

*“Respect the past so that you can understand the present and work on the future.”*

István Széchenyi

## **A Retrospective on the Early Period of the German Social Market Economy\***

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*During the 1950s and the first half of the 1960s, the social market economy produced significant long-term prosperity for German citizens, even though not only welfare measures were introduced in the early period. While from the second half of the 1960s the paradigm of the social market economy could no longer produce adequate answers to the emerging challenges (stagflation, impact of changing circumstances in the world economy), its main pillars, such as its “social” character, social responsibility and its aspects of sustainability, cannot be disregarded in other, dissimilar socio-economic systems either. In this article, we outline the operating model of the German social market economy and draw the conclusions applicable to our own era.*

### **1. Introduction**

We have already seen numerous examples of economic and social challenges in the 21<sup>st</sup> century. In relation to the handling of these challenges, the question arises about the extent to which such measures have been or will be successful in solving the emerging problems, or whether perhaps they themselves contribute to the rise of other, different types of problems. *We have seen that achieving and maintaining price stability, developing the right economic policy and finding a sustainable path for growth and development constitute an increasingly difficult challenge in our time, not only in Hungary but at the international level as well.* In response to the increasing number challenges (the importance of which is by no means diminishing), we would be well advised to revisit some earlier trends and paradigms, which (though obviously not as permanent solutions) successfully coped with the challenges appearing in their own time. It will be exactly 60 years ago this year that Ludwig Erhard (1897–1977) was elected Chancellor of Germany.

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He remained in office until 1966. Together with his predecessor, Konrad Adenauer, his policies played a decisive role in the practical implementation of the concept of the social market economy. It is also for this reason that we would like to offer a short introduction to Erhard's life and his most important measures, and provide an outline of the German model of the social market economy, which produced outstanding results in the 1950s and the early 1960s. We would also like to draw the relevant conclusions and lessons that may be useful in our own time.

Before reviewing the German programme of the social market economy, we need to briefly touch on the origins and development of the paradigm itself. While the basic idea of the social market economy originated in Germany of the 1930s, later members of the so-called Freiburg Circles and their followers (e.g. Wilhelm Röpke, Ludwig Erhard, Alfred Müller-Armack, Walter Eucken and others) tried to find a way out of the economic and moral crisis consequent upon defeat in the Second World War, keeping in mind the social requirements of German society. It was along these lines of thought that the theoretical framework for a social market economy was born. In contrast to the classical capitalist market economy and to a system based on planned economy, the theory offered a third solution – see Wilhelm Röpke, *Die Gesellschaftskrisis der Gegenwart* (The Social Crisis of Our Time), Hungarian title: *A harmadik út* (The Third Way). Röpke's book presents a kind of "intermediate state" between the two aforementioned economic systems (Lentner 2015), following ordoliberal notions, meaning principles based on order and state intervention, but upholding market principles. In his book, Röpke (1950) espoused the importance, among other things, of a humane society, the freedom of economic activity, the encouragement of market competition, the strict supervision of market actors, as well as (limited) state intervention. The principles of the social market economy concerning the market, the state and value systems differed significantly from the philosophical approaches of neoliberalism or those of the welfare state, because, while the social market economy essentially aims to create market competition as well as price regulation – a competition regulating state – inspired by the concepts of social partnership and individual responsibility, the neoliberal market economy promotes the freedom of contract, liberalisation and deregulation. In the latter approach, the state is a fundamentally inadequate proprietor; based on its value system, the aims can be identified primarily as the success of the individual, collective responsibility and marketisation (Kocziszky 2023). By contrast, the welfare state prioritises equal opportunity, equitable distribution of wealth and protection against social risks (Sandmo 1995) through the promotion and protection of the economic and social well-being of citizens.

The concept of the social market economy was first used in a study published in December 1946 by Alfred Müller-Armack, professor of economics at Cologne University, later Under-Secretary of State for Economic Affairs (Glossner – Gregosz 2011). The basis of the social market economy is a free, self-disciplined human being with a sense of responsibility and initiative, who strives to acquire private property and is able to fend for themselves. The human being as a free and independent citizen

is the ideal human exponent of the social market economy (*Diós – Viczián 1993*). Furthermore, it is important to note that, largely due to the influence of the Protestant pastor and theologian Dietrich Bonhoeffer, a Christian Social value system was also built into the paradigm of the social market economy. Thus, notions of “prosperity for all”, social responsibility and the maintenance of healthy competition received special emphasis – even if, regrettably, these basic principles lost some of their importance in later decades. Reflecting on the above, *Erhard (1993:215)* who played a decisive role in the practical implementation of the social market economy, but not in the formulation of its theory, also underlined: “*Perhaps – I should like to say certainly – many of us in concentrating all our human energies in regaining and securing the material basis of our life may have gone wrong, and in so doing the sense of a true and proper scale of values has been lost.*”

## **2. Ludwig Erhard, influential advocate of the German social market economy**

Ludwig Erhard was born in 1897 in Fürth, a town close to Nuremberg, into a family of textile merchants. After elementary school, he became an apprentice in a textile shop in Nuremberg, which ended with his conscription into the army upon the outbreak of the First World War. He was seriously wounded by shrapnel at Ypres in western Belgium in 1918. Following his recovery, he continued his tertiary education in the Nuremberg Commercial College and subsequently studied economics and sociology at Goethe University in Frankfurt. He received his doctorate in 1925; in his dissertation he mainly investigated the economic schools discussing theories of value. He joined the Economic Observation Institute in 1928 and from 1945 he served as Minister for Economic Affairs in the Bavarian State Government. In 1947, he became responsible for the financial affairs of the united British-American Occupation Zones (Bizonia), where he, among other tasks, was charged with preparations for the currency reform of 1948 (introduction of the Deutsche Mark). From 1949 to 1963, he was the first Minister for Economic Affairs in the West German government and subsequently successor to Konrad Adenauer as Chancellor from 1963 to 1966. From the spring of 1966, for one year, he was Vice-President of the CDU (Christian Democratic Union of Germany). He died in 1977 in Bonn at the age of 80.

Ludwig Erhard’s main work also appeared in Hungarian under the title *Jólétet mindenkinek (Prosperity for All)*. The English title, *Prosperity Through Competition*, indicates perfectly that in Erhard’s view the road to prosperity leads through competition. Therefore, his argument already ran counter to several schools of thought (for instance, those advocating monopolistic solutions). In his introduction written in 1957, the author warns that copying the methodology of achieving economic prosperity in Germany does not necessarily guarantee economic success in other countries. In light of the results of this policy – for instance, that by 1957 production had increased by nearly two and a half times compared to the pre-war

years, that industrial output rose sixfold following the currency reform, and that between 1949 (when the social market economy was introduced in the Western half of Germany) and 1957 more than 4 million homes were built with significant simultaneous increase in gold and foreign exchange reserves – it appears worthwhile to survey the main cornerstones of this economic programme. All the more so, since the economic problems and challenges facing Germany at that time, i.e. increasing and preserving the value of the currency, achieving price stability, formulating an economic policy in times of war, and sustaining economic growth are economic difficulties that we also face today in Hungary as well as the rest of the world.

### **3. The model of the social market economy in Germany in the second half of the 1940s and during the 1950s**

In order to secure market competition, the German social market economy was characterised by a strong emphasis on the statutory regulation of monopolies. In the absence of such regulation, as Erhard puts it, the social market economy would quickly come to an end. “Prosperity for all” can only be achieved through the concept of “prosperity by means of competition”. While the first maxim indicates the aim, the second identifies the road leading to it. At the same time, Erhard issues a strong warning against revolutionary reforms, which, in his view, may lead to “economic paralysis”. (We would use the term “stagflation” today, but the concept had not yet been current at the time.) The word “social”, as the first part of the concept of the social market economy, implies that those who cannot participate in production for reasons beyond their control (e.g. because of their age or illness or due to injuries suffered in war) should still be furnished with the means of creating the basic living conditions. Accordingly, social expenditures also grew significantly in the Western half of Germany: from 10 billion marks in 1949 to 21 billion in 1955, in which the pension reform introduced at this time played an important part. Due to the pension reform, the amount of the pensions disbursed rose significantly; thus the amount of pension contributions increased from 17.7 billion German marks in 1954 to 22.0 billion marks in 1956.

Erhard also rejected the planned economy and price regulation (he called the latter “price-frozen inflation”) (*Erhard 1954*). As a first step, he recommended the introduction of a prudent budget policy involving budget cuts (e.g. a wage freeze, reducing the number of foreign trips to the necessary minimum, job cuts) and then he would only envisage tax cuts in line with increased revenues resulting from increased production. We need to call attention to yet another important change in taxation; the incentives that were introduced in order to increase industrial productivity. Extra income earned during overtime was exempted from tax in this scheme, and thus the total number of weekly hours worked increased from 39.1 hours in 1947 to 48.6 hours in 1954. A reduction can be seen in the figures by 1956 as the weekly number of hours worked by women and men decreased to 48.0 hours

as a result of a rise in the general living standards as well as in real wages. Erhard's view on early tax cuts was that even though the cuts may appear, in themselves, to make a positive contribution to economic reconstruction, in a later phase, due to conflicts with economic policy, they are more likely to hinder it. The temporary wage freeze, another highly controversial measure at first, also contributed to stabilisation in the long run. The result was that the general increase in price levels was not followed by a similar increase in wages. Because of this, the policy measure led to the general strike of November 1948, but in the long run it contributed to reducing inflation as it prevented a price-wage spiral. To measure inflation, the ministry regularly published a so-called "price mirror", in which they followed the changes in inflation on the basis of prices posted by the various service sectors. Unemployment also posed a problem in Germany at the time. To address this problem, Erhard advocated the creation of "real" jobs. In his opinion, the creation of "non-real" jobs was not beneficial either for employees or for the German economy in the long run, and non-real full-time employment made no contribution at all. The large numbers of foreign "guest workers" arriving in Germany added significantly to unemployment; but even for them, Erhard argued for the creation of genuine jobs. In relation to unemployment, Wilhelm Röpke contended – at least under the gold standard – that rigidly aiming for full employment could be expressly harmful for the economy, because it opened the way to economic nationalism, which he thought had doubtful value in maintaining economic growth. In Röpke's (1950) view, such a policy may result in turning away from foreign markets, leading to an extreme degree of economic isolationism. Besides, as early as 1957, Erhard warned of the dangers of overconsumption, adding that *"the luxury of today is in general demand tomorrow and in general consumption the day after"* (Erhard 1957:57); therefore, aspects of sustainability already appeared in the social market economy.

The Korean War, which lasted from 1950 to 1953, had some temporary positive effects on the German economy (e.g. higher production due to increased demand), but on the whole the negative impact dominated (e.g. renewed increases in price levels and the cost of living). Thus, the trajectory of development of the German economy broke, opening the way to critical opinions concerning the social market economy (lasting to this day). However, at least temporarily, the system withstood the test of time and the years between 1958 and 1964 were also characterised by marked economic prosperity (See *Table 1*).

<b>Table 1</b>				
<b>Per capita gross national product (GNP) in Germany from 1950 to 1964 (in German marks)</b>				
	<b>1950</b>	<b>1958</b>	<b>1960</b>	<b>1964</b>
Per capita gross national product (GNP)	5,754	9,707	13,200	15,106
<i>Note: From 1960 includes the Saarland and West Berlin.</i>				
<i>Source: Erhard (1993:62)</i>				

*Ferenc Jánossy* (1914–1997) offers an interesting interpretation of Germany's development during this period in his book about trendlines. Having examined the reconstruction periods of several countries in the aftermath of the Second World War, Jánossy came to the conclusion that the period of reconstruction does not end when production reaches the pre-war level, but only when the volume of production once again matches the economic development trendline of the given country. Thereafter, it will follow a growth trajectory as if the war had not taken place. If the economic development had been uninterrupted prior to the outbreak of war, then the actual pre-war development of production coincides with the trendline. Therefore, production will continue to grow until it has reached the trendline of economic development. Thereafter, the growth of production will again – at least for some time – share the trendline trajectory (*Jánossy 1966*). New challenges appeared from the second half of the 1960s (e.g. stagflation, negative impacts of changes in global market conditions, and then the oil and raw material price explosion in the 1970s), to which, as Erhard himself admitted, the paradigm of the social market economy could not respond adequately. As a result, a new kind of economic system, neoliberal market economics came to replace the social market economy.

#### **4. Conclusions**

As shown above, the German social market economy – at least in a short perspective – was not always particularly social in character. Among other things, the freezing of wages and the tax exemption for overtime were not altogether favourable measures for the citizens since in many instances these led to excessive work, employees being overdriven and mentally as well as physically exhausted. Nonetheless, the achievements of the social market economy during the 1950s and the first half of the 1960s (also, obviously, due to the Marshall Plan) are undeniable. They produced a significant level of prosperity for German citizens and for many years Erhard was Germany's most popular politician. From the second half of the 1960s, however, it failed to offer solutions for the newly emerging problems.

Recent economic and social developments (economic crisis, energy crisis, bank failures, pandemic, war) may lead us to wonder whether we have yet again arrived at a turning point and a necessary new paradigm shift, as neoliberal market economics is seemingly unable to respond to the numerous new challenges. It is still an open question whether the solution lies in rethinking the current economic paradigm or if there is a need for the development of a totally new one, but we can be fairly certain that there is a need for comprehensive change, and the sooner the better. Regardless of whether we prefer to remodel the existing economic paradigm or to adopt an entirely new one, we will definitely need the “social” components of the social market economy and its social responsibility, as well as the long-term

elements, such as regarding economic policy in a long perspective, in this system of thought that broadly corresponds to the concept of sustainability.

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