Future
Social Market Economy

BertelsmannStiftung

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Measuring the Modern Social Market Economy

The "Index of Modern Social Market Economies" (MSME Index) defines and measures the features of a modern social market economy in international comparison. In contrast to other indices that measure economic performance, the MSME Index takes an institutional approach, outlining a system of essential institutions and measurable indicators for the construction and assessment of modern social market economies. Among other insights, the index could guide the European Union toward achieving the "highly competitive social market economy" that it defines in the Lisbon Treaty as its desired economic order.

Focus

Figure 1: Constitutive and Regulatory Principles of a Competitive Market Economy

Translation and Diagram based on Eucken 1952 | BertelsmannStiftung

Walter Eucken placed an effective price system at the core of his principles for a competitive market economy. Without this steering mechanism for competition, he assessed all other constitutive principles as futile. Monetary policy is closely linked to this system and requires independence from political pressure in order to function. The regulating principle of Correction of Abnormal Labor Supply refers to a phenomenon in which workers increase their supply of labor in situations of poverty. In such cases, Eucken proposes minimum wages.

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Having entered into force on December 1st 2009, the Treaty of Lisbon defines the desired economic order of the European Union to be a "highly competitive social market economy". While interpretations of the social market economy (SME) abound, many involved in writing it into the treaty intended for it to serve as a constitutional foundation for a new economic order within the EU (Joerges and Rödl: 12). Until member states reach agreement on its precise configuration, however, the SME will remain for many a rather vague commitment to a balance between economic freedom and social wellbeing that is difficult to benchmark and even more challenging to achieve.

The social market economy as an economic order has in fact a very distinct historical background with an elaborately defined system of intertwined institutions that in their entirety are indispensible for its conception. At the very root of the social market economy lies Walter Eucken's concept for a competitive market economy. While several other figures such as Alfred Müller-Armack, Wilhelm Röpke, Alexander Rüstow, Franz Böhm und Ludwig Erhard also belong to the group of influential thinkers and founding fathers of the social market economy, Walter Eucken's early work offered the most elaborate normative system of economic governance and shaped the later discourse around the subject.

The social market economy in this sense reflects a tradition of ordoliberalism, which articulates state responsibility as establishing a functioning legal framework for effective economic governance, aiming to avoid more direct political interventions in economic processes. Although economic scholarship around the term "ordoliberalism" has not found much resonance outside of German-speaking countries, its ideas are not foreign to mainstream economics in other parts of the world today. In fact, they extend into the core of both constitutional economics and new institutional economics (NIE).

The common characteristic between ordoliberalism and NIE lies in their joint concern with an historical and institutional perspective rather than a predominantly mathematical approach. In particular, both of them do not concentrate on the measurement of short term economic outcomes but place particular emphasis on the systematic consideration of long-term institutional conditions. However, while NIE concentrates on the positive study of economic systems, ordoliberalism in addition takes a normative approach, advocating for the state to create a system of rules and institutions that ensures a workable, stable and sustainable economic order.

NIE concerns itself with the study of institutions for the purpose of improving the efficiency of economic systems. In doing so, it aims to increase the accuracy of modeling by factoring in positive transaction costs, bounded rationality and imperfect foresight. Eucken and his ordoliberal followers on the other hand sought not to achieve economic efficiency for the sake of efficiency, but rather in order to circumvent power accumulation and privilege, subsequently ensuring individual freedom. Moreover, Eucken doubted that industrialized economies could produce an efficient economic system for the whole of society with a laissez-faire governance approach. He therefore designed a system of constituent and regulatory principles that would allow for the proper functioning of a competitive market economy if the system were ensured by the state as a public good (Richter 2011).

Ordoliberalism is remarkably compatible with the goals of EU economic governance and could guide future progress toward economic integration and the development of the social market economy within Europe. Its tradition of the SME advocates a balance between market-making and market-correcting mechanisms. The main instrument applied within the EU for policy governance in the areas of the European Employment Strategy, social inclusion, pensions and others, namely the Open Method of Coordination (OMC), could profit from a normative institutional framework consistent with ordoliberalism.

With the OMC, European economies have made some progress toward convergence, which should not be underestimated. Nevertheless, even conceivers of the current coordination approach acknowledge that it will not suffice moving forward with the newest stage of the OMC for the area of jobs and growth, namely the Europe 2020 strategy (Rodrigues 2010: 46-7). The most common criticisms of the OMC include the non-binding and non-scrutinizing nature of the self-reviewing process as well as the lack of specificity in the focus of the economic targets (Martens and Zuleeg 2010). Currently, Europe 2020 lists an array of policies that member states should implement for the common goal of creating jobs and growth within the EU. The question remains, however, how one should systematically measure, compare and monitor progress toward convergence in these policy areas.

Commensurate with the siloed structure of the Commission's areas of responsibility, Europe 2020 focuses exclusively on those key areas deemed as central to fostering growth and creating jobs. Unlike ordoliberalism, it does not encompass principles and indicators for the overarching economic order in which such policies are embedded and that also influence the success or failure of these policies. However, a clearly defined and measureable overarching economic order is indispensible for Europe 2020 because it offers guidance for the multifaceted individual policy areas that comprise the de facto economic order.

With its pilot project, "Index of Modern Social Market Economies" (MSME Index), the Bertelsmann Stiftung and the Center for Applied Economic Research at the University of Münster (CAWM) sought out to define and measure the features of a modern social market economy in an international, comparative study. On this basis, they seek to determine the extent to which each of the examined national economic orders indeed follows the logic of ordoliberalism, i.e. the principles of a social market economy. Results will be forthcoming this fall, but the design of the index itself offers a benchmark for progress toward the competitive social market economy that the EU has chosen as its economic order.

Although inspired by Walter Eucken's concept for a competitive market economy, the index made two important alterations to the original concept. Firstly, it reevaluated Eucken's 11 principles according to societal values and expectations of today. It was not without reason that Alfred Müller-Armack, who built his work upon Eucken's system of a competitive market economy and was the first recorded explicitly using the term social market economy in 1946, placed a significantly stronger focus on social policy. While Eucken even gave notice to issues such as environmental protection that demonstrated incredible prescience for his time, his concept underestimated the importance of social inclusion and, in particular, social mobility, which find consideration in the MSME Index. Secondly, the ordoliberal concept, albeit designed within the context of Germany's economic history, was never fully implemented in Germany (Barth 2011; van Suntum et al. 2011). Other economies display strong traits as well that reflect aspects of a social market economy, without necessarily coining them as such. Against this background, the index defines indicators broadly enough to allow for functional equivalencies, and in a subsequent step interprets how one would measure these indicators today.

Given the interwoven nature of the indicators, the MSME Index groups them into four categories for the sake of clarity: Competitive and Efficient Market Allocation, Efficient Property Rights, Economic and Ecological Sustainability and Social Inclusion.

Many of the indicators necessary for measuring the index already exist and thus could be collected from various other institutions. For the remaining indicators needed to operationalize the index, questions were formulated for an expert assessment. Rather than measuring economic performance, these indicators measure the existence of the relevant institutions, in accordance with the institutional approach of the concept of a social market economy.

Competitive and Efficient Market Allocation

This category emphasizes the fundamental economic freedoms necessary for competition: openness of markets, a functioning price mechanism and monopoly oversight authority. We expanded the set of existing indicators to account for capital controls that go beyond prudent arrangements in temporary situations, migration and integration policies and barriers to market entry, which can arise from overregulation or monopolized markets. For example, in terms of migration policy, the EU can boast an open internal common market, but when it comes to coordinating labor immigration policies from outside the EU, vast discrepancies exist which may affect the European economy as a whole. The European Blue Card initiative represents a positive step in the direction of approximation for highly skilled workers. Nevertheless, much remains to be done in order to establish structured immigration and integration programs for foreign workers as well as labor reintegration for redundant domestic workers.

Efficient Property Rights

The recent global financial and economic crisis demonstrated the importance of inextricably linking property rights with responsibility and liability.

Table 1: Competitive and Efficient Market Allocation

Principles	Indicators
Open Markets	Controls on Capital Movement
	Freedom of Migration
	Barriers to Market Entry
	Product Market Regulation (OECD)
Effective Price System	Price Control (Fraser Institute)
	Administrative vs. Market Prices (World Bank)
	Subsidies and Other Transfers (% of expenses, OECD)
Competition	Media Pluralism (Sustainable Governance Indicators)
	Competition Oversight Authority (Global Competition Review)

Questionnaire   External Sources

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Liability measures in international comparison remain scarce. The MSME Index incorporates a series of indicators that assess rules that shape private insolvency, manager liability in firms and the structure of the risk landscape in the private economy. Only when rights and responsibilities are balanced can the institutions of property rights function effectively. Liability rules differ greatly in the EU member states. For example, while it may take seven years to clear a credit record following insolvency in Germany, other countries allow for a much quicker turnaround. Such discrepancies carry with them significant consequences for the willingness to take economic risks in the various economies.

Table 2: Efficient Property Rights

Principles	Indicators
Property Rights	Investor Protection (World Bank)
	Patent Protection (Park Index of Patent Rights)
	Intellectual Property Rights (World Economic Forum)
Freedom of Contract	Occupational Choice
	Market Transparency and Consumer Protection
	Judicial Review (Sustainable Governance Indicators)
Liability	Private Insolvency
	Ratio Medium-sized Companies to Total Companies
	Manager Liability

Questionnaire External Sources

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Economic and Ecological Sustainability

Institutions that foster economic and ecological sustainability must be both workable in the short term and sustainable in the long-term. In particular, a sound monetary constitution that ensures currency stability is not only important for financial stability, but as a necessary supporting mechanism for the automatic steering of an effective price system, which serves as a precondition for the successful achievement of other economic goals. This effective price system lies at the core of the SME. Therefore, the MSME requires an independent central bank that exclusively pursues this goal. The Maastricht Treaty establishes such a formal foundation for the monetary union through an independent European Central Bank. Because, however, the political reality may differ from the formal framework, the questionnaire also covered assessments on the practical monetary policy including possible political interventions or even political pressure on the monetary authorities. Concerning the ECB, the index scores all of the countries in the Eurozone the same in accordance with the institutional framework, both de jure and de facto.
In contrast to monetary policy, significant differences exist within the Eurozone in terms of the degree of competitive structures that promote or hinder the dominance of a few large actors that are “too big to fail” in the financial sector. Yet, when bailouts of systemically important banking institutions become collectivized through the European Stability Mechanism, the more relevant these institutional differences become. The MSME Index attempts to capture some of these differences.

Market instruments that work to internalize the true costs of externalities such as taxes on emissions, gas, congestion and tobacco also contribute to long-term sustainability, in particular in environmental areas. Likewise, institutions that promote investment in future human resources while responsibly tackling fiscal consolidation create a policy framework for consistent economic governance.

Table 3: Economic and Ecological Sustainability

Principles	Indicators
Financial Stability	Independence of Central Bank
	Depth of Credit Information Index (World Bank)
	Public and Private Credit Registry Coverage (World Bank)
	Prevention of Too-Big-to-Fail
	Bank Capital to Assets Ratio (World Bank)
	Equity Ratio of Companies
Consistency of Economic Policy	Control of Financial Consolidation (OECD)
	Extent of Staff Training (World Economic Forum)
	Pension Systems Linked with Life Expectancy (OECD)
	Social Security Spending (OECD)
	R & D Spending (OECD)
Efficient Enviromental Protection	Market Economy Instruments
	Environmental Policy (Sustainable Governance Indicators)
	Revenue from Green Taxes (OECD)

Questionnaire External Sources

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Social Inclusion

International studies conclude that employment status and specifically the avoidance of unemployment constitute a decisive determinant of personal well-being and social inclusion (Fleche et al. 2011). In congruence with these findings, the social inclusion category of the MSME Index goes beyond mere redistribution to encompass the structure of labor market and other policies which promote social mobility and equal opportunities.

In the highly globalized and post-industrial OECD, labor markets increasingly require employability rather than specific skills. Against this background, active labor market programs that successfully reintegrate workers into employment simultaneously afford workers the ability to regain the basis for social inclusion and security throughout their working lifespan and later on in retirement. Additionally, social partnerships that manage to maintain a relatively balanced level of employer-employee parity tend to protect workers and reach favorable outcomes for the whole of society.

Social mobility requires institutions that promote equal opportunities, beginning at the earliest and most crucial age of development, namely early childhood development. Education structures should be permeable and flexible and a minimum level of social security provides a prerequisite for any further qualification efforts.

Table 4: Social Inclusion

Principles	Indicators
Effective Labor Markets	Active Labor Market Policy per Umemployed (OECD)
	Employment Protection Legislation (OECD)
	Prevention of Duality
	Employer-Employee Parity
	Effective Labor Market Programs
Social Mobility	Social Inclusion (Sustainable Governance Indicators)
	Non-Discrimination (Sustainable Governance Indicators)
	Public Spending on Childcare and Early Education (OECD)
	Education Structures
	Compulsory Unemployment Insurance (OECD)
	Guaranteed Minimum Social Security
	Income Taxation and Incentives to Work

Questionnaire External Sources

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Outlook

While this policy brief cannot elaborate on all of the indicators at length, the MSME Index has its strength in its entirety. Balanced policies in these key areas of economic governance do justice to the term of the social market economy and can serve as a benchmark for measuring and monitoring progress toward convergence around the modern social market economy. It serves as a point of departure for discussions about alternative or supplementary indicators that may become apparent through empirical evaluation, learning and a dynamic, iterative redesigning process in dialogue with the member states. In doing so, however, evaluations should be carried out through external and independent experts and go beyond the current strategy of "naming and faming".

Further Reading

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Policy Brief 2012/02: Statutory Pension

(Only available in German)

Demographic change has direct effects on the social security system, which also affects the long-term sustainability of overall public finances. Pension policy must thus respect the need to retain future scope for financial and political flexibility, and should strictly adhere to reforms already in place, such as the transition to "retirement at 67." Only under this condition can financial and economic policy create the maneuvering room necessary to allow the pension system to cope with demographically driven increases in expenditures.

Policy Brief 2012/03: Shaping Sustainable Economies

A society acts sustainably if it ensures the long-term stability and productivity of ecological, sociopolitical and economic systems. In the past, issues of sustainability were typically handled separately, neglecting individual measures' effects on other elements implied by a comprehensive concept of sustainability. The challenge ahead is to develop a holistic strategy for sustainable economic activity that takes into account interdependencies between the various aspects of sustainability, and does not seek to solve problems of sustainability at other aspects' expense.

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