and Harry D. White, the chief of the Treasury’s monetary research department, with the aim of ‘turning the industrial heartland into a country of peaceful farmers and craftsmen’ (Giersch et.al, 1992:18). This aim is first embodied in the ‘Joint Chiefs of Staff directive JCS 1067 of April 1945’ whose elements prescribed that the industrial disarmament of the Germany should be maintained, instead of heavy industry, ‘peaceful industries’ should be supported and the agricultural development should be encouraged. According to that

directive, the foreign trade was largely restricted and this fact considerably prevented the finance of the reparations with the gains from the foreign trade. Consequently, first implications of economic policies of US administration did not refer to a satisfactory economic recovery for Germany, rather, for strategic reasons, it concentrated on dissolving the previous economic power of Germany.

The post-war economy inherited the centrally administered economy of Nazi period. Nazis mainly maintained the capitalist economy with the private actors, however, the business were directed to the goals which were centrally determined. During the war period, Nazi economic legislation brought about 'the fixing of prices, wages and rents at their levels of autumn 1936, the rationing of consumer goods and foodstuffs, the central allocation of labour, raw materials and major commodities, a system of compulsory delivery quotas for farmers and a tight regulation of housing'.

Because of the structural conditions of the previous centrally administered regime, its adverse effect were felt at the post-war economic misery both in micro- and macroeconomic relations. There appeared the incapability of the economic mechanisms to make the efficient coordination and allocation of inputs and the distribution of outputs. A rigid structure of prices did not indicate the actual post-war scarcities and the price signals did not serve for 'steering resources into the most productive uses' (Giersch et.al, 1992:20). This led to the 'self-production of inputs' by firms which further made difficult the overall coordination of the economy.

In macro-economic relations, the extension of 'repressed inflation' from the Nazi Period was seen. In 1932, an expansionary monetary policy was implemented which later ended up with a 'price freeze' in 1936. In time of war, for the financing of war necessities, money supply increased ten fold. The growth in money supply with 'repressed inflation' led to the loss of the credibility of the official money as a medium of exchange at the post-war economy (Giersch, et.al 1992:20-21). Illegal black markets became common and as the Reichsmark lost its value as a means of payment and store value, cigarettes were commonly used in transactions instead of official currency. On the other hand, illegal barter became the common style of exchange because of which there appeared a turn from financial assets to the physical assets and the firms restructured their productions to get barterable output which

meant the 'hoarding of raw materials and semi-finished products' (Giersch, et.al 1992:21)

After the war, German economy was faced a destroyed capital stock, low level of production and low level of investment. Investment decreased in post-war period mainly due to the insufficient profit opportunities for firms and their unwillingness to invest in fixed assets because of political uncertainties. In 1948, 'the capital stock was 21 per cent below its peak level of 1944 and 7.3 per cent below its 1945 level (Giersch et.al, 1992:22). Industrial production have only reached one-third of its 1938 level. On the other hand, there was nearly no activity relating to the foreign trade. This situation was greatly resulted from the Allied policy in the way that they controlled all the internal and cross-border transactions and 'prohibited all the exports except for the compulsory exports' (Giersch et.al, 1992:24). In 1947, 'Joint Export and Import Agency' (JEIA) attempted to encourage commercial exports, however, its effects remained limited. First , the volume of exports was not so great compared to the volume of imports. Second, the traditional German exports based on finished products did gain ground. On the other hand, German producers had little inclination to invest in export production due to the loss of Reichsmarks' value and comparatively more profitable local markets.

At the beginning of 1947, the overall economic conditions deteriorated. The main concern was not the unrealized economic recovery, but merely the 'survival of the population'. For that reason, Allied powers relaxed their strict economic policy based on the directive of JCS 1067 and initiated the new directive of JCS 1779 which aimed 'more stable economic and political conditions'. According to the directive, the ability of German economy to reach its industrial production of the pre-war level would be enhanced. British attempt for nationalization of industries were left aside and the burden of reparations were relaxed. At the beginning of 1947, American zone and British zone were combined under the name of Bizone (Giersch et.al, 1992:23).

This change in Allied policies was partly caused by the 'transatlantic balance of payments crisis' as a result of lack of Germany's effect in foreign trade. Most importantly, Allied powers realized the importance of Germany' political and economic stability against the Soviet Union's influence in Eastern Europe. They perceived that uncertainty in the political structure and continuing economic problems

contributed to the Soviet's interests in the region. For that reason, the promotion of new stabilization measure became crucial. Western Allies built up the central bank (Bank Deutscher Lander) in March 1948 and gave support for a currency reform which would ail the most crude problems of the economy (Giersch et.al, 1992:26). Also the need for a separate German State was matched with a more active involvement of German politicians and academicians in economic policy making decisions.

Bizonal Economic Administration was set up in January 1947 and Viktor Agartz, a trade unionist, became the director of the economic administration by the support of SPD. However, his administration did not last long and as a result of a debate with British experts, he resigned on 1 July 1947. There were three major economic groups with competing programmes for the character of future economic policies. 1) 'Outright socialists backed by British socialists' 2) Keynesians which proposed government interventions and expansionary demand policies 3) Ordoliberal. On the other hand, regarding the mainstream parties, CDU favoured the 'nationalization of basic industries' and a limited planning with market economy elements while SPD stood for 'extensive central planning and nationalization of major industries' excluding strictly the option of free market economy (Giersch et.al, 1992:32-3).

These two parties competed for the direction of economic administration. After the resignation of Agartz , a Bizonal parliament (Wirtschaftsrat) was established. The Parliament did not accept SPD's control of the Bizonal Economic Administration. In March 1948, as a result of the election in Parliament, Ludwig Erhard became the director of economic administration. Erhard was a liberal who believed in free market policies and advocated an extensive liberalization of the economy. However, it is clear that to support a free market economy was an radical attempt for the post-war time when the planning was the key word for the economic policies in Europe. Additionally, in German public there was a great pressure for national planning even among the liberals. However, Allied powers' policy change giving up its previous aims regarding 'the tight control of the economy for the purpose of industrial disarmament and nationalization of the basic industries' opened the gate for the liberal policies (Giersch et.al, 1992:34).

In January 1948, an Independent Advisory Council of Academic Economists, composed of mostly Ordoliberalists such as Böhm, Eucken, Miksch and Armack, was incorporated to the Bizonal Economic Administration. Ordoliberal ideas through this council had the opportunity to influence the economic policies of post-war Germany and Ludwig Erhard's attempts for decontrolling the economy were further backed by the majority of the Council. In its first report of 1948, Council foresaw that introduction of the 'new and stable currency' would solve the problem of 'repressed inflation' and a functioning price mechanism would necessarily steer the market coordination without any need for extensive controls (Giersch et.al, 1992:34). Further, the majority of the Council gave consent to the policies of decontrolling the economy by freeing the prices except for some basic industries. The minority in the Council supported the idea of a mixed economy which have both the market and planning elements. They thought that a 'gradual approach' should be followed while deregulating the markets with the active involvement of the government in channelling the resources into necessary investment. The speedy deregulation was not accepted by the minority group as this will cause socially unbalanced results in the economy. On the other hand, Ordoliberalists favoured a 'liberalization of the markets' through which 'voluntary savings' by the guidance of the prices would stimulate the investments and raise the industrial production. For that time, Ordoliberalists greatly trusted in the structural power and tendency of the German economy to enter in a growth process which mostly necessitated the freeing of the markets.

3.4.2 Currency Reform of 1948 and Subsequent Economic Growth Process

The Currency Reform was introduced by the Allied Powers in 20 June 1948. Currency reform mainly had three targets: 1) the contraction of money supply by the replacement of Reichsmark by the new Deutsche Mark 2) a 'restructuring and consolidation of existing private and public debt' 3) setting forth of institutional mechanisms to contain the inflationary processes (Giersch et.al, 1992:36). The Reform stipulated that 'all currencies and bank deposits were to be converted into the new Deutsche Mark at a rate of 10:1, in other words, scaled down to 10 percent of the

original amount'. Net effective conversion rate became 100:6.5. Additionally, to prevent the misery and to give an initial consumption basis to the individuals, the individuals were granted with a per capita allowance which amounts to 60 DMark. 40 DMark of this amount was given at the date of currency reform and the rest two months later. 'The sharp reduction in liquidity' necessitated 'a reorganization of the debts' (Wallich, 1955:69). According to the prescriptions, all debts were devalued by 10 per cent for the necessary adjustment to the new currency. However, 'the official prices and all recurrent payments (wages, rents and social security payments) remained unchanged. As an institutional protection of the new currency, the Bank Deutscher Lander became the only legal institution for dealing with the monetary issues and gained the independence from all political influences including the government. On the other hand, with the direction of military government, Article 28 of Conversion Law stated that expenditures of government should avoid excessive budget deficits (Giersch et.al, 1992:37).

Currency reform was complemented with decontrol measures in the economy. The system of central planning was abolished and Erhard lifted the price controls for almost all manufactured goods and some foodstuffs. However, basic foodstuffs, basic raw materials (such as coal, iron, steel and oil) , wages, rents and rates for basic public services such as electricity, gas and water were exempted from the price decontrol. The reasons for these exemptions were the interests of Allied power in crucial sectors and possible socially negative effects of decontrolling some sectors like basic foodstuffs (Giersch et.al, 1992:38).

Military government introduced the 'little tax reform' to encourage the capital formation and investment. Accordingly, throughout the reform, the personal income taxes were cut by one third and the corporate income tax was reduced from 65 to 60 percent. 'Little tax reform' also brought about some tax exemptions for 'income saved and invested' and provided considerable incentives to give the necessary dynamism to the production structure of the economy.

Generally, currency reform was conceived as a 'tremendous success' by most of the public. Wallich described the immediate effect of currency reform on the economy as such: "On June 21, 1948, goods reappeared in the stores, money resumed its normal function, black and gray markets reverted to a minor role , foraging trips to

the country ceased, labor productivity increased and output took off on its great upward surge. The spirit of the country changed overnight” (Wallich, 1955:71). For Wallich, most important characteristic of the currency reform was its toughness in the sense that it gave priority to the sound establishment of the monetary system over the concerns for the ‘social equity’. Actually, with the devaluation of the debts and the unchanged values of wages, rents and social security payments in the new currency, reform favoured ‘entrepreneurs, businessmen and debtors at the expense of fixed-income receivers and creditors’ (Wallich, 1955:72). There appeared some proposals by the German experts in favour of ‘a redistribution of wealth to achieve an equalization of war and post-war burdens (Lastenausgleich)’, however, the attempts for making a link with the monetary reform and ‘Lastenausgleich’ were rejected by the Allied authorities (Giersch et.al, 1992:38). Thus, the effects of currency reform remained uneven *via* the various parts of society.

On the other hand, the currency reform became successful in mobilizing the active forces of the economy. Production considerably increased: according Giersch’s data, “in the second half of 1948, industrial output grew at an annualized rate of 137 percent , with the 1936-based index of production leaping from 50 in June to 57 in July and 77 in December”. This increase was partly caused by the increasing labor productivity which was expressed with ‘higher productivity per hour’ and ‘increased working hours’ since the incentive of labour to go work was stimulated as a result of currency reform. Giersch stated that in the sectors where the price controls were lifted production increased considerably while in industries where tight control remained , there has been comparatively little progress (Giersch et.al, 1992:39).

Utilization of existing capital stock was improved and the formation of new capital gained momentum. In the second half of 1948, the capital stock started to grow at an annualized rate of 5.6 percent. Increasing rate of investment with growing capital stock constructed the necessary basis for a further economic growth. In the post-reform period, as a result of the initiated incentives with the aim of stimulating the private initiative in financing the investments, ‘aggregate investment was financed largely by high business profits’ also with the assistance of foreign aid and fiscal surplus of public sector (Giersch et.al, 1992:40).

Despite these positive developments in the overall performance of the economy, the success of currency reform was challenged by an increasing monetary demand which gave way to inflationary pressures. Contrary to the expectations, both the money supply and velocity of money has increased in an unexpected rate (Giersch et.al, 1992:41). After currency reform, the funds extended to the business was limited to make the hoarded stocks be sold to the consumers. However, the expansionary pressures was widely observed. The amount of bank credits arose to 5.2 billion from zero at the currency reform; conversion of old balances to the new currency created large amounts of money; the rest of the initial 60 Mark per capita allowance was granted (Wallich, 1955:74). According to Giersch, “in the first four months after the currency reform, consumer prices rose at an annualized rate of 33.1 per cent and producer prices increased at an annualized rate of 45 per cent” (Giersch et.al, 1992:42)

Due to the inflationary pressures in post-reform periods, the gains from the currency reform was jeopardized and the demands for the reintroduction of price controls were strongly voiced. However, the economic administration did not respond with a direct intervention to regulate the economic process. Previously made tax and expenditure legislation prohibiting ‘deficit financing’ did not create a large room for manoeuvre for expansionary fiscal policies. For this reason, the important task was given to the monetary authorities. The Bank Deutscher Lander applied a restrictive policy to reverse the inflationary process. The Bank increased the reserve requirements from 10 to 15 percent; it refused to discount bank acceptances except for the financing of exports and of public storage of foodstuffs and certain raw materials; it requested all banks to limit their total loan volume to the level of October 31, 1948’ (Wallich, 1955:76).

At the end of 1948, inflationary process came to an end. The annualized increase of consumer prices dropped to 8.8 and that of producer prices to 2.9 per cent (Giersch et.al, 1992:43). Besides monetary restraint exercised by the Bank Deutscher Lander, there were also other factors contributing to the disinflation. Among the most outstanding ones were ‘the growing gap between prices and consumer purchasing power created by wage stability, the end of influx of converted balances, Marshall plan imports, the emergence of budget surpluses and the downturn in world markets’

(Wallich, 1955:78). As a result, the incentives for stimulating the consumption and production through the currency reform did not result in a macro-economic failure.

After the currency reform, the main concern of the policy makers became to sustain the expansionary momentum of the economy without generating an inflationary process. In the period of 1949/50, although post-currency reform growth relatively declined, industrial production grew by 24 per cent in 1949 and by 12 per cent in the first half of the 1950 (Giersch et.al, 1992:46). The main reason for the 'aggregate output growth' in this period was high labour productivity. In this labour productivity, 'a rapid reconstruction of capital stock' and 'a powerful structural adjustment of employment' became the main effective factors. Utilization of capital stock grew as a result of repair investments and working hours returned into normal levels. On the other hand, in parallel with this dynamism in production factors, a 'structural adjustment' occurred in employment. With the migration of the refugees to the industrial regions and a general influx of employment from agriculture sectors to the industrial sectors, the utilization of capital stock was combined by the increasing labour force with a low level of wages. As a result, it could be assumed that the 'liberal currency reform led a thorough reorganization of the economy's production structure, immune to the effects of short-term cyclical factors' (Giersch et.al, 1992:47).

However, in time, the unemployment rate reached to the higher levels. As far as the readjustment to the normal economic conditions completed in the post-reform period, there emerged a 'regional disparity of unemployment between the rural areas and industrial regions' (Giersch et.al, 1992:49). After currency reform, the capital shortage became obvious given the fixed proportions of capital and labour and this situation led the industrial firms lay off part of their labour force. In agriculture, the absorption of the labour force as a substitute for capital reached its limits. Therefore, a structural unemployment dominated the economy which does not indicate a 'mismatch between actual labour supply and actual labour demand' but mainly between the 'actual labour supply and potential labour demand' if the necessary capital was provided. Thus, the main reason for the unemployment was capital shortage which created an idle labour force in rural areas who were ready to work in industrial sectors. The unemployment did not arise from the restrictions of mobility of

labour or the high labour costs. In the period of 1949/50, labour productivity increased enormously while the real wages remained more or less constant. The moderate wage demands in this period compared to the increase in labour productivity made the high profits possible and contributed to the reconstruction (Giersch, et.al 1992:50-51). Thus, the main cause of unemployment was seen as capital shortage.

To overcome the capital shortage and to cure the unemployment problem, economists and politicians made various policy proposals revealing diverse economic policy positions. This competing views on the problem of unemployment and accepted policy stance was also indicative for the future course of macro-economic management in Germany. Apart from the philosophical standpoint of the economic administration, the pragmatic choices regarding the domestic and international affairs became also effective in the implementation of economic measures.

Giersch ascertained three positions which offered solutions to the unemployment problem: 1) 'Keynesian position which was advocated mostly by Erich Preiser and the working group of the German Economic Research Institutes 2) 'The dogmatic liberal position as presented by Röpke' 3) 'The pragmatic liberal position as presented by the Advisory Council to the Federal Minister of Economics including some Keynesians such as Kromphardt, Peter, Preiser and Weisser and mostly the outstanding Ordoliberals like Böhm, Eucken, Miksch, Armack and Wessels' (Giersch et.al, 1992:52).

Keynesians proposed that economic administration should apply 'expansionary monetary policy, special tax incentives for saving and investment planning' to stimulate the investment. This could only be achieved by an additional investment of the government to push the aggregate demand and this act would set into motion an expansionary multiplier process which would result in 'income-induced increases in both saving and consumption'. This necessarily would involve the financing by Bank Deutscher Lander. The possible inflationary process could be counteracted by 'a system of tax incentives for saving' (Giersch et.al, 1992:52-53). The full-employment policy requiring 'central bank expansion and budget deficits' was seen feasible. Unemployment was perceived as the most crucial problem of the economy. An immediate action to be taken against unemployment was prioritised over the concerns about the balance of payments equilibrium and currency stability.

Any possible external deficit as a result of expansionary policies would be responded by 'direct import controls'. Keynesians saw any 'mild' inflation as a tolerable risk with respect to the gains of the expansionary policies (Wallich, 1955:82).

Dogmatic liberal position was advocated by Röpke. He stated that a capital shortage could only be overcome by increasing saving (Giersch, 1992:54). The traditional ways of achieving it were 'outright taxation, open inflation or suppressed inflation'. However, for Röpke, their usage generally had distortive effects to the markets. He proposed that increasing the interest rates would solve the problem of capital shortage and these would be basically achieved through household savings and capital imports. In his view, economic liberalization and efficient capital markets would be primarily set up at the expense of structural problems and the concerns about the future economic growth which needed more active role for the governments.

The pragmatic liberal position favoured by Advisory Council saw the inflation as the main danger to the economic system. For that reason, to maintain a sound currency and the external balance became the first task for an economic administration in order to contain the inflationary threat. As the previous experiences of German economy with the catastrophic effects of inflation indicated, they thought that a few concessions to the inflationary measures could start a process which could not be resisted further. These concerns prevented them from taking extensive governmental actions to stimulate the economy. However, they could not be fully inactive regarding the problem of unemployment and capital shortage by only relying on market economy measures and leave all the economic process to the market mechanism. Although the maintenance of monetary stability through stable currency became the most important safeguard of the economic order, the presently arising problems with capital shortage seemingly as a short-term phenomena were perceived as a part of the long-term task of the government to stimulate the production in favour of a sustained economic growth. These targets could not be given up, though the immediate instruments to achieve that was not applicable from a stability point of view.

Giersch *et.al* (1992:55-6) expressed: "In its main reports on unemployment, capital shortage and monetary policy (reports of 8 May 1949, 26 February 1950 and 10 June 1950), the Council struck a delicate balance between Keynesian macro and neoclassical price theory". In its report of February, Council supported a 'moderate

credit expansion' without an inflationary effect for pre-financing the investments. Also it envisaged introduction of some 'tax privileges for special forms of savings' and a 'general cut in individual and corporate tax with tax savings being transformed into a compulsory loan'. Additionally, the need for a labour market policy was underlined to facilitate the labour market adjustment without introducing a public works programme (Giersch et.al, 1992:56-57). As a result, the proposals of the Council revealed a pragmatic liberal view of economic policy characterised with the combination of liberal market incentives and moderate Keynesian elements.

Economic administration with the support of the Council responded conservatively to the problem. Bank Deutscher Lander initiated some limited expansionary actions. The credit ceiling was lifted, the restrictions on the rediscounting acceptances were removed, the discount rate was reduced from 5 per cent to 4 per cent and the reserve requirements were scaled down (Wallich, 1955:84). A moderate credit expansion was made to selectively finance 'particular export and investment projects'. Government did not introduce large expenditure programmes in a counter-cyclical manner and most of the tax incentives to increase the capital formation had been already introduced before the unemployment problem. Therefore, these measures were regarded very insufficient to directly solve the problem arising from unemployment and capital shortage. In spite of the pressures from the trade unions, Social Democratic opposition and the call for a 'more aggressive monetary and credit policies' by ECA (Economic Cooperation Administration), West German Government did not change its position, thus, implied that the general vision for economic policy mostly respecting price stability and external balance could not left for the short-term aims of employment (Giersch et.al, 1992:59). Generally, government took an inactive attitude and greatly relied on the structural strength of German economy to recover within its dynamics without extensive government intervention.

This attitude of government was rewarded by stimulating effects of Korean war on the German economy. Demand for German goods has increased enormously and this demand and the increasing capacity of economy to absorb that demand initiated an export-led growth. While before the Korean war there was a pressure by the public in favour of Keynesian stimulus, the effects of the war made unnecessary to apply an

extensive public expenditure policy by providing an external demand stimulus without an inflationary pressure in domestic markets.

Next to the Korean boom, in 1950's a high economic growth was experienced: the five years from the Korean boom to the cyclical upswing of 1955 could be characterised by 'an enormous output growth reaching to the levels of 9.5 per cents high utilization of capital stock and a virtual price stability' (Giersch et.al, 1992:63). It was a spontaneous growth process. The government has played nearly no role in it as the expansionary forces driven from the external demand was powerful enough rendering an additional stimulus for growth unnecessary. For the second half of the 1950's, the growth of total expenditure on domestic goods was still high amounting to 7.6 per cent in real terms. Expansion of the economy after the boom of 1955 was high, but it was more balanced compared to the prior period. Export-led growth continued with a normalization but government passive attitude was changed albeit in moderated terms. After the extraordinary boom of 1955, real GDP growth was 11.9 per cent 'with high degree of capital stock utilization, increasing use of domestic labour force with falling unemployment and a moderate price inflation (Giersch et.al, 1992:66). The expansion from 1955 to 1958 was slowed down and resulted in a recession in 1958 with a 4.4 percent growth of real GDP. Recession kept price inflation at 1-2 per cent and the current account surplus at the 3 per cent of GNP (Giersch et.al, 1992:67). After the recession, a sharp recovery took place in 1959-60 and ,at the end, the economy reached the full employment.with inflation at moderate levels and a continuous current surplus.

Various factors contributed to the rapid economic growth of Germany. Actually, sound monetary and fiscal policies facilitated the expansion of the economy by policies enhancing the productive capacity. However, the favorable production conditions of economy with various incentives for growth became very decisive in strenghtening of the supply-side of the economy and ,this increasing production power has also influenced the choices of economic policy instruments. Thus, it is crucial to ascertain the real causes of the so-called economic miracle apart from the economic policy measures of government.

First, the global demand was high in 1950's and 60's due to the general reconstruction and growth process in world economy (Leaman, 1988:111). West

Germany has benefited from this process more than other countries because reconstruction process was more effective as the domestic property was severely destroyed and the reconstruction had a growth stimulus. Additionally, high technological potential and low levels of private consumption increased the capacity of the economy to absorb the global demand. On the other hand, the traditional structure of German economy in favour of exports supported the process. West German manufacturing sectors mostly with its investment goods took a larger share of global demand than other countries. According to Giersch, 'in the first half of the 1950's, the production index of manufacturing increased by an average of 13 per cent per annum and its employment by 7 per cent; the investment goods sector grew 16.7 per cent in production and 9.6 per cent in employment (Giersch et.al, 1992:70). Leaman put out that other reason for external interest in the German goods could be found in the saving capacity of the German economy due to the low consumption at home and the lack of 'wasteful military production' (Leaman, 1988:113). Additionally, rising terms of trade and low exchange rate of Deutschmark with currency stability are the other factors which strengthened the competitiveness of German economy.

The production structure of Germany also contributed to export-led growth. The industrialists faced with a huge reserve of labour force which was mostly consisted of refugees from East Germany. The age structure of this labour force was favourable; the qualification levels were high and structural mobility of the labour was increased due to the rationalization of agriculture and industrial production processes (Leaman, 1988:114-15). Thus, a highly educated labour force was mobilized to the industrial sectors where high utilization of labour and capital was realized at the face of external demand.

On the capital side, after the currency reform profits were as high as to 'finance additional investment in plant and equipment'. Appropriate conditions were created for making profits. Export demand did not only encourage the investment, but also led to the increase in capital stock. Rapid capital accumulation in the reconstruction provided the firms with 'a young industrial capital stock' (Carlin, 1993:24) Firms greatly benefited from increasing labour productivity. This was derived from the advantages taken from the 'new and modernized capital equipment and the

intersectoral change towards high-productivity manufacturing' (Giersch et.al, 1992:70). This led to a high capacity utilization and a greater role of industrial sector in increasing the national wealth (Leaman, 1988:116). On the other hand, the rises in labour productivity was higher than the increases in unit labour costs (Leaman, 1988:115). The slower increase in wages compared to the business income and increasing capital stock reduced the wages bill by 4 per cent between the period of 1950-60. The relatively weak condition of trade unions gave way to very moderate levels of wage demands. Apart from the other factors, surplus labour from East Germany undermined the bargaining power of trade unions (Carlin, 1993:24). Therefore, a structurally appropriate environment for the large profits of the business was created with 'highly competitive cost-price structure of the German goods' in external markets.

Marshall Aid was also other component which made the economic growth in 1950's possible. These funds took an integral role in the reconstruction of the economy especially in sectors which did remain under control and could not make of use of the advantages initiated by the currency reform. These sectors are coal, iron and steel, electricity, water and transport which suffered from the loss of capacity and the low investment rate. Thus, Marshall Aid with an efficient channeling of the funds contributed to the restructuring of these sectors. Marshall Aid through the Counterpart Funds financed over 40 per cent of the investment in coal in 1949-50, 20 per cent in electricity in 1949-51 and 15 per cent in iron and steel in 1950-51 (Carlin, 1993:22-3).

3.4.3 Monetary Policies and Institutions

Since the establishment of the Bundesrepublik, a great prominence was given to the maintenance of monetary discipline as a precondition for a sound economic order. Previous experiences of Germany with monetary crisis oftenly characterised by inflationary processes led them to give a priority to the monetary policy in economic policy. With the previous crisis, inflationary period from 1919 to 1923, the world crisis between 1929 and 1933 and the post-war period from 1945 to 1948 taught the Germans that the functionality and the stability of the monetary order is directly related to the stability of economic and social order (Lampert, 1993:66).

The Bank Deutscher Lander was constituted by the Allied Powers as an autonomous institution in March 1948. With the initiation of Federal Bank Act (Bundesbankgesetz) in 1957, its name became German Federal Bank (Bundesbank). Article 3 of the Act stated that ‘the German Federal Bank shall, ‘by the authority in currency policy with which it is endowed by this Act, regulate the circulation of money and the volume of credit available to the economy in a manner suitable for safeguarding the stability of the currency while ensuring the proper handling of bank transfers at home and abroad’ (Lampert, 1993:69-70). The autonomy and independence of Central Bank from the governmental agencies was indicated in Article 20. However, it did not meant the isolation of the Central Bank from other agencies of the state. Article 12 expressed that ‘the Federal Bank shall support in general terms the economic policy of the Federal Government as far as it is in conformity with the Bank’s proper mission’ (Lampert, 1993:70). The extent of the ‘mutual coordination and cooperation of Central Bank and Federal Government was formulated in Article 13. Article 14 gave to the Bank the monopoly to issue currency. The instruments of the Central Bank to control the money supply could be listed as such: “fixing and varying the lending rate, refinancing by specifying qualitative loan parameters, setting and modifying the reserve asset ratio and undertaken open market policies” (Lampert, 1993:71-72).

By the principle of currency stability, primarily the stability of price levels was implied. However, protecting the currency stability had also an external dimension in the sense that Bundesbank had to care about the exchange rate (Michler-Thieme, 1998:250). The external institutional monetary order and changes in that order affected the direction of Central Bank policies. Although Bundesbank dealt with the only one aim -currency stability- , to maintain that necessitated the involvement of the Bank in the various fields in economic policies relating more or less to the currency stability.

It is true that until 1960’s the only effective economic policy was monetary policy. Limitations to the fiscal policy in that period has also supported the priority of monetary policy. To control inflationary trends in the economy became the primary concern of Bundesbank. The strict position of the Bundesbank with regard to inflation in post-currency reform period was not only dominant in monetary field but also

decisive in other economic policies of the government. Currency reform of 1948 implied that a monetary order based on a sound currency was the most important motive for the reconstruction of the economy. Any inflationary process was perceived as distortive to all parts of the economic order, thus, it was the belief of the monetary authorities that any concession to inflation can have contagious and harmful effects which could eliminate the productive advantages of the economy. Keynesian thinking foresaw expansionary monetary policies for financing the extensive public expenditure to stimulate demand which could have inflationary effects. Monetary policies in Germany excluded this kind of policy choices. Generally, they took a restrictive stance to avoid from inflationary pressures. In the 1950's Central Bank is frequently criticised for its inactivity to respond to cyclical downturns and its rare use of expansionary policies. In contrast to the expectations, it did not change its position and gave priority to prevent the inflation over other short-term aims. This position of the Central Bank generally implied that once currency stability was maintained, the other problems could be solved in time on this sound monetary basis. On the other hand, to reach a superior balance of payments became the other important policy objective of Central Bank as it is important for the currency stability and favourable relations of foreign trade. By diagnosing the general dependence of the economy on the export for its growth, Central Bank's activities is directed to maintain the low exchange rate of the Deutsche Mark and favorable balance of payments. Thus, the monetary policies in 1950's and the adjusted economic policies tried to achieve balance of payments with a stable currency and the role of monetary policies for achieving other aims like employment was simply ignored (Wallich, 1955:107).

For achieving its basic aims, the Central Bank could be counted as successful in the period of 1949-66. The boom periods of the economy did not create large inflationary effects but even when there appeared such a tendency, Central Bank intervened by contractionary measures. From 1949 to 1958 the average annual rate of inflation was 2.6 per cent and from 1958 to 1966 3.2 per cent. Low exchange rate was also kept in this period. The exchange rate of the Mark to Dollar which was set in 1933 as RM 4.2:1 Dollar continued until 1961, when 'the Deutschemark was revalued by 4.6 per cent to a higher rate of DM 4.0 to the dollar (Leaman, 1988:132).

Although the policies of Central Bank was regularly described as restrictive, it was restrictive in the sense that the monetary authorities did not use expansionary policies. However, in two inflationary processes (the postcurrency-reform boom and Korean boom), the restrictive policy of the Bank Deutscher Lander was moderate and the outcome of this policies was not quite restrictive in the boom periods (Wallich, 1955:108). Although price increases and external deficits were prevented, this was mainly due to the natural consequences of favourable terms of external trade than any effective policy of Central Bank. Money supply increased from 12.3 billion in 1948 to 25.9 billion in 1953. According to Giersch ,in the first half of the 1950's, Central Bank has followed a 'passive accommodation' policy being relatively moderate in applying restrictive or expansionary policies (Giersch et.al, 1992:64).

As the 1955 boom began to have inflationary effects and decrease the current account surplus, the Central Bank intervened in a sharply restrictive way. This intervention was more restrictive than the ones in the first half of 1950's and represented an 'active restraint' policy rather than 'passive accommodation'. However, when 'expansionary' measures were needed after the recession of 1957, they again responded 'passively' like in the first half of the decade. Chancellor explicitly criticised the measures of Central Bank because of its restrictive policies after the boom period of 1955 (Giersch, et.al 1992:66); however, Central Bank kept its own position and for the whole decade, it could be said that it successfully maintained its autonomy and independence as prescribed in 'Bundesbankgesetz'.

Leaman argued that the currency stability of the 1950's could not be directly attributed to the success of monetary policies of Central Bank. The external demand for German goods continued and the export volume in balance of payments is in a rising trend while the consumption quota was under control largely due to the relatively modest wage increases. Thus, inflationary effects of continous balance of payments surplus were avoided (Leaman, 1988:133). Favourable terms of trade with low exchange rate with the dollar was beneficial for the German economy and the stable domestic position made any need for a devaluation unnecessary. On the other hand, government's respect for budget balance and avoidance from extensive expenditures largely contributed to the aims of Central Bank as any expansionary

fiscal policy in this period could create financing problems and lead to inflationary results.

Consequently, in 1950's the autonomy and independence of the Central Bank were strongly institutionalized and its primary role in monetary policy was tested when there is conflict with other political agencies. The Central Bank proved its competence and remained out of political manipulation. Although there were continuous pressure by the public upon the Central Bank for taking expansionary policies and some conflicts with the government, the 'moderately restrictive' monetary policy of Central Bank was in conformity with the general guidelines of economic policy in that period. Reliance on the productive capacity of the German economy *via* external demands expressed itself in 'accommodating' policy making which concentrated in sustaining the conditions which created a favourable place of Germany in international markets. Thus, external balance was important and any expansionary monetary measures for overcoming domestic concerns of employment and income distribution were out of question. Government's unwillingness to take extensive steps in that problems strengthened the Central Bank's position. It could be argued that the favourable economic conditions of Germany helped the Central Bank's fulfillment of the protecting the currency stability, however, economic growth process was neither counteracted nor stimulated by the monetary policies of Central Bank for the short-term.

3.4.4 The Role of the Government and Fiscal Policy Developments

West German government in the recovery period of 1950's did not take measures to directly affect market process for regulation of allocation and distribution of resources. Rather, it used some market incentives to facilitate the functioning of the market and encourage saving and investment. Introduction of free market policies with increasing competition provided an incentive for businessmen and labour to engage in market activities. Businessmen faced with profit opportunities and labour at least had some motives to go to work in spite of the low wages. Tight monetary and fiscal policies contributed to the competitive environment and tight money created the incentive for consumer saving with an increased confidence in the currency

Inflationary tendencies were curbed and competition was intensified (Wallich, 1955:127-8). Monetary and fiscal policies were designed to put strong incentives on going to export business. Other than this, taxation policy and some institutional reform laws were intended to be used to stimulate capital formation in economy as indirect instrument.

At the beginning, Allied Powers imposed very high tax rates with the Control Council Law 1946 and Law Nr 64 in June 1948 and the German authorities are not allowed to change these high rates without the approval of Western Allies until 1955 (Leaman, 1988:117). Government attempted to introduce some tax privileges through modification of 'Income Tax Law (EStG)'. As a result of several modification of para 7 of EStG between 1948 and 1952, for Leaman (1998:117) 'the allowances for increasing the offset value of new investment were extended from farmers and other self-employed groups to private enterprises in general' and 'degressive depreciation' was introduced which greatly favoured 'self-financing of investment' of the businessmen with large income while general tax rates remained as high as about 80 per cent. However, with the successive tax reforms of the 1950, 'little' tax reform of 1953 and grand tax reform of 1955, marginal tax rate was reduced to 55 per cent (Giersch et.al, 1992:79). These tax concessions primarily aimed at subsidizing investment and also mitigating the burden on tax payer to give way for saving. For Wallich (1955:129), concessions especially favouring investment and saving became successful in creating capital formation which provided big business with the necessary private incentives to go ahead while Giersch *et.al* (1992:80) thought that the tax privileges had 'minor incentive effect on work effort' in a short period of time . Leaman insisted that tax privileges introduced by the government were greatly to the advantage of 'self-financing investment' which raised the critiques of Ordoliberalists depending on the idea that the encouragement of self-employed entrepreneurship through tax concessions could pose 'the danger of high prices, increased capital concentration and dangerous social and political demands for co- and collective ownership' (Leaman, 1988:119). Increasing concentration of capital through 'self-financing' was contrary to the original Ordo-liberal policy aim in favour of spread of capital formation.

‘Investment Aid Law’ of 1951 was introduced mainly for enhancing the productive capacity of the bottleneck sectors like coal, mining, steel and energy which had narrow self-financing capacities due to the price controls. According to the Law, government imposed on the business to ‘give a mandatory credit of 1 billion Marks to a special fund which would be granted to the selected sectors and projects through the decisions of a board of fund administrators (Giersch et.al, 1992:83). After the law, investments in energy, iron and coal doubled , however, while the capacity was increased, the production did not follow it at the same level which led to surplus capacity (Leaman, 1988:119-20). Additionally, the Law did not find a solution to the self-financing but extended it to the other sectors.

In September 1952, ‘the Law Concerning the Promotion of Capital Market’ was introduced with the aim of providing the ‘flow of private savings into the capital markets and thus spread the ownership of productive capital’ (Leaman, 1988:120). Interest rate ceilings were removed and some tax exemptions were given for the interests on bonds issued by public authorities (Giersch et.al, 1992:83). The Law was successful regarding the capital formation especially with the increasing funds for housing market, however, the spread of capital ownership to the wider sections of the society was not maintained.

Generally, the taxation policy and the laws for stimulating capital had the primary aim of increasing the investments and the capital formation so as to sustain the growth process through necessary market incentive. In fulfilling its task it became successful though its effect on capital formation could not be easily measured. The priority was given to the big business as it was perceived as the locomotive of the economic growth by the economic administration, however, the effect of capital formation through tax concession to the wider segments of the society remained limited. Leaman (1988:121) argued that ‘wage earners did not benefit from the state foregoing some DM 2 billion in taxation yearly from 1951 to 1954’ ; according to him, while ‘the taxation burden on those paying Wage Tax increased’, through the tax privileges ‘the burden on the business income decreased’. In theory, It was the precondition of the Ordoliberal support for capital ownership that it should be widely held, however, this ‘social’ side of private property was ignored in 1950’s as the state supported the capital formation of big business as the only way of increasing total

wealth without much concern about the effect of capital formation on the degree of distribution of wealth.

In general, German government in the 1950's took a strict fiscal policy which did not involve in expansive policies. State expenditure in this period did not indicate a counter-cyclical activism as envisaged in Keynesian thinking which would be decisive in economic growth process. Rather, it generally acted 'procyclically' and avoided from taking extensive steps in the demand side (Leaman, 1988:137). The strict fiscal policy also contributed to the sound monetary policies of Central Bank as their respect for balanced budget and sound financing of expenditures increased the credibility of the currency (Wallich, 1955:109).

Contrary to the other states in that period like U.S.A, German economic administration did not recourse to 'deficit spending' for its expenditure programmes. There were some economic and political reasons for such a preference. First reason was the general dislike of large budget deficits by economic decision makers for their inflationary effects (Wallich, 1955:110). This feature was mostly reflected in the prudential and conservative attitudes of Finance Ministry in most of the 1950's. Second, there was some constitutional limitations to the 'deficit spending' prescribed by the Allies Occupation Statutes which led the government to adapt a balanced budget.

As another factor which kept the fiscal policy from being expansionary, federal fiscal constitution expressed that collection of taxes and use of tax revenue would be implemented through the coordination of central, regional and local authorities (Leaman, 1988:139). This political imposition made difficult to pursue an independent central fiscal policy if the other authorities did not act in the same way. In a sense, fiscal policy action of central authorities was controlled by the local and regional authorities. Although in 1950's there are no conflict-based relations between different levels of government, there is evidence that some anti-cyclical policies of central government were offset by the pro-cyclical action of the other authorities, and, thus, at the national level certain limits were put on the central fiscal behaviour (Leaman, 1988:140).

In the period of 1951-56, German government was faced with a large budget surplus which was about 3 per cent of GNP (Giersch et.al, 1992:64). The main reason

for this result was the effort of the government to accumulate funds for a future rearmament project. However, in spite of the given tax concessions, national budget was supported by unexpectedly very high level of tax revenues due to the outstanding economic growth process and this created budget surpluses given the favourable market situation which did not require any additional government expenditure.

In the second half of the 1950's, this situation changed sharply. Budget surplus decreased from 4-5 per cent of GDP to 1.5-1.8 per cent in 1958-59 (Giersch et.al, 1992:67). First, the German economy entered a recession in 1957 and growth rates, though still high, were comparatively at normal levels. These developments inevitably led to a decrease in tax revenues relatively to the previous periods. On the expenditure side, rearmament project gained momentum; in 1957 a 'new and greatly improved old-age pension scheme' was introduced and a massive amount of agricultural subsidies under the name of 'Green Plan' was extended (Shonfield, 1965:285). These developments necessarily put a considerable burden on budget. In addition to these external restraints, there appeared some concessions from the strict fiscal policy. To influence the electoral process in 1957, one year before, expenditures from the budget were made to particular groups as 'social gifts' and for the same aim, some tax concessions were granted. Although the effects of them was not visible in short-run, some of them gained the status of 'built-in permanency' which could distort the budget balance in the long-run. On the other side, in the recession of 1957, budget fulfilled a role of automatic stabilizer through which process the tax revenues decreased pro-cyclically with the recession while the public spending continuously increased in the whole period. While these foregoing of tax revenues could contribute to overcome the recession, budget surplus was reduced to a low level of 1.5 per cent of GDP in 1958 (Giersch et.al, 1992:67-68).

3.4.5 General Character of Economic Policy In The Reconstruction Period and The Changes In The 1960's

The conduct of the economic policy in 1950's could be described as 'orderly housekeeping' especially in financial policy. In this time, decision makers were primarily concerned with maintaining price stability and external balance over other

objectives like employment or incomes policy. Economic policy was greatly confined to monetary policies and the independence of the Central Bank limited the scope of central government intervention in the markets. Also a strict policy stance was dominant in Finance Ministry which prevented the great expectations from a central macro-economic policy. Actually, economic authorities did not prescribe very ambitious objectives to be realised by expansionary economic policies. This policy choice also conformed to the principles of 'Ordnungspolitik' advocated by Ordoliberalism which prohibited any active steering of the market processes. However, the main motive was the favourable historical condition of German economy in world markets and its traditional structures which rendered any government intervention unnecessary at this period.

Germany did not resort to French type economic planning which depended on the leading role of the public sector in the post-war growth process. In this choice, German economic authorities relied on the power of German industry which was able to act in the 'right' direction when the necessary motives and incentives (i.e. low labour costs, high profit opportunities, tax concessions) were available in the market (Shonfield, 1965:275). Highly organized industrial structures which have their roots in pre-war period has revived after the war with favourable external demand rising for the German goods. Given these advantages of the German economy, the policy of the government was neither *laissez-faire* nor clearly interventionist in terms of resource allocation and financing of investments. First, unlike in a planning activity, it did not use public power as a substitute of the private one and obviously, in German recovery process private initiative was on the fore. In this situation, public power was mobilized to encourage the private initiative through the use of various market policy instruments. Actually, this process, at least in Ordoliberal perspective, was not initiated to satisfy the profit motives of industrial firms with a dependent role of the government on business. It was the perception of the decision makers that the collaboration of public and private initiative is crucial for supporting the growth process. Thus, with the discriminatory tax concessions and the selective investment projects, government greatly affected the direction of economic processes. The role of Ministry of Economics in this process is undeniable. This governmental action were not derived from a long-term planning of the quantitative factors of economy but rather

it intervened according to the special conditions of recovery which came as a result of assessment of general needs of German economy and long-term 'qualitative' features of market economy. Besides the adherence to the free market philosophy, the tendency of the Ministry of Economics under the control of Ludwig Erhard in governmental intervention expressed itself in various occasions. Although it did not approach to planning methods, the 'hidden' hand of economic administration was felt through its indirect *ad hoc* interventions by the discriminatory tax concessions, subsidies and loans to particular sectors and support for the selected investment projects which were achieved with the collaboration of business. These actions did not imply a total decontrol of the market process prescribed in free market doctrine but the maintainance of particular market considerations of the administration.

The recession of 1958 became the turning point for a macro-economic policy change. Policy makers realised that extraordinary economic expansion will not last forever and fluctuating cyclical conditions will require a more active stabilization policy. As we have seen before, first concessions were given from the fiscal orthodoxy of 1950's. Most importantly, economic authorities began to emphasize on a more effective business cycle policy which would correct the unfavorable fluctuations. Previously, price stability became the most important concern of economic policy, however, in time, other objectives like employment and economic growth came more frequently to the economic policy agenda. Also from the beginning of 1960's, the effects of Keynesianism were observed among the politicians and academicians which contributed to the debate of a more active demand management and approach to some 'planning' instruments. On the other hand, with the rise of the left wing of the politics in 1960's and increased economic prosperity through the economic recovery led to the 'social' demands for a more equal distribution of the rising national wealth and this dominant 'social' consciousness necessarily called for greater state involvement in the market and a 'rational' economic policy which would pursue a set of economic objectives with a multitude of instruments and broader cooperation and coordination of economic actors. In 1960's, legal regulations for a more broadly defined economic policy was made and by that legal background, the range of instruments provided for the government was enlarged in favour of a more flexible economic policy making.

In 1961, a law was passed which gave the government ‘the right to decree an increase in tax allowances for new investment, without to recourse to parliament, on the basis of its own judgement of business cycle trends (Shonfield, 1965:287). Inter-ministerial work tried to enhance a counter-cyclical policy concept. The result was published in 1964 in a report which envisaged a ‘radical reform of the financial machinery of the government’ and intended to increase the capability of the government to intervene in the case of business cycle fluctuations. For the first time, English phrase of ‘deficit spending’ was used as a financing option for a government intervention. As a response to the lack of central power due to the wide dispersion of power among economic actors, the report proposed that all the resources within the sphere of local, regional and federal powers could be mobilized for particular investment projects ‘within the framework of a coordinated national programme’ (Shonfield, 1965:288).

From the beginning of 1960’s, some instruments of planning were gradually institutionalized through a legal framework, although it was not a determined act for planning like in France. In 1963, the ‘Council of Economic Experts’ was constituted by the decision of West German Parliament. According to the law, Council consisted of five independent members who are not subject to the orders of the government. The main task of the Council was to ‘periodically evaluate the macro-economic developments with respect to the four objectives’ i.e. ‘price level stability, a high level of employment, external balance and steady and adequate growth’ (Giersch et.al, 1992:139). The law prescribed that Council of Experts should restrict themselves to evaluate the trends of economic development and provide the viable policy options for the public agencies, however, it was not allowed to make policy recommendations and ,thus, take a policy stance. Although it is difficult to guarantee a non-political position of the Council, this institution in time with its annual reports became an influential organ affecting the policies of government and Central Bank (Giersch et.al, 1992:140).

Government’s tendency for planning was expressed in the ‘Report on Economic Trends in 1962 and Prospects for 1963’. Report argued that ‘on the demand side, the expansive factors which were strongest in past years, namely, capital investment and exports, are tending to lose weight’ while ‘the relative weight of

demand for private and government consumption is increasing' (Shonfield, 1965:291). Report implied that increasing dynamism in domestic market with 'the rise of wages and cut in working hours' gave to the government a more extensive role in terms of public investments and social services. On the other hand, there were other reasons behind the expectations from the state for a more active stabilization policy. First, the influx of foreign workers due to the labor shortage at the beginning of 1960's led to a 'over-dependency of the economy on the non-German immigrants and this condition required the governmental control of this trend. Second, the protection of the domestic capital market in 1950's was challenged by the increasing mobility of capital in international markets in 1960's. This automatically attracted the inflow of capital and mitigated the effects of monetary policies on domestic markets. This factors put out the need for a more complicated economic policy which did not merely rely on the instruments of 'conventional' monetary policy (Shonfield, 1965:291).

After a consolidation process between 1960 and 1963, a new economic expansion began in 1963. However, price inflation was in an upward trend compared to the previous phases of German economy. Council of Economic Experts concentrated on solve 'the conflict between domestic price-level stability and powerful inflationary pressures from abroad in a world of fixed exchange rates' (Giersch et.al, 1992:142). The Council saw the transition to the flexible exchange rates as the only way to curb the 'imported' inflation. However, this view was clearly rejected by other public authorities as it could lead to the revaluation of DM and a partial dissociation from the international economic system.

In the first half of the 1960's, an expansionary fiscal policy was observable. For Giersch, 'since 1961, public spending increased significantly faster than public revenues', so that this situation resulted in a budget deficit of 0.1 percent of GDP in 1964 (Giersch et.al, 1992:143). While previously budget surpluses limited the domestic inflation, newly emerging budget deficits posed a threat to the price stability since 1963-64 (Owen Smith, 1994:119).

In this situation, Central Bank did not immediately apply contractionary policies as this will further exacerbate the problem of rising external surpluses. However, since domestic expansion grew enough to offset external revenues, balance of payments turned into a slight deficit in 1965. At this point, restrictive policies

began to be implemented by Bundesbank in the form of raising the discount rate from 3 to 4 percent in two steps (Giersch et.al, 1992:143).

At this stage, Council of Experts published its second annual report called as 'Stability Without Stagnation'. It envisioned that the public actors should use a more 'smooth' restrictive policy to prevent the inflationary pressures so as not lead to a 'profit squeeze' and a sharp decline in economic growth rate. The Council recommended a 'gradualist strategy' to maintain price stability by a 'Concerted Action' between the major economic actors. Although initially they welcomed such an idea, both the Bundesbank and the government took a 'sharp' restrictive stance at the end. By issuing the 'Law for Securing Budget Balance' in 1965, government initiated the consolidation of the budget and indicated that a balanced budget is also crucial for price stability. On the other side, Bundesbank implemented a contractionary monetary policy by raising the discount rate from 4 percent to 5 percent. As a result of the combination of these measures, a decline in domestic demand largely due to the profit squeeze was observed and economy entered in its worst recession in 1966-67 in its post-war history. Real GDP shrank by 0.1 per cent in that year (Giersch et.al, 1992:144-45).

3.4.6 Stability and Growth Act of 1967

The recession of 1966 badly affected the credibility of the CDU in the government and of Ludwig Erhard as Chancellor. In 1966, government was not able to achieve its objective of balanced budget and CDU dominated coalition was replaced by the 'Grand Coalition' of CDU and SPD. Karl Schiller from SPD became the Minister of Economics. With his personal and intellectual influence in the direction of economic policy-making, the rising demands for using Keynesian macro-economic instruments in 1960's was followed by the relevant steps for a more coordinated and active macro-economic demand management at the face of recession.

Schiller theoretically embraced the importance of 'Ordnungspolitik' formulated by Eucken. He accepted that the market conforming measures to make qualitative changes in institutional framework is the most important part of 'Ordnungspolitik' and the concept excluded 'Prozesspolitik' by prohibiting all

‘quantitative’ measures in both macro- and micro-economic relations. However, he made the distinction between special (punctual) and general (global) measures (Schiller, 1964:68). He argued that the special measures involves micro-relations and , thus, had a more possibility to weaken competition in markets than the global measures. According to him, micro-relations should be left to the competitive forces of the market but competition is not enough to achieve a ‘desirable’ market order. For Schiller, the self-steering of the markets through competition should be complemented by a ‘Globalsteuerung’, which deals with the steering of the macro-economic complex which was not accepted merely as the result of the micro-relations of market as envisaged in traditional ‘Ordnungspolitik’. Thus, the motto of Schiller’s economic policy was as follows: ‘Competition as far as possible, planning as far as necessary’. In this way, Karl Schiller attempted to combine the ‘Freiburger Imperative’ of Ordo-School with Keynesian elements of macro-economic management by introducing ‘Globalsteuerung’ as a new economic policy instrument (Schiller, 1964:69).

In June of 1967, the ‘Law For the Promotion of Economic Stability and Growth’ was passed by Parliament. The Act provided the ‘legal framework’ for the various use of counter-cyclical instruments. Germany was the only country which legalised its counter-cyclical arrangements at that time. The Act ascertained four basic macro objectives which should be pursued in economic policy-making. According to it, macro-economic measures should be so designed to achieve ‘price stability, full employment, external equilibrium and ‘stable and adequate growth’ at the national level. Hence, the precedence of price stability and external equilibrium in economic policy has given way for the increasing importance of new objectives like full employment and economic growth. At the end of 1950’s, German economy had reached full employment and ,though it was still high, economic growth rates came to normal levels in 1960’s compared to the previous period. Economic authorities concentrated more on the questions of keeping the high economic growth rates with full employment in the case of large business cycle fluctuations. The economic recession of 1966-67 emphasized the necessity of intervening in markets with a variety of economic instruments and a more active pursuit of new objectives in addition to the price stability. Although the level of economic growth and ‘high’ employment are difficult to ascertain as a macro-economic objective (Michler and

Thieme, 1998:253), The Act did not prescribe a kind of planning to achieve some quantifiable objectives annually but required a coordinated action between the basic economic actors which in their own economic policies would not act without information of the plans of other agencies and without respecting the general macro-economic goals expressed in Stability and Growth Act. For this aim, ‘Concerted Action’ previously advocated by the Council of Experts was institutionalized by Schiller, mainly due to the fact that counter-cyclical movement necessitated a centralised coordination between economic actors especially considered wide vertical and horizontal dispersion of power among economic authorities in Germany. ‘Concerted Action’ mainly contained ‘the regular meetings of representatives from the government, the Bundesbank, employer’s associations, unions and the economic profession to coordinate expectations and plans in various fields of economic policy’ (Giersch, et.al 1992:148).

The Act enlarged the scope of counter-cyclical arrangements by the government. Through the Law, a ‘kind of emergency right’ was given to the government to automatically intervene in the markets through subsequent taxation policies in the case of a recession or boom, however, its scope remained limited. On the other side, the legal regulations introduced by the Act extended the scope of fiscal policies and improved the coordination of three levels of government in budgetary arrangements, and ,thus, ‘creating a greater degree of coherence in the formulation of the Federal Budget’ (Owen Smith, 1994:119). Stability and Growth Act made an amendment in Article 109 of Basic Law (Constitution) with which the Federal and Lander governments were authorised to have an anti-cyclical reserve fund at the Bundesbank. By the ‘Budgetary Principles Act’ in 1969, this article was further amended to legalise the cooperation of two levels of government in ‘fiscal policy implementation and planning’. The amendment of Article 115 in both Stability and Growth Pact and Budgetary Principles Act provided the legal framework for the ‘deficit spending’ according to which ‘borrowing to finance a deficit in any one year must not exceed investment expenditure provided for in the budget unless it is necessary to avert a macro-economic imbalance’. Additionally, Stability Pact set up a ‘Business Cycle Council’ while ‘Budgetary Principles Act’ of 1969 led to the constitution of a ‘Finance Planning Council’ which consisted of ‘the Federal and

Lander finance ministers, the Federal Economics Minister, representatives of local authorities and Bundesbank'. Especially, 'Financial Planning Council' provided an important platform for the long-term concerns of federal finance while 'Business Cycle Council' dealt with the 'short-term economic impacts of economic policy' (Owen Smith, 1994:120).

3.5 Establishment of the Competition Order In Post-War Germany

In Social Market Economy, an extensive role was given to the state to set up an active competition policy and protect the competition order from its major threats. Competition policy in Social Market Economy was based on the idea that an efficient competition order could not emerge by inherent mechanisms of the markets. There is always the tendency to restrict the competition in the market to take advantage with regard to other competitors. Thus, it is the first task of the competition policy in Social Market Economy to prevent any restrictive practices to competition.

Apart from that preventive task, competition policy should also actively involve in creating the rules that guarantee a competition based on performance (Leistungswettbewerb) and sets out the possibility of using other methods which does not fit to the competition based on performance such as 'dumping'. To secure the 'Leistungswettbewerb' in the market is also crucial for bringing more positive market results for the society as this mechanism give the necessary incentives to market participants to improve their performance as the only way of withstanding competitive pressures.

As we have previously emphasized, Germany became the 'land of cartels' until the end of Second-World War and cartels were generally used as the symbol of national economic and political power. For that reason, Allied powers made an attempt to de-cartelize the country, first, the reason was the belief that persistence of the cartels in the country could prepare the basis for a national aggression in the future and ,second, the restriction to competition in the form of cartels and monopolies were not compatible with the competition order intended to be set up. It is interesting that the Allied Powers' intention for de-cartelization was overlapped with the Ordo-liberal idea of competition. However, apart from the strategic necessity to abolish the cartels,

the Allied Powers did not put a strong will to establish a competition order from the beginning. As Soviet Union began to be perceived as a threat in the framework of East-West conflict, Western Allied Powers saw their interest in building a strong and stable German economy to counteract the Soviet influence in Europe.

In 1947, U.S.A , in his zone, introduced De-cartelization Act (Dekartellierungsgesetz) which aimed at preventing vertical and horizontal restrictions of competition as much as possible (Gröner and Knorr, 1998:206). It was the first act for a comprehensive cartel prohibition in Germany. This act was crucial since , while Social Market Economy as a new economic system was introduced in 1948, this act ruled out the revival of cartelization in the country. The de-cartelization act functioned until Restrictive Practices Act in 1958 was resolved.

The preparations for a new cartel act began in 1949. In 1952, Josten proposal put out the basic idea upon which a competition policy should be built: ‘the idea of markets and the free competition’ (Gröner and Knorr, 1998:207). This proposal emphasized the principle of freedom of competition as the basis of the competition order. On the other hand, it indicated that there are some crucial sectors and cartels which should be exempted from free competition. For Gröner and Knorr, the sectors subject to this exemptions constituted approximately one third of the whole economy and this part stayed outside the influence of new Restrictive Practices Act. Another government proposal in 1955 put the emphasis on the need for a ‘control of fusions’ but this proposal was not realised in Restrictive Practices Act in 1958 (Gröner and Knorr, 1998:208).

The idea expressed in the proposals were rejected by the industrial interest associations. They stated that ‘unregulated’ competition practices could lead to economic and social negative consequences. On the other hand, they argued that while the proposal foresaw the prevention of the concentration processes of the big business, small and medium sized enterprises were allowed to conduct cooperative behaviours against market position of big business. For industrialists, business should be free and responsible to influence the rules of the market order while state’s task should be to prevent the ‘abuse of market power’ (Gröner and Knorr, 1998:208). Thus, they proposed that the prohibition principle in the proposal should be replaced

by the principle of ‘abuse of market power’ and control of the abuse of power should not be so strict as envisioned in the proposal.

3.5.1 German Law Against Restraint of Competition of 1958 (Gesetz Gegen Wettbewerbsbeschränkungen)

As a result of the long debates on the content and extent of the new Act, ‘Law Against Restraint of Competition’ was accepted in 1958. The ‘cartel act’ in the law was conceived as the basis of the economic order of Germany as it served as the main instrument for the preservation of competition in the market (Thieme, 1991:65). In spite of the industrialists’ pressure, the act accepted the ‘prohibition principle’ and made an attempt to enhance the freedom of competition. However, the act put out the exemption of a large variety of sectors from the free competition and ‘prohibition principle’. For Gröner and Knorr, the act provided the opportunities to build up cartels in the market and insurance sector was singled out as the new sector benefiting from exemption (Gröner and Knorr, 1998:209). ‘Control of Fusions’ were excluded from the scope of the act.

Until now, Law Against Restraint of Competition was renewed five times. Especially the amendments made in 1973 were important. According to it, the control of fusions were brought into the framework of the law. Control of the ‘abuse of power’ was intensified; ‘price fixing of the second hand’ was left out and new cooperation facilities for the small and middle size enterprises were introduced (Thieme, 1991:65).

The first article of the Law put out the ‘general prohibition of cartels’ (Verbotprinzip). Cartels represented the attempt of various enterprises to prevent the competition in the market through collective action on the market behaviour which would normally be competitive and, thus, it restricted the competitive behaviour of the other market participant. Although freedom to make contract was accepted as a principle of market order, this freedom should not be abused in the way of violating the basic principle of the order i.e. freedom of competition.

However, ‘prohibition principle’ was not applied fully. The act provided various exemption clauses which ascertained the sectors and kinds of cartels that

should not be subject to the 'prohibition principle' and be partly or fully closed to the freedom of competition. Articles from 98 to 103 identified the sectors which should be protected from free competition such as agriculture, transport and banking sector. Apart from that, the act gave a wide list of cartel forms which were exempted from the 'prohibition principle'. Among them were 'calculation cartels, export cartels, rebate cartels, specialization cartels, rationalization cartels and import cartels' (Thieme, 1991:67).

Article 15 of the Act also brought a ban on the vertical competition restraints i.e. 'a ban on the fixing of sales prices by suppliers and particularly on the fixing of the retail prices by the manufacturers of a product' (Lampert, 1993:103). Article 23 dealt with the issue of emergence of market power as a result of market mechanism and the exploitation of market power. This market dominating position could appear due to a merger activity or an internal development of a firm *via* market processes. Until 1973, for mergers, there were no regulation apart from the necessary registration. In 1973, Article 24 introduced the 'prohibition of mergers' which included the mergers that constituted a superior position in market or intensified its prior position. To apply the principle of prohibition of merger, the relevant merger should apparently restrict competition in the market. Article 24 put out the criteria according to which the exemptions from the prohibition principle would be decided (Thieme, 1991:70).

Article 22 contained the control of the 'abuse of market power' and the Federal Cartel Agency was assigned to that task. However, the effectiveness of this procedure was questionable. The said article put out the circumstances in which the merger destroys the competition in the market and when the act of Cartel Agency is required. The ambiguous definition of this 'abuse of market power' limited the controlling actions of Cartel Agency and from 1970's there is an observable increase in the number of mergers (Thieme, 1991:72).

With the act of 1973, Article 25 foresaw a ban on 'policy agreements' which does not necessarily require cartel contract. The main aim was to prevent the collective price strategies without cartel contracts. Apart from these, Article 24a envisaged the establishment of an independent 'Monopolies Commission' whose task was to monitor the concentration processes in the market and make recommendations for the necessary modifications in the Cartel Act (Thieme, 1991:73).

3.5.2 Ordoliberal Critique Of ‘Law On The Restraint of Competition of 1958’

Although it is true that this act provided the basis for a competition order by embracing the idea of free competition and a general ban on cartels, a large part of the regulations in the Act contradicted with the principle of competition. Ordoliberal demand for a competition order was not satisfied with the general framework brought by the act and there appeared a wide discrepancy between the theoretical underpinnings of Ordoliberalism and the realization of competition policy in Germany. While economic order theory (Ordnungstheorie) prescribed a competition order whose parts functioned according to the principle of competition and competition policies based on this idea, with the introduction of the Act some parts of the economic order were excluded from the effects of competition. As regards this discrepancy between theory and practice, Thieme set out some reasons which one related to the extent of the willingness of the people to endorse competition as the main principle of the markets.

First, from the beginning of 1960's, a competition theory having an empirical content replaced the price theoretical model. Second, the increase in market concentration took an incremental character and its harmful effects to the competition order and to the performance of economy were not felt suddenly. For this reason, the problems relating to the competition were not immediately put into the agenda of politicians. On the other hand, long periods of time needed for the modification of the act and the political influence which reduced the effect of necessary amendments prevented the improvement of the framework regulation to create a ‘functional competition order’. Most importantly, there did not appear an exact political consciousness and responsibility to conceive competition as the most decisive factor in economic policies. Rather, competition was commonly seen as an instrument to strengthen the economic performance of the country and a secondary importance was given to the freedom of competition (Thieme, 1991:74).

Exemptions from the principle of competition in the Articles from 99 to 103 was criticised from an Ordoliberal point of view as the related sectors constituted a large

part of the economy. For Gröner and Knorr, there are widespread political interests in these sectors to influence and steer the market results. For this reason, the specific restraints on competition were not only allowed but also furthered by the state. The restraints on competition was legitimised by the argument that these market organization forms in the relevant sectors will provide the best means to achieve the market results for the whole of the economy. By that assumption, competition as an ‘intermediate goal’ was instrumentalised as far as it facilitated the realization of some above-standing political goals, if it did not guarantee the desired results, restraints on competition were accepted to make the market results more predictable and managable (Gröner and Knorr, 1998:214). For Gröner and Knorr (1998:216), there is a continuing trend to extend the sphere of market regulations by the state in federal and as well as in regional and local level. In some sectors such as tele-communication, energy and house insurance there is the dominance of communal interests in creating the market structures closed to competition. In the federal sphere, the social insurance system is the most outstanding example.

For Gröner and Knorr, the exemptions in the act implied that the economic policy in Germany inclined in the market interventions as traditionally and both in politics and public the effect of competitive market process was ignored. This attitude was largely caused by a lack of complete trust in the competition as the ‘most efficient coordination and organization principle’ in the market and the reliance on the state as the most important stabilizer of the market. In addition, rent-seeking opportunities provided in the market regulations are also effective in this general support for market interventions. For that reason, according to the Ordoliberal point of view, there is a tendency in the society towards overvaluing the grounds of market regulations and undervaluing the costs of those regulations (Gröner and Knorr, 1998:p.217)

Thieme underlined the need to set forth more sound criteria in conducting the control of mergers and abuse of power and strenghten the capability of Cartel Agency to operationalize that criteria (Thieme, 1991:74-75). On the other hand, control of the abuse of power did not deal with the sources of the abuses. Monopoll Commission in 1980 worked on giving a detailed criteria to prevent the abuses from the beginning , however, this view was rejected by the public .

In the Act of 1973, the differentiation between competition based on performance (Leistungswettbewerb) and its opposite (Nichtleistungswettbewerb) was integrated into the cartel law (Gröner and Knorr, 1998:212). The goal was to supplement the competition rules and tasks with the qualitative definition of competition which was based on performance. Such a formulation of competition as a desirable form gained ground also with the structural policy concerns. However, the criteria for a 'competition based on performance' could not be easily found and for this lack of clear definition, the term was generally used to impose certain kinds of market structures to achieve certain market results. As a result, the protection of competition concentrated on the market results rather than on the qualitative behaviour of the market participants (Gröner and Knorr, 1998:213).

CHAPTER 4

IV. SOCIAL EQUILIBRATION OF MARKET ECONOMY

This chapter will mainly deal with the ‘social’ side of the Social Market Economy. First, the theoretical conception of the social policy in Social Market Economy will be explained. For Ordoliberalism, social policy by the state should be kept at minimum and it should have a subsidiary character. It emphasized that ‘order policy’ with the aim of improving the market economy framework fulfilled a social function. Apart from that, a complementary social policy could be introduced in a limited sense. However, Social Market Economy, especially with Armack’s arguments, gave a more extensive role to the social policy than Ordoliberalism. Although he made an emphasis on the ‘market conformity’ rule in social policy and warned against the incentive killing effects of extensive welfare policies, Armack added that a wide social security system is indispensable for a ‘socially balanced market economy’. Thus, theory of Social Market Economy created a space for social regulation especially if the traditional tendencies of German society in social integration was considered.

In the second part, the development of German welfare state from the late 19th century to post-war time will be presented with important policy turning points. Then, the organizational principles and the institutions of post-war German welfare state will be reviewed. In this context, the share of social expenditure in GNP and the trend in the social benefit payments will show quantitatively the merit of social security in Germany.

On the other hand, in post-war period, labor was gradually integrated to the industrial system through a legal framework which secured the position of labor in industrial relations. This feature was supported by the state to replace the potential

conflicts between major classes by cooperative relations among them facilitated but not regulated by the state. In Germany, trade unions and employer associations have traditionally assumed a great power in collective bargaining which led to a rigid wage determination. Also co-determination rights and vocational training are other institutions which guarantee the labor participation and development of skills in industry.

Social security system and regulated labour markets are the most distinctive qualities of German capitalism. In the last part, the question will be on whether the so-called institutional rigidities in German market have a negative or positive effect on the market economy relations. Although it did not reject the need for social institutions, Ordoliberal point of view suggested that social regulation in Germany has over-expanded to the extent that it reduced the market economy incentives in economy and 'self-help' motives in individuals. For them, the reform of the system is inevitable. On the other hand, there is also a neo-liberal argument which proposes flexibility in labor markets and declining role of social security arrangements as the only way of enhancing competitiveness and stimulating economic growth. However, when considered the special importance given to social security within German society and the legally protected nature of social rights, some authors argued that social protection is supportive for the distinct operation of German capitalism which concentrated on non-price competition with high quality products and highly skilled labour.

4.1 Social Policy In Social Market Economy

Ordoliberalism also differed from classic liberalism by its stress on the necessity of social policy for the efficiency of the market economy. First, they find out that to design and shape an appropriate economic system in a way can serve as a social policy itself. They believed that to enhance the 'effectiveness of competition' will lead to an 'increase and a more equitable distribution of income and wealth' and this situation will necessarily bring socially positive results. Eucken argued that social policy measures should carry 'a subsidiary character' to the market economy and should be activated when application to the market mechanism is not able to function

and when market needed an outside help to provide better socio-economic results (Lenel, 1989:28). In addition, he emphasized that not the efficiency of market economy but also the elements respecting 'human dignity' in the competitive system could contribute to the social policy aims. For him, 'equality of opportunity' and the 'security of working conditions' was counted as a part of an efficient economic system (Lenel, 1989:28). However, a kind of 'equality of income and property distribution' was refused because of its incompatibility with market system. Eucken only foresaw a 'limited redistribution' of income through progressive income tax only if there is apparently great inequalities of income in the system (Lenel, 1989:28).

On the other hand, proponents of Social Market Economy gave a special attention to the social question as 'social' as an adjective for the market economy is an integral part of the system. As Schlecht put it out, 'social equality is not an appendage to the system but it is an essential component of Social Market Economy' (Schlecht, 1998:282). For Armack, Social Market Economy is 'the attempt of a synthesis of a free, entrepreneurial organization and social exigencies of modern life' (Zweig, 1980:35). There was a widely agreed belief that there is a tradeoff between the 'social goal of equity in distribution' and 'the economic goal of efficient resource use' (Weisman, 1989:167). Social Market Economy tried to overcome this problem by attempting to pursue social objectives compatible with the market demands and defining the condition of social order as a crucial factor for functioning of the market. On the other hand, for the theory of Social Market Economy it is also true that appropriateness and effectiveness of the social policy in fulfilling its social and market objectives depended on the preassumption that the two sides of the duties are complementary each other and implied that 'without social protection there is no market order, and without market order no social protection' (Zweig, 1980:35)

First, we should say that Social Market Economy did not view the social policy from an economic point of view but from a totality of the social order which contained various aspects and dimensions in an interdependent manner. Additionally, there is the strategic idea that social and spiritual objectives should also be pursued with a combination of economic ones. Weisman, on this issue, argued that Social Market Economy is an ideological concept' seeking to lead to a cooperation between various groups of the society, including state, market and social groups (Weisman,

1989:164). Thus, Social Market Economy as an 'irenical' formula should activate social means to achieve the 'state of equilibrium' in society rather than merely concerning itself with regulation of market processes. Koslowski claimed that Social Market Economy used the concept of 'equilibration' (Ausgleich) to eliminate the undesirable results of the market (Koslowski, 1998:81). According to him, "the Social Market Economy equilibrates on the basis of competitive economy between the free initiative of the individuals and social progress" and these means of equilibration was deployed in various policy initiatives in Social Market Economy (Koslowski, 1998:82). Though the market system as a coordination mechanism is perceived as the decisive factor in economic order, Social Market Economy pointed out the possibility of market insufficiencies or failures. In this situation, there appears the need of equilibration in various parts of social policy.

According to Armack, competition order as a 'mechanical process' should be complemented by a social policy which is directed to find a 'workable common denominator' in seeking social objective (Armack, 1998:263). For him, the basic task of social policy is to create 'an integration formula' which covers all segments of the society and to make necessary 'constructive interventions' in favour of the 'common good' of the society (Armack, 1998:264). It implies an increase in the social task of government which, according to Social Market Economy, should take care of the long-term interests of the society.. For Armack, economic stability does not lie only in the 'stability of individual factors, prices and wages but in a 'dynamic stability' which necessitated an answer to the 'complex demands' of the society rather than only concentrating on the economic ones (Armack, 1998:271).

In a paper of 1948, Armack give a wide of list of policies which should be realised as a part of social policy (Koslowski, 1998:85). While there are some policies which have an indirect social impact such as anti-trust policy and stabilization policy, there are also some policies which are socially defined within the scope of governmental action. For instance, a redistribution policy should be pursued which aims at 'the equilibration of income differentials' through taxation and direct transfers (Koslowski, 1998:85). Armack clearly stated that 'a national redistribution of incomes could be made by 'taxing those whose increase in income is considered too large and favouring those whose wealth accumulation is desired to be promoted' (Armack,

1998:268). The basic criteria for government intervention in social policy is ‘to be in conformity with the market mechanism and not to destroy the efficiency of the market’. Moreover, ‘zoning policy and subsidies for inexpensive homes’ and ‘transfer of capital to small and medium sized firms’ are among social policies. Especially the wealth formation appeared as a new social policy which should be promoted as far as it is ‘in conformity with the market’ and not be provided ‘by uncontrolled and unregulated tax privileges’ (Armack, 1998:267).

Armack clearly argued that ‘ a market-oriented social policy differs from discretionary intervention not by its goals but by its instruments’ (Zweig, 1980:27). Although Social Market Economy covered a wide extent of social policy, the criteria for market-conforming interventions should be respected. Also for him, social policy should not transform into a welfare state dealing with a wide range of services which discourage self-help and responsibility. Armack was against the use of governmental social policy for political interest and vote concerns and proposed the limitation of governmental social policy by legal rules. Hence, theory of Social Market Economy envisaged a comprehensive social security system without limited redistributive measures.

4.2 Historical Development of Social Policies In Germany

First attempts for social policy in Germany goes back to the Bismarckian authority in the second half of 19th century. In order to counter-act the rising power of working class, Bismarck introduced the ‘Sozialistengesetz’ in 1878 and the ‘Kaiserliche Botschaft’ (Imperial Announcement) in 1881, which announced that social legislation will be initiated. This act primarily targeted to lessen the role of trade unions and the influence of SPD on the working class. As a response to the ‘social question’ by the state, though it was mainly derived from strategical concerns of state, in 1883 the ‘Workers Health Insurance’, in 1884 ‘Accident Insurance Act’ and in 1889 the ‘Disablement and Pension Insurance Act’ were launched (Rösner, 1995:138). The finance of the social insurance was not provided by the state but the contributions of the workers and payments and benefits depended on the income of workers. Through this system, the role of state in the organization of the social

insurance remained limited while the 'self-help' and 'self-administration' became the dominant organizational mode. The administration of social insurance was coordinated by the representatives of employers and employees. This structure proved that the development of social insurance in Germany had a close relationship with the interest intermediation between the industrial actors. While Bismarck thought that social legislation will undermine the power of trade unions, decentralized system of social insurance provided the opportunity to unions and SPD to penetrate in the controlling positions in that system. In this way, 'political rights of workers' was incorporated to the 'new social rights in the social insurance schemes' and the emerging German welfare system had a 'quasi-public character' where there is no complete control of the state and increasing influence of unions at sub-national level (Manow, 1997:9-13).

In Bismarck period the 'Reich Interior Office, after 1918, the 'Reich Labor Ministry' and after 1949, the 'Federal Ministry of Labor and Social Affairs' became the competent authority in both the social policy and industrial relations (Manow, 1997:17). In Weimar Period, an unemployment insurance scheme was introduced in 1927. With this act, 'the National Employment Placement and Unemployment Insurance Office' was established. However, as a result of the effects of Great Depression, it became difficult to finance the extensive social security system and from 1930, the expenditure on social insurance schemes including the unemployment considerably declined (Owen-Smith, 1994:196-97).

In the post-war period, although 'Social Market Economy' was introduced as a distinct form of economic order from other market economies, in the recovery period to establish the market economy on a sound basis became the first concern of the policy makers. The 'social' side of the market economy did not gain a special treatment. For Erhard's market philosophy, to stimulate the total growth was the best social policy in that time according to which increasing national wealth will eventually positively affect personal incomes. For that reason, in 1950's large masses were mobilized in order to achieve the high economic growth rates and excessive social demands for redistribution was postponed to the successive phases of German economic development. Erhard's 'People's Capitalism' entailed some solidaristic characteristics within the framework of a market economy. According to the concept,

the class-based solutions to the economic problems were largely ignored and the members of society were assumed to be prone to cooperative relations for some common objectives. The inherent contradictory relations of a market economy were balanced by the social consensus on some economic and social aims. From the 'social' side, the system did not require a redistribution of income in favour of equalization of incomes but it favoured the increasing participation of the masses in owning the productive capital and the wide dispersion of the wealth as the system depended on the idea that members of society were aware of the fact that their benefits will increase as far as the general prosperity increases and this provides the necessary incentives to the people to contribute to the economic growth by their productive forces. Given the 'implicit' consent of society to market economy relations, Erhard's vision could only function when there is no diverse conflicting interests among society and if a wide capital formation policy including large segments of the society was introduced to prevent concentration of wealth and large income differentials. However, capital formation policies remained limited in 1950's (Leaman 1988:122). Social policies mainly concentrated on integration of expelled people and refugees, housing construction and equalization of war burdens.

In post-war era, however, Germany began to reconstruct the Bismarckian social security system with some modifications. Due to the war time destruction of social insurance system's financial assets, in 1957 the pension reform was introduced which brought about a transition in financing from a 'funded scheme' to a 'pay-as-you-go model' (Manow, 1997:26). Accordingly, the contributions were not turned into long-term capital assets of the social insurance system but immediately made available as transfer payments to the contributors. The previous system depending on the accumulation of the contributions of the insured was replaced by an 'inter-generational contract' according to which the contributions of the currently employed were used to finance the benefits of the newly retired persons. The system relied on the idea that coming generations will behave in the same way in financing the future retirements.

The distinctive quality of post-war social insurance was its broader application. By 1965, 'all workers and persons earning salaries up to 1800 marks per month' and some parts of self-employed were integrated to the old age pension scheme. New

insurance system had some difference in its application compared to the previous one. First, pension payments did not only take individual's total contributions as the only criteria for the benefits. According to the old formula, the retired person while gaining a high income in last years before retirement could gain a low income in his retirement due to his low total contribution. To prevent the sharp income cuts in the retirement, new system took into account the level of the income of the person in his work time. Secondly, a yearly adjustment of benefits was made according to the increases in general productivity and income, so that efficiency in production system was directly reflected on the level of benefits in social insurance system (Stolper, 1967:286).

4.3 Structure of Social Security and The Scope of Social Expenditure

Social policy in Germany could be divided into three parts: social insurance, the provision of social security (Versorgung) and social welfare (Fürsorge) (Owen Smith, 1994:198). Social insurance system constituted the core of the social security system of Germany. The insurance benefits did not involve in providing the minimum needs of the society but a 'consistent standard of living' was guaranteed against the risks of the life. Through gradual reforms in health, retirement pensions, accident and unemployment insurance, a comprehensive social insurance system was established in Germany. The system operated on the basis of contributions of the individuals so that their future benefits was proportionate to their contributions to the system in their working time. In social insurance system, the redistribution of wealth was limited, however, the equivalence of premiums and benefits was modified in time by some relatively redistributory measures funded by state. The most important characteristics of the social insurance was 'its para-fiscal nature of financing and self-administration' (Neumann and Schaper, 1995:159). Finance of social insurance institutions was supplied by the contribution payments and its budgets are independent from the governmental budgets and tax revenues. This 'para-fiscal nature' of the system brought a stability which is largely immune to the political and economic fluctuation but, on the other hand, it reduced the opportunities for redistribution. However, in case of large deficits, social insurance system is open to government subsidies. 'Self

administration' in the system required the participation of the members directly influenced by the insurance to the administrative mechanisms so that possible governmental discretionary decisions were prevented.

There are three types of retirement pension insurance: 'non-contributory scheme' mainly introduced for public servants, the 'compulsory contributory schemes applicable to employees in both the private and public sector' and the 'voluntary insurance' (Owen Smith, 1994:207). Retirement-pension insurance was the most costly arrangement in social insurance and as the economic prosperity increase, the retirement pensions became more generous in time. After the pension reform of 1957, the system was revised in 1972 and 1992. Statutory pension-insurance system initially included pension-insurance funds for blue-collar workers, the white collar worker's pension funds and a pension fund for miners. By the 1972 reform, the large segments of the self-employed were also integrated into the system so that retirement-pension insurance system gained a national character (Neumann and Schaper, 1995:165).

In statutory health insurance, benefits were provided not only to give a financial support to the sick but also extended them the same medical treatment 'irrespective of income, family size and age' (Owen Smith, 1994:216). The system did not entirely depend on the equivalence of the benefits and contributions. Rather, it had also some redistributive elements from higher income earners to lower ones. Statutory health insurance benefits were extended in the form of pharmaceuticals and medical services rather than by direct financial support for the needy. Thus, a standard level of medical treatment was provided for all. Decisions for the extent of the health benefits were determined both by the patient and the provider of the medical services.

In unemployment insurance, Federal Labor Office (Bundesanstalt für Arbeit) is the most important authority. According to the 'Employment Promotion Act', an active labor market intervention was initiated to help the unemployed in his or her job search and to direct him or her to the training facilities. The rise of unemployment in 1970's led to a increase in the expenditure of Labor Office on the unemployment benefits. Besides the measures introduced by Labor Office, federal government also subsidised the employment creation and training programmes through the federal funds as prescribed by the 'Act to Promote Education and Training'. Unemployment insurance was mainly financed by the contributions of employers and employeeed.

Additionally, there was also 'unemployment assistance' which was directly funded by the Federal Budget. The general aim of the measures of Labour Office was 'to maintain the previous living standard of the unemployed and have time to train and search for new jobs through the provision of unemployment insurance'. This logic necessitated a high level of financial support for the unemployed in order to prepare him to a new job in a transition process. Until 1993, unemployment benefit for an unmarried person was 63 per cent while for the persons with at least one child, it was 68 per cent' (Owen Smith, 1994:229-30).

Other than the social insurance side of the social policy, there were also provision of social security and social welfare. Social security included the 'benefits for war victims, child benefits, promotion of education and vocational training and housing benefits'. As a difference from the social insurance, social security benefits were not extended according to the income level or other social circumstances but the claimants in a particular sphere of society were responded by the governmental benefits to improve their living standards. These benefits were financed by taxation in contrast to the contributions in the social insurance system. Lastly, 'social welfare' based on directly giving financial support to the most needy people at that time. 'Social assistance and the benefits for youth and child welfare' constituted its major parts. 'Subsistence assistance' as a part of social assistance was given mainly to provide every person in Germany with a 'minimum existence of living' while there were also another kind of social assistance for particular conditions like the 'assistance for the plus-care for aged and sick and the reintegration of handicapped' (Owen Smith, 1994:238-41)

The share of 'social budget' in GNP was 22.7 per cent in 1960 and it increased to 29.4 per cent in 1990 (Owen Smith, 1994:198). Beginning from the 1960's, the rise in social expenditure was observable. The reason for that could be found in the rising social demand for more comprehensive social security and the call for social redistribution of rising wealth. While the economic recovery period in 1950's prioritised economic growth over the concerns of more equal distribution, after reconstruction, the state maintained its role as a provider of welfare though it was mainly through the support for the extended sphere of social insurance institutions rather than through a mere redistribution of wealth through direct state involvement.

Increasing role of social interest associations and trade unions is undeniable in the gradual increase in social expenditure.

If one looked at the development of social expenditure within the period of 1960-90, nearly in all levels of social security system there was a visible expenditure increase. Retirement pensions in 1989 was 639.3 per cent higher than in 1957 (Owen Smith, 1994:208). This rise was largely due to the demographic changes which increased the number of the insured persons and the wage increase which had a dynamizing effect on the pension benefits. The expenditure on health insurance was 3.2 per cent of GNP in 1960 while it rose to the 6.3 per cent in 1987, largely because of the cost increases in medical services which was extended to all people without an entirely contribution-based analysis (Owen Smith, 1994:222). Unemployment benefits is the sphere where the social expenditure considerably rose. As a proportion of social budget, unemployment benefits rose by 5.2 per cent and from 0.4 to 2.3 per cent as a proportion of GNP (Owen Smith, 1994:233). Especially the 1970's and the 80's witnessed an increase in expenditure by Federal Labor Office which was responsible for the allocation and extension of unemployment benefits. The main reason for this increase is the increased rate of unemployment in that period and the persistence of high unemployment in 1980's. Additionally, Labor Office involved in the vocational training activities which necessarily led to the increase in expenditure of Labor Office. At the end of 1980's, Labor Office run into deficit which was further financed by Federal Subsidies. On the other hand, in 1980's the unemployment assistance which was directly funded from the Federal Budget was generously extended. The number of recipients of unemployment assistance rose from 170000 in 1981 to 620000 in 1985 (Owen Smith, 1994:234). Consequently, the increasing share of 'social' expenditure in GNP put on additional burden on the state and social security institutions in financing the benefits.

4.4 Institutions of Labor Market Regulation

4.4.1 Collective Bargaining

Tight labor market regulation became an integral part to the operation of German capitalism. Actually, German labor had a historical strong position in

industrial relations and trade unions traditionally wielded a great industrial power in German political economy. As it was previously emphasized, Bismarck intended to suppress the rising organizational power of trade unions by successive social insurance schemes, however, it did not become successful in the long-run. The industrial workers who were members of unions constituted the largest proportion of the industry, which was decisive in collective bargaining power of labor and unions further penetrated in the administration of social insurance institutions (Manow, 1997:9). On the other hand, trade unions became the center of sub-cultural integration of labor as a class. Thus, within the 'organized capitalism' of unified Germany, labor unions constituted a part of 'authoritarian' industrial relations of that time.

In Weimar period, trade unions gained a legally structured position within the framework of corporatist industrial relations. It gave way for 'collective self-governance' of industrial relations by the major trade unions and employer associations mediated by the state's authority. Reich's Labor and Economics Ministry supported the 'economic self-administration based on collective contracts between the central organizations representing the interests of capital and labor and based on a rough 'balance of class powers' between them' (Manow, 1997:19). This gave equal representation of the both classes in collective bargaining with the state assuming the role as a neutral intermediary. Additionally, first co-determination rights of labor in Work Councils were introduced in Weimar years.

In post-war period, a more democratic and collaborative industrial relations between capital and labor was observable. First, the role of state in industrial relations changed considerably in this period. The state left its role as an active partner in collective bargaining and gave the employers and employees the right of 'autonomous collective bargaining' in 1949 (Tariffautonomie) (Giersch et.al, 1992:73). With this decision, labor and capital gained a considerable power of self-regulation in the industrial matters. However, the state did not totally abstain from involving in industrial processes. Generally, it took an 'enabling' role in 'through the support of institutions and policies with a generalized impact on industry as a whole' (Vitols, 1996:1). Post-war state facilitated the creation of some labor market institutions which emerged out of the consensus of industrial partners. The distinctive feature of industrial relations was their legal basis. It was the underlying idea behind the state's

attitude that through the legal framework which clearly ascertains the position of labor and capital in industrial relations and provides necessary instruments for consensus-building among them, the class conflicts could be mitigated and turned into collaborative relations within a national framework. Extended labor rights in both collective bargaining and intra-firm organization was the part of the same strategy which aims at the integration of the labor to the industrial process and containment of class-based antagonisms by legally covered labor rights.

Declining tension in industrial relations also made an impact on the role of trade unions. Their dominant role as the main representative of labor continued, however, their class-based arguments antagonistic with capital was replaced by an increasing sensitivity on the side of trade unions to the interests of the entire national economy. Unions realised that by peaceful relations with capital, it is possible to institutionalize gradually labor's sphere of influence. Indeed, during the recovery period trade unions posed moderate wage demands and concentrated on gains in the institutionalization of labor rights. By the end of 1960's and in 1970's, an aggressive wage policy was pursued, but in any way it remained within the legal framework of the industrial system. Consequently, it could be argued that in post-war era trade unions with their organization and policies served for the integration of labor to the national economic system.

In West Germany, both employer associations and trade unions were 'large, centralized and encompassing' (Katzenstein, 1989:10-11). The Federation of German Trade Unions (DGB) combined seventeen unions which totally represented 7 millions workers across industries. The most important industrial union in it is metal-workers union with its 2.5 million members (IG Metall). On the other hand, business was represented by the central organization of the Federation of German Industry (BDI) and the collective bargaining strategy of business was formulated and implemented by the Federation of German Employer's Associations (BDA).

Within this centralized organizational structure, the Collective Bargaining Law of 1953 created the legal framework which depended on the bargaining power of these comprehensive trade unions and employers associations. The effect of the centralized bargaining could be found in its power to create industrywide standard wage settlements and wage levels. According to the labor law, 'collective bargaining

agreements between a union and an employer association may be declared legally binding by the Labor Ministry on all companies in the sector when employers accounting for at least 50 per cent of the employees in an industry belong to an employer's association (Vitols, 1996:3). The result of the centralized collective bargaining was the legally prevented diversion from the centrally determined wage contracts on the part of employees and employers. Most importantly, the collective bargaining power of labor by centralized unions largely contributed to the high levels of wages in Germany which was protected by law and to the low levels of wage differentials within German industry (Vitols, 1996:3-4).

4.4.2 Co-Determination (Mitbestimmung)

Co-determination is another institution which relates to the labor participation within industrial firms. Co-determination of labor in intra-firm organization was achieved in two ways: co-determination at the plant level with the operation of Work Councils and co-determination at the enterprise level through the participation of labor representatives to the supervisory boards of the enterprise and partly to the management board.

Work Constitution Act of 1952 put out the conditions for creating the Work Councils at the workplace. According to Act, in the firms with a minimum six employees workers could establish a Work Council whose task would be to represent the interests of workers by involving in 'information, consultation and co-decision' activities with employers with regard to labor matters. For the representation of labor in supervisory boards, the Act said that 'in joint stock companies, companies with limited partners holding shares and limited liability companies with at least 500 employees one-third of the seats on the supervisory board had to be allocated to representatives of the workforce' (Streeck, 1992:138). The real extension in co-determination at the enterprise level was brought by the Co-Determination Act of 1951. It required the 'parity' representation in the supervisory board which meant an 'equal number of workforce and stockholder representatives' (Streeck, 1992:139). However, the application of the Act was limited to the coal and steel industry while in other sectors one-third formula of Work Constitution Act was applied.

From 1950's to the 70's, there was a continuous demand of trade unions for the extension of co-determination rights to the other sectors of the industry. By the Work Constitution Act of 1972, the structure of Work Councils were strengthened and its role in management especially in manpower policy and manpower planning was enhanced. Through this regulations, Work Councils became the integral decision partner of employers in matters directly relating to labor. Furthermore, regulations increased the trade union power on Work Councils (Streeck, 1992:146-47). On the other hand, Co-Determination Act of 1976 brought about 'parity representation' in the supervisory board but with the condition that 'one of the labor representative had to come from the ranks of middle management'. The Act came as a result of compromise and trade unions' demands were partly satisfied. After the Act, the Federal Association of German Employers' Association (BDA) alleged that the Co-Determination Act of 1976 was not constitutional, however, Federal Constitutional Court's decision in March 1979 approved the foundation of the co-determination within the terms of the Act (Streeck, 1992:148-9)

The most important effect of co-determination on the industrial relations is that it strengthened the status of labor within the firms. As a result of co-determination, labor became a 'less variable and more fixed' factor like capital. These features changed the strategies of firms in the way of long-term relationship with a 'committed' labor. Most importantly, co-determination served for employment protection within firm as with co-determination some organizational rigidities were introduced to the system which prevented an employment adjustment to economic fluctuations. With the Work Constitution Act of 1972, Work Council gained 'the right to be informed of the impending mass layoffs and to negotiate social plans regulating mass layoffs'. With these rights, Work Councils also assumed a greater role in the enforcement of 'Dismissal Protection Act' of 1951 (Vitols, 1996:4). The negative impact of it was that co-determination protected the insiders at the expense of the outsiders who are trying to enter the market. This structure made difficult to control unemployment by the state through labor market policies. Although co-determination have brought some institutional rigidities to the labor markets to the disadvantage of the capital, internalization of labor with the firm have provided some benefits for the enterprise. As far as labor was internalized within the firm, some managerial tasks of

the firm were fulfilled by labor and labor contributed to the manpower management within a long-term cooperative framework (Streeck, 1992:160-1) Additionally, labor began to identify itself more with the enterprise which could reduce the control of trade unions in the long-run. In that sense, for Streeck co-determination facilitated “a mutual incorporation of capital and labor by which labor internalizes the interests of capital just as capital internalizes those of labor with the result that works council and management become subsystems of an integrated, internally differentiated system of industrial government” (Streeck, 1992:164) It is also a part of the industrial strategy which proposes that integration of labor to the industrial system reduces the possibility of class-based conflicts.

4.5 The Relation of Social Policy With The Economic Order

In general, social benefits were gradually extended from the beginning of 60's and social system was enlarged. Social policies in Germany had also important implications for the economic order. Market efficiency is not the absolute norm when extending social rights. Although social insurance system depended on the contributions, the sphere of social benefits expanded and the state got involved more and more in financing this generous social payments. Self-administration of the social institutions became insufficient in most cases which needed Federal subsidies. Most importantly, social policy in Germany was used to counteract the economic crisis. From the beginning of the 70's, economic situation deteriorated. Rising unemployment became the critical concern of economic policy making. Through early retirement schemes, unemployment was partly contained by absorbing some of the labor supply into the social insurance system. This created an 'externalization regime' in Germany by which 'the externalization of certain groups out of the active workforce into 'acceptable' alternative roles and the externalization of the costs of economic restructuring for a broader risk community' (Manow, 1997:30). Given the high employment protection, government used other social measures to alleviate the effects of unemployment. Short-term working subsidies were granted to the unemployed during the recessions of 1974-75, 1980-82 and 1992-3 to lessen the labor market pressures (Vitols, 1996:16) and the financial burden of unemployment benefits

increased as unemployment became a persistent phenomenon. Inevitably, these measures implied increasing state expenditure on social policy. In 1970's, vocational training facilities were introduced to find a long-standing solution to the unemployment by training high-skilled labor which is appropriate to needs of German product markets. However, vocational training put an additional burden on the social budget. Actually, structural rigidities in German labor markets identified by high wages and high employment security have greatly affected the social policies which tried to cover the outsiders of the highly regulated labor markets and only by such measures the system with high wage employment could survive. Moreover, another measure to prevent unemployment is the reduction of working hours in order to open up new employment opportunities. This was particularly important in a country like Germany where part-time employment is not common.

However, all the social measures taken to resist negative effects of recessions have reached their limits. Social security system is suffering from financial problems. Considering unfavorable demographic developments that signal an aging society, it became difficult to finance retirement pensions in which a drastic decrease in its amount could not be allowed due to the inter-generational contract. On the other hand, externalization regime created high contribution and tax ratios. While the workforce did not increase, the number of persons covered by the social security system rose. As a result, the share of contributions of current employees and employers is in an increasing trend which brought about 'heavy fixed labor costs which ,in turn, discourage employment growth'. This created a 'self-reinforcing negative spiral' which led to the rise in the number of persons to be covered by the social system due to the high non-wage labor costs (Manow, 1997:31-2). However, the reform of the social security system seems inevitable at the face of rising financial difficulties. Ordoliberalism argued that beginning from the 70's German state turned into a welfare state which made excessive social expenditures. For Ordoliberalism, the positive effect of these measures is doubtful as gradually increased social benefits provided disincentives in the economy. Institutionalized social benefits increased the dependency of the individuals on the social assistance of the state and reduced the self-help within the society. As the contribution-based social insurance system was complemented more with the comprehensive social benefits financed by state, the role

of the state in social expenditure rose which was assessed by Ordoliberals as contradicting with the market economy principles of Social Market Economy and the dynamism of the economy was frustrated by the excessive social measures. For Ordoliberals, the pressure of the organized groups in favour of redistribution of wealth and the political strategies of governments made the extension of the social policies more attractive. In that sense, as expressed in the theory of Ordoliberalism, social policies should be implemented with its relation to the economic order and protected from the interference of political interests. Although they did not propose a total disintegration of the social institutions in order to bring a flexibility to the labor markets as in most of the neo-liberal arguments, the easing of institutional rigidities in the German market was thought to be necessary for the dynamism of the economy without losing the positive impact of social institutions on the productive forces which is the most outstanding quality of German capitalism.

CHAPTER 5

CONCLUSION

The degree of the effect of Social Market Economy on economic policies and structure of Germany changed according to the interpretations of various authors. Most Social Market Economy proponents agreed that Ludwig Erhard's free market policies in favour of institutionalization of market economy was decisive in producing high economic growth rates in the post-war period. According to this argument, market economy reforms in the forms of monetary reform and price deregulations in various sectors created market efficiency and contributed to high productivity rates and capital formation. In correspondance with the Social Market Economy programme, the basic drive behind the economic policies was the principle of minimum state intervention and the trust in the market economy process as the main allocative and distributive mechanism (Nicholls, 1994). Generally, the success of German economy was attributed to the institutional framework based on market economy. Indeed, for this idea, priority of price stability and external equilibrium and non-expansive fiscal policies in economic policy facilitated the working of market economy without living an inflationary pressure (Wallich, 1955). The institutional framework what we have described previously supported this argument. Exclusive choice of the Ordoliberals for the private initiative as the main organizational unit in the market and rejection of planning instruments and Keynesian demand management were thought as the principal factors behind the dynamism of German economy in that period.

Proponents of Social Market Economy pointed to the limited stance of state in the economic growth process. Position of the state in the 1950's greatly matched with the Ordoliberal vision of 'strong but limited' state. As prescribed in the theory of

Social Market Economy, Erhard's economic policies abstained from intervening in the market as far as possible. In the sense of social policies, Erhard embraced the 'order policy' as the most important part of fulfilling social prerequisites of Social Market Economy and introduced limited 'complementary' social policies which did not envisage wide redistributive aims. In that context, state's social policies did not go beyond the rule of market conformity which was appreciated from the perspective of Social Market Economy theory. Social Market Economy advocates usually emphasised the political effectiveness of Erhard's economic philosophy and its impact on the establishment of new economic system. Thus, for this argument, the so-called economic miracle of Germany could not be explained merely by chance or strength of productive forces but by the sound market economy framework and the direct influence of theoretical principles of Social Market Economy.

What Ordoliberal and supporters of Social Market Economy agreed about was that the changing style of economic policies and state's growing role beginning from the 1960's represented a diversion from the original concept of Social Market Economy and the market economy policies initiated in Erhard period. For them, the source of changes was mainly political in nature.

First, the content of competition law of 1958 did not correspond to the Ordoliberal conception of competition order. Although the Act was regarded by some neo-liberals as a 'conceptual breakthrough' for the institutional protection of competition (Kloten, 1989:75), there were various exemptions from the ban on the cartels which did not include a strict position by the state against concentration processes (Lenel, 1989; Thieme, 1991). Although Erhard made pressures for the extension of free competition to all markets, certain sectors and cartels were exempted from full competition mainly as a compromise to the interests of industrial groups. The Competition Act of 1958 was amended in 1973 with more restricting measures on private concentration, however, especially in the economic growth process of the first decades of Federal Republic, industrial concentration had already gained ground (Owen-Smith, 1994).

On the other hand, the defenders of original concept of Social Market Economy talked about a 'decay of economic policy' (Streit, 1998:52) which was embodied in the 'enlightened market economy' initiated by Karl Schiller. While some saw the

workability of the concept as a renewed version of Social Market Economy, others criticised it on the grounds that extended macro-economic instruments encouraged state's steering function in the market which represented a clear diversion from Ordoliberal vision of state. This argument expressed that Stability and Growth Act with its Keynesian elements indicated a turning point for the next phase of economy associated with state interventionism (Watrin, 1998; Kloten, 1989). 'Concerted Action' incorporated to the legal framework enabled organized interest groups to penetrate in economic policy making which fostered the strength of corporatist structures (Lenel, 1989).

From the perspective of Social Market Economy, increasing 'social' expenditure and state's extensive role in that respect led to the transformation of 'social state' into a 'welfare state' which was not explicitly prescribed by the theory of Social Market Economy (Cassel, 1998; Kloten, 1989; Lenel, 1989). From the beginning of 1960's, state's place in social and economic order increased obviously and in that way, social elements of Social Market Economy were more frequently emphasised than market economy elements (Streit, 1998; Cassel, 1998). For this argument, increasing rates of social benefits with extended sphere of the state were mainly resulted from the political attractiveness of redistribution of wealth.

First point of this argument is that there is an obvious difference between the first phase of post-war German economy dominated by the free market economy policies of Erhard and generally by the Social Market Economy programme and the second phase which contained various departures from the original concept mainly due to the changing political forces. Thus, for that idea, in the first two decades, impact of the Social Market Economy programme on economic system is obvious with some minor exceptions, however, in time new developments in economic policies and system caused a wide discrepancy between the practice and theory of Social Market Economy. Besides the impact of political factors, the diversion from the Social Market Economy programme also resulted from the theoretical deficiencies of the concept. Streit argued that some Ordoliberal theorists opposed to the concept of Social Market Economy as the 'social' epithet in Social Market Economy implied state's interference in the market for the 'social' correction of market results which was contrary to the Ordoliberalism (Streit, 1998:55). Although the original

concept envisaged a 'limited state', the 'social' phrase opened the gate for political misinterpretations of the concept. Additionally, the principle of 'Social State' in Basic Law without necessary limitations stimulated this trend. Second, Klotten and Cassel thought that 'market conformity rule' and 'subsidiarity rule' for the state intervention did not provide a clear-cut position for the state in Social Market Economy and these 'useful but insufficient' criteria remained vulnerable to diverse interpretations as our theoretical analysis showed (Cassel, 1998:18-9; Klotten, 1989:77-8).

On the other hand, a series of other writers opposed to the assumed effect of the Social Market Economy programme on the high economic growth rates in first decades of West Germany. The main argument of them was that German economy in 1945 did not start its recovery from 'grade zero' but its industrial structure remained alive and post-war German political economy did not pose a complete historical break with its historical and traditional practices. For that reason, the decisive factor in German economic reconstruction was not the free market policies of Erhard by a sound theoretical understanding but the 'favourable' export relations relied on high productive capacity of German economy. This process was already in motion as an extension of the previous historical development before the market economy reforms were introduced (Abelshauser, 2001; Borchardt, 1991). High economic performance in this period allowed state non-interventionism and legitimized the establishment of market economy under the label of Social Market Economy. In fact, although in principle Erhard rejected excessive state interventions, in practice state was tendent to intervene in market and directly or indirectly state interventions became crucial in the economic growth process (Wallich, 1955; Shonfield, 1965; Leaman, 1988; Borchardt, 1991). For Borchardt, state's role in this process was accepted by economic forces mainly because of high economic performance. Although there were some macro-economic changes in new period, state interventions were restructured in time (Borchardt, 1991:129-30).

Borchardt stated that after 1948, economic system of Federal Republic changed in favour of market economy. Undoubtedly, this change introduced new developments. However, one could not mention a direct reversion of the previous process. It is true that previous administrative forms of Weimar and Nazi period were left but some organizational forms of economic structures revived in the new period.

Borchardt's main argument is that the post-war German economy did not experience a complete new development but in time constructed its traditional institutions with some modifications within the framework of market economy. For him, it is not easy to assess post-war economic growth process either as a reconstruction process which envisioned the revival of old economic structures or wholly as a new development. In the post-war period, a structural change in the economy which was a 'prerequisite of economic growth' took place which was previously blocked in the Weimar and Nazi Period. New economic and political system tolerated this structural change within the consensus environment created by high economic performance. However, in contrast to most market economy believers, this was the continuity of an historical process (Borchardt, 1991:110-126).

Abelshauser used the term of 'continuity in change' for German political economy in the last century. For him, German social system of production with its distinctive features came into being at the end of 19th century and persisted until today with some changes. Abelshauser stressed the dominance of the traditional qualities of 'modern' German capitalism which made the radical reforms in the system dependent on its survival like in the time of 'economic miracle'. Thus, these structural factors became decisive in the direction of German economy and allowed new economic and political processes as long as they did not pose a threat to its existence (Abelshauser, 2001:2). According to this logic, Social Market Economy framework in the post-war period have preserved this structure without living serious distributional conflicts in a time of high growth rates, however, low economic performance in the subsequent period undermined the credibility of market economy framework and traditional institutional relations gained ascendancy over the principles of market economy as a response to the economic crisis.

Abelshauser focused on the persistence of strong institutions of German political economy which were not overthrown in the reconstruction period (Abelshauser, 2001). Usually, there have been emphasis on traditionally defined institutions and practices which characterise the continuity of a distinct German Model. From our analysis of the principal persistent practices of German institutional structure, various long-standing institutions were observable. A universal banking system which conducted strong relationship with the industrial firms through its long-term financing

mechanism became an integral part of German capitalism (Shonfield, 1965). The origin of this regulated capital market and the strong relationship between banks and firms could be found in the German industrialisation process (Smyser, 1992). Strong corporatist relations in the industrial structure with strong trade unions and employer associations have traditionally assumed a great role in regulating the market process in Germany as underlined previously. This structure in industrial relations was also maintained in post-war Germany as it could be seen from the labour market developments. This economic structure as a by-product of German industrialization process had been combined with the protective and interventionist character of state as a supporter and active partner of these corporatist relations. Although the state principally avoided from extensive interventions in the post-war period, still its role in the economic processes was undeniable. These features of German economy were described as ‘organized capitalism’ (Carlin 1993). On the other hand, our analysis of post-war social regulations illustrated that Bismarckian social welfare system was restructured in the new period and became a part of long-standing institutional framework of German political economy (Manow 1997).

This line of writers emphasised on the historical continuity of traditional features and claimed that even immediately after Second-World War these features were the factors behind the high rates of economic growth. In this context, the effect of theoretical aspirations of the new economic order was secondary. ‘Exceptional growth’ rates was attributable to more structural factors rather than macro-economic management based on a sound theoretical backing. Thus, they underestimated the influence of Social Market Economy theory as the conditions beginning from the 1960’s indicated that in low economic growth rates, the market economy elements of Social Market Economy began to be ignored while traditional ways of relations in favour of more state intervention and social regulation were fostered.

In a more middle-way position, Giersch *et.al* (1992:71) assumed that in the reconstruction period, ‘a long chain of efficiency gains through capital formation and structural change’ was maintained mainly due to the ‘West Germany’s return to world markets’. Thus, he accepted the drive within the German economy for expansion combined with the high export growth. However, Giersch argued that institutional reforms at that period with their market incentives encouraged this economic growth

process. In this sense, the economic success of Germany came as a result of a combination of the favorable structural environment and the ‘appropriate’ institutional framework shaped by the market economy policies. Also Wallich (1955) had taken a similar stance in explaining post-war German growth.

Proponents of Social Market Economy believed that the post-war economic development represented a break with the previous economic processes. High economic performance with ‘appropriate economic policies’ brought successfully the realization of Social Market Economy though there were some divergences from theoretical principles in some economic policy areas. However, what mostly Ordoliberals criticised was that the practices at the state level and organized community in the 1970’s represented a departure from the concept. What two group of writers agreed on was that in the 1970’s there was a visible change in economic and social relations in West Germany.

In order to properly analyse the correspondance of theory of Social Market Economy with the post-war development of German economy, we should first accept the existence of diverse positions in the theory. As it was previously indicated, from various standpoints, different theoretical evaluations are possible.

Second, theoretical constructions could not be thought without making reference to the previous experiences and traditions of the German economy. The thorough analysis of theoretical origins of Social Market Economy pointed that theoreticians were inevitably influenced by the economic order in which they lived and their value systems. Historical understanding of the German economy and society made a visible impact on the theoretical principles of economic programmes. Both Ordoliberalism and the economic programme of Social Market Economy did not represent a ‘pure’ theory but they proposed various theoretical principles which could have only a meaning when they were properly translated into practice.

From our theoretical survey, it could be said that previous dominant schools like classical liberalism or German Historical School and embodiment of their principles in some concrete economic policies affected theoretical constructions of Ordoliberalism. Also collectivist ideologies and practices became negatively effective in the construction of value system of Ordoliberalism. In paralel, the concept of Social Market Economy was fed by various sources ranging from the Christian social

thinking to the younger German Historical School which indicates the close relation of Social Market Economy with the traditional development of German society and its reflections on theoretical conceptualization. Thus, a variety of theoretical roots shaped the framework of Social Market Economy.

The realization of theoretical principles is also related with the degree of their capability of affecting political and economic process. In the analysis of the reconstruction period, it was observable that major Ordoliberals took the opportunity to influence post-war economic policy-making by directly taking place in governmental agencies. Actually, a favourable environment existed after war for the spread of Ordoliberal ideas. Ordoliberal vision of market economy was radical in the sense that for it, a 'certain' economic order should be constructed in order to maintain a market economy based on a legal framework which is binding both to the state and markets. 'Grade Zero' in the German economy immediately after war provided Ordoliberals with the opportunity to construct such an economic order in accordance with their design. Additionally, an active protection of competition, building a market framework, implementing a coherent order policy-making necessitated the existence of a 'political will' which will turn these principles into practice. Actually, post-war political condition was very suitable for that aim. Erhard's political power as a liberal-minded man was fostered since economic success in the way of reconstruction became more apparent. A direct comparison with the theoretical data on Ordoliberalism could prove that the content of his market economy policies greatly coincided with the principles of Ordoliberalism. Although there were special circumstances which gave way to the correspondance with the Ordoliberal principles and economic policies and there appeared many divergences from the principles of Ordoliberalism, Ordoliberal vision have made a long-lasting impact on the German political economy. A strong institutionalization of monetary policy and the continuity and coherence in economic policy, the establishment of a competition order though with some deficiencies and the 'limited' stance of the state in the post-war period controlled with a legal framework are the successes of Ordoliberal programme. However, while economic order policy in Ordoliberal vision could serve well in the reconstruction period, in the later phases of economic development, the limited instruments provided for the state in Ordoliberal design and the over-emphasis on

market economy elements in a relatively secondary role of social policy could not fulfill the requirements of an economic order around the objectives of Social Market Economy.

Generally, visible economic growth in the reconstruction period helped to mitigate possible interest conflicts and led to a consensus among productive forces and political opposites. The role of the idea of Social Market Economy both in increasing political credibility of liberalism and social acceptance of market economy relations was crucial. Since initially Social Market Economy did not depend on a strict and pre-determined economic order design, but embraced the principles of social welfare, freedom in markets and implicitly economic growth, Social Market concept referred to a national regulation of market economy relations mostly by pragmatic instruments in that period. Thus, the Social Market Economy concept could not be conceived isolated from the developments in the economic and social structure of Germany.

Although its original principles were initially developed by Ordoliberal and Social Market theoreticians in the post-war time, the concept could not be equated with the policies of Erhard or strict Ordoliberal vision of market economy. Within the general principles of 'freedom and efficiency in markets' and 'social equality', Social Market Economy was open to reinterpretations according to the necessities of the time. Hence, it was a continuous attempt to find an optimum between its general principles by the instruments provided by the unique German social and economic system. For this reason, within the system there could be times when there could be more emphasis on one principle than others as observed in the long-term development of major policy areas. However, it is certain that Social Market Economy could not allow a wide discrepancy between the roles of its principles within its framework since it represented a balanced economic order which necessitated a consensus framework between various political, economic and social actors. The changes in the economic system beginning from 1960's could be viewed from this perspective. Although Ordoliberal criticisms on the growing role of state and social regulations have an empirical basis, the incompatibility of these developments with Social Market Economy is questionable. In unfavourable international economic conditions in 1970's, German economy tried to find a solution to the economic crisis by protecting

its institutional framework. Thus, a social and economic consensus was maintained in a different equilibrium from the 1950's at the wake of economic recessions. However, it was not the result of a political change but a response to the low economic growth rates within economic and social perspective of Social Market Economy. It means that stagnation in the German economy in 1970's was not the result of mismanagement of the state or increasing regulation of social markets, but in world recession current policies aimed at preserving the economic and social order and adjusting to the new international economic order without giving up the basic principles and institutions of Social Market Economy. In this sense, while there was a discontinuity in the international environment, in Germany there was an effort for the continuity of post-war economic system. Generally, in contrast to the Ordoliberal view, the 1970's did not represent a complete break with the policies of previous periods. Although there appeared some changes in the legal framework by Stability and Growth Act as mentioned before, 'cautious' style in macro-economic policies did not change (Katzenstein, 1987). Also the economic policies after 1982 in CDU power proved that Germany generally avoided from economic policy experiments which distinguished it from other Western countries exposed to the neo-liberal waves at that period. On the other hand, an over-emphasis on the increasing role of organized group interests and social regulations could not describe a turning point in German political economy towards corporatist relations. Although trade unions and employer associations is more powerful in Germany compared to other countries, post-war liberal framework persisted which limited and controlled expressions of corporate interest. Also the attempt to explain the success of market economy in the 1950's with the absence of effect of interest groups especially trade unions and the stagnation of German economy in the 1970's with their revival seems arbitrary.

In contrast to the writers emphasizing on historical determinants of German capitalism, the role of traditional institutions should not be exaggerated. The reconstruction of traditional institutions of German capitalism could not be thought as totally incompatible with the concept of Social Market Economy. Although it is true that most traditional institutions were restructured in the new period, their role within the new framework has changed greatly. First, a legal framework that control the sphere of interest groups prevented their excess influence on the state policies, second,

the legal protection of labor rights and guarantee of their participation in management issues led to their integration to the national industrial system and the dissolution of aggressive class-based positions as our analysis of 'co-determination' illustrated. Heavy state interventionism of the previous period turned into the existence of an 'enabling state'(Streeck:1997) which abstained from over-actions and encouraged decentralized organizations. Indeed, dense network of institutions in German society reinforced this changing role of the state. Social welfare system with its decentralized institutions was constituted independent from the state finance.

It is certain that Social Market Economy both as a concept and the existing economic order could not be thought without its unique institutions that provided the fulfillment of its principles. The interrelation between these institutions is crucial for the sustainment of the system. Other important point is the capability of the system to respond to external competitive pressures with the flexibility of its instruments.

Until recent times, Germany became a good example against the convergence thesis of the neo-liberals. Within its unique institutional framework, it created its own style of capitalism which more or less achieved its objectives, namely market efficiency and social equity. It is true that this balancing function prevented it from taking extensive steps in both objectives and brought about a stability-oriented approach mainly directed to protect the status-quo within the economic structure. Although until now with its production system and socio-political framework based on consensus it managed to survive at the face of external pressures to change (Streeck, 1991) the system has some limits. In recent times, most proponents of Social Market Economy argued that a reform of institutional framework of economic order seems crucial for the dynamism of German economy. Especially the financing of social security system became an acute problem which should be solved. On the other hand, to maintain high economic growth rates in the long-run is necessary to remedy the partial losses due to the institutional rigidities. The strategy in the 1970's towards the improvement of supply-side conditions with various industry and labour market policies were rewarded by the high economic growth rates of late 1980's. However, in the 1990's with the new challenges of unification, globalization and European integration process, German economy entered into a stagnation and inevitably the institutions of German Model was again put into question. The capability of Social

Market Economy to meet these challenges largely depends on the continuity of consensus around its major principles and the modification of its institutional arrangements which will both respond to external pressures and maintain traditional institutional relations in a new equilibrium.

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