

# **Cooperation and Solidarity - Opportunities for an international social market economy**

## **Experiences from Germany**

**Speech by Former Federal President Horst Köhler**

**at the conference ‘Cooperation and Solidarity -  
Opportunities for an international social market economy’**

**Dar es Salaam, 15 June 2011**

1. In its recently published 2011 Africa Progress Report the Africa Progress Panel, chaired by former UN Secretary General Kofi Annan, made the following statement "What was termed 'the hopeless continent' ten years ago has now unquestionably become the continent of hope." And according to this report Tanzania is in the front row of the most promising countries in Africa. I was glad to hear about this and I would like to congratulate you and your country.
2. This Progress Report is entitled: "The Transformation Power of Partnerships". And interestingly it underlines in particular the potential of partnerships which mobilise the energy, creativity and the resources of the private sector (and those of civil society). The Report expresses this in the following words: "As businesses realize the commercial opportunities and benefits involved, they are increasingly willing to complement the development efforts of African governments and international donors, and bridge important gaps in a results-oriented (because profit-driven) manner." Here, the Progress Panel addresses an experience which was made as well by us in Germany during the reconstruction after World War II within the conceptual framework of the – as we call it - Social Market Economy. And that is what brings me straight to the topic of our conference.
3. The working title of this conference “Cooperation and Solidarity - Opportunities for an international social market economy” might be even somewhat misleading. There will never be *one* International Social Market Economy. Depending on history, culture and the level of development there will always be different interpretations and implementations of the concept of Social Market Economy. And moreover, the Social Market Economy is not a static concept. It has to respond to ever new challenges. In the 21st century it has in particular to reconcile economy and ecology.
4. The Russian author Leo Tolstoy began his novel “Anna Karenina” (1878) with a famous sentence: "Happy families are all alike; every unhappy family is unhappy in its own way." That observation holds some truth for nations as well, if one will allow the notion of a happy nation. Happy nations, to offer a working definition, are at peace with themselves, they enjoy a sense of belonging and togetherness, they feel they are getting ahead towards

better living conditions for all; they share convictions of justice and fairness. In all that, they are very much alike, however much their histories and accomplishments may differ. Their happiness, scientific research suggests<sup>1</sup>, does not mainly depend upon the level of material wealth they have reached, although economic progress is an important factor in the equation. A nation's happiness rather mirrors the quality of life as a complex social mixture of material and immaterial goods, it mirrors the moral tonus of the society, its openness for talent and initiative, the reliability of its institutions and laws and whether the weak and disabled are cared for in decent ways.

5. This may seem somewhat elusive and atmospheric rather than dry-bone-economical. But it is precisely this moral and psychological dimension of a nation's wellbeing that the concept of the Social Market Economy presupposes and aims to strengthen. That approach is, by the way, far from original. It is, after all, no coincidence that Adam Smith, *before* he turned to his famous "Inquiry into the Nature and the Sources of the Wealth of Nations"<sup>2</sup>, wrote a "Theory of moral Sentiments"<sup>3</sup>. And it was not by chance that Ludwig Erhard named his bestseller on the German version of Social Market Economy "Prosperity for All" [Wohlstand für Alle], and that in the public perception the words "for All" counted at least as much as the promise of "Prosperity".
6. Mentioning Adam Smith indicates: The Social Market Economy is no purely German invention. Many thinkers from many nations contributed to its theoretical insights, and many governments heeded them. Consequently, there are several practical variations of the Social Market Economy and different traditions of thought about it<sup>4</sup>. Still, the German example may be especially instructive, perhaps mainly for two reasons:

(1) The apparent success: Germany has established a Social Market Economy in two extraordinarily difficult situations, and mastered both: at first, after Germany's criminal war of aggression and her defeat and utter destruction, a Social Market Economy was formed in the Western part of the country only, in the Federal Republic of Germany. With good effect so that "Wirtschaftswunder" [economic miracle] had become a loan word all around the world and interestingly enough is in these days again used by international observers in commenting Germany's rapid and strong recovery after the slump triggered by the international financial crisis.

In 1990, after the peaceful revolution in the East, the Social Market Economy was extended to the former German Democratic Republic, which was by then a region haunted by economical and infrastructural inefficiency and vast ecological damage. Revitalizing Eastern Germany was a daunting task - but the German Social Market Economy brought it on track.

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<sup>1</sup> cf. e.g. Benjamin M. Friedman, *The moral consequences of moral growth*, New York 2005, pp. 78 seq.

<sup>2</sup> ed. R.H. Campbell, A. S. Skinner, vol. IIa and IIb of the Glasgow Edition of the Works and Correspondence of Adam Smith, Reprint Indianapolis 1981.

<sup>3</sup> ed. D.D. Raphael, A. F. Macfie, *ibid*, vol. I., Indianapolis 1982.

<sup>4</sup> cf. e.g. Xaver Kaufmann, *Varianten des Wohlfahrtsstaates*, 5. Aufl., Frankfurt am Main 2003; *id.*, *Sozialpolitisches Denken, Die deutsche Tradition*, Frankfurt am Main, 2003.

(2) Finally, the German reputation for pensiveness is also well-deserved in the field of studies on the Social Market Economy. Walter Eucken, Alfred Müller-Armack, Ludwig Erhard and the "Freiburg School of Ordoliberalism" are household names not only in our lecture halls, but in our parliamentary debates, in our party system and in our daily newspapers. The theoretical heritage of ordoliberalism is cherished, and that means: it is being fought over in practical politics almost all the time.

For all these reasons, I appreciate that the Konrad-Adenauer-Foundation has organised this conference. We want to report to you about some of our own experiences with the concept and practice of the Social Market Economy. But I don't understand what follows as a blueprint for a Tanzanian Social Market Economy. Circumstances differ obviously between Tanzania and Germany. My humble hope is that my introduction and the presentation of the Konrad Adenauer Foundation meets some curiosity in Tanzania for discussion and so may contribute to help this proud nation to further define its own way towards a good future.

7. "Ordoliberalism" is the key word for the German understanding of the Social Market Economy. It unites the Latin words meaning "well-ruled order" and "strive for freedom". The name is program: Ordoliberalism addresses the question of how best to balance state and society, public policy and private enterprise, power of the state and freedom of the individual, general welfare and exclusive profit seeking. And ordoliberalism answers: The state must regulate the *forms* of the economical process, it must set the rules for competition and guarantee compliance and the state must provide public goods but should refrain from micro-managing the citizen's affairs. In other words: If one compares the economy to a ballgame, then the state must set its rules including incentives and disincentives and act as a referee, but it is mainly the citizens who shall play - and make - the game.

This ordoliberal concept is based upon assumptions and arguments so old and familiar they deserve to be called classical: The natural, decent self-interest of the individual makes him strive for improvement of his own situation. That brings about industriousness, inventiveness and cooperation - under the precondition, of course, that the individual can freely engage her talents and safely enjoy the fruits of her efforts, which presupposes education, professional freedom and private property. Decent self-interest also brings about division of labour, markets and competition.

Now, decent people will readily agree which forms of competition are licit and fair. Unfortunately, markets do not attract decent people alone. On the contrary: If markets are left to themselves, some individuals and groups will inevitably bend the rules, and their avarice will destroy the necessary fairness and often enough the market altogether. Adam Smith, by the way, was quite caustic about this phenomenon, and he stated: "People of the

same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the publick, or in some contrivance to raise prices."<sup>5</sup>

Therefore, the state has to furnish freedom of enterprise and private property, has to rule out cartels and monopolies and uphold the price mechanism, and therefore the state has to guarantee as much transparency of the economic activities as possible, and free market entrance.

8. In a land devastated by war and faced with millions of destitute refugees and expellies, that position sounded originally somewhat academic. Men like Ludwig Erhard, our first Federal Minister of Economics, and Chancellor Konrad Adenauer agreed that the state had to achieve the core program of ordoliberalism, but they were convinced government had to reach beyond and engage in a host of policies for economic progress, for fair opportunity and for social welfare.

Again, in itself, this was hardly new. When Adam Smith listed up what the state should see to and care for, his third count, after defence and a justice system guaranteeing the rule of law, was the following: "The third and last duty of the sovereign or commonwealth is that of erecting and maintaining those publick institutions and those publick works, which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature, that the profit could never repay the expence to any individual or small number of individuals, and which it, therefore, cannot be expected that any individual or small number of individuals should erect or maintain. (...) works and institutions of this kind are chiefly those for facilitating the commerce of the society, and those for promoting the instruction of the people. The institutions for instruction are of two kinds; those for the education of the youth, and those for the instruction of people of all ages."<sup>6</sup>

So basically Adam Smith was referring to infrastructure and education, which in our day encloses the promotion of research and development. Add to that Smithsonian insight what had already been reached under Count Bismarck (1815-1898): a compulsory system of worker's accident insurance, a compulsory national health insurance, and likewise insurance for old age and disability. Add the ideas of distributing the wealth harvested by productive gains more broadly and of giving workers more of a say in their factories' matters, and add the resolve to stimulate and cushion structural change by state intervention and to insure those who loose their jobs against destitution. Finally: Add the resolve to be open-minded for new challenges, for example for finding market-based ways of internalising external costs like pollution of the environment and of finding the path to a "green", ecological Social Market Economy - and you have more than just the contours of the Social Market Economy Germany has arrived at today.

9. Germany did well with her version of Social Market Economy. It *did* provide prosperity for all. We embraced the world market - and it embraced us. We cooperated regionally, and the European integration has been a success story ever since - good news for a world

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<sup>5</sup> An inquiry, loc. cit., Tom. II a, Book I, Ch. 10, Pt. 2, p. 151. For the same reason, Smith was very critical of guilds and corporations.

<sup>6</sup> *ibid*, Tom. II b, Book 5, Ch. 1, Pt. 3, pp. 130 seq.

twice set in flames by European wars. We have had our share of folly and market failure, too - whenever the Wall Street wizards came up with a particularly foul credit default swap or collateralized debt obligation, they would say: the German\_Landesbanken [state banks] will buy it. And our Social Market Economy had its phases of governmental overreach, of political micromanagement coupled with the illusion that state bureaucrats could know and anticipate what only the free choices made by millions of customers and producers can settle. All that is on record, in the books, and even on debate now and then, for each new generation of citizens and politicians are entitled to their own mistakes, even if the latter are not that new. I don't want to dwell on this systematically. Let me just add some ad hoc observations regarding questions that I think might be interesting for you, as decision-makers in the United Republic of Tanzania here and now. There are three points I'd like to stress:

10. One: The rule of law is crucial for every Social Market Economy's success.

Your own people as well as foreign investors and customers will only plan and engage themselves and their talent and capital long term if they trust in the laws of the land and the enforcement of their observation. Rule of law means: a strong and beneficent government and a law-abiding civil service, i.e. honest judges and policemen and soldiers who obey their democratically authorized political leaders. They provide the people with the ability to make long-term contractual arrangements. Martin Wolf (Financial Times) has called it the "symbiosis between two cultures or moral syndromes - commercial culture and guardian culture." His description of both is worth citing: "The essence of the commercial syndrome is voluntary agreement, honesty in dealings, openness to strangers, respect for contracts, innovation, enterprise, efficiency, promotion of comfort and convenience, acceptance of dissent, investment for productive purposes, industry, thrift and optimism. This is the attitude of the merchant through the ages. Guardians, on the other hand, shun trading, control territory, show obedience, bravery and discipline, follow precedent, respect tradition, are loyal, admire leisure and treasure honour. This is the ethos of the warrior. Today, guardians are servants of the state. Merchants are servants of the market. Because both are necessary and each is suspicious of the other, there is a permanent tension. But the symbiosis has proved fruitful."<sup>7</sup> Therefore: No enduring prosperity without the rule of law and a fine civil service.

11. Two: The transition to a modern, successful Social Market Economy means nothing less than the transition to a new society. This transition will take years, even decades, and permeate every aspect of life: the quantitative and qualitative supply of jobs, the differences in education and income rise, interfamilial and tribal ties get weaker. Many gain from these developments, but some will - or at least feel they will - be worse off.

To keep such a newly developing society together is a political challenge of the utmost importance and difficulty. The challenge: to give all citizens a credible perspective that their lives, or at least the lives of their children, will improve palpably, too. If people can be convinced that the political and social system they live in is so open and just that it will finally furnish them and their children with chances for advancement and a better life,

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<sup>7</sup> Martin Wolf, Why globalization works, London 2005, p. 31 seq.

then people will be prepared to meet hardships and tolerate inequality for that much longer.

The political economist Albert Hirschman once likened the situation in a developing society with still vast differences in living standards to the response of drivers stuck in a traffic jam. When, as typical, one of the lanes at last moves forward again, even those drivers still stuck in the other lanes are usually relieved, because they assume that soon their lane will start to move, too. Only if it doesn't and time passes further, their frustration doubles and their anger mounts<sup>8</sup>.

For that reason, all matters concerning the reward for achievement, the openness for talent and the distribution of economic success and growing wealth deserve the keenest political attention. The temptation to hit and run - to make money and flee the country - must be ruled out. And neither will the opposite, the Robin Hood-approach – take thoughtless from the rich and give to the poor - do it, for it will sooner throttle the initiative of the productive than end the plight of the afflicted.

Much more promising is to aim at a virtuous circle that rewards good performance, opens the way for upward mobility, explains inequality that is well deserved and still lets all participate in the improvement of living conditions.

12. Three: Globalisation cannot be defeated. All success-stories are written within it, not against it. That does not mean that there is only one way of achievement. On the contrary, each nation should make its own way, just as each should find its own balance of Social Market Economy-principles and -policies. The Washington Consensus for example with its cocktail of prescriptions ranging from competitive exchange rates and hastily full-scale trade liberalisations to openness for any kind of foreign direct investment and privatisation of state enterprises was long believed to be the gospel of globalisation. Well, no more, as for example the more cautious and more successful approach of states like India and South Korea towards the financial markets has proven.

Even so, some lessons should be heeded: Regional cooperation pays off. State investments into infrastructure and education pay off. Diversification pays off - only to export oil, or coffee, or cocoa makes an economy all too sensitive for the mishaps of nature and the greed of speculators, for stock exchange manoeuvres and crop failure. Ecological thoughtfulness pays off. Africa still has much of the Garden Eden in which all people of good faith like to believe. To preserve Africa's natural beauty and richness by internalizing all cost to it caused by economic development will be a huge, long-term investment - for the African people as well as for all mankind. And it will pay off best in my view when it is done in accordance with the principles of a Social Market Economy.

13. Finally, I would like to report to you that the perception of Africa is changing now in Germany as well. I am glad about this. This new perception has been brought to the point by a critical but very knowledgeable German journalist in a small book entitled "Africa before the great leap". In the blurb it says "Contrary to the prevailing sceptical forecasts

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<sup>8</sup> cited after Friedman, op. cit., p. 309.

shaped by Western views, Dominic Johnson describes roots, possibilities and risks of a changed Africa. The youth is stepping out of the shadow of colonial oppression and postcolonial despotism. If thereby the age of mass poverty and state crime can be overcome will have to be shown. The future of the continent is wide open." In Germany, I am campaigning that we do not sleep away this future and that we continue to develop our partnership with Africa vigorously.

Thank you for your attention.