

IDEAS REPORT



Social Market Economy: The Case of Germany and Suggestions for Malaysia

By Robert Haas



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About the Author

Dr. Robert Haas was head of the Friedrich-Naumann-Foundation (FNF) office in Kuala Lumpur from 1991-1996 and also served as deputy head of the Foundation's regional headquarters in Singapore from 1994-1996. He later became head of the East and Central Asia Division in the German Federal Ministry of Economic Cooperation and Development (BMZ). Dr. Haas is now working as an independent consultant.

Note on the Text

This paper is an edited and extended version of a lecture delivered at a workshop organised by the Institute of Democracy and Economic Affairs (IDEAS) Malaysia on 13th July 2011, for leaders from the Islamic Party of Malaysia (PAS) in Kuala Lumpur. The views expressed are those of the author and do not necessarily coincide with the views held by IDEAS, the FNF or BMZ.

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Foreword

When I asked IDEAS Fellow Keith Leong to review and edit this paper by Dr Robert Haas, his immediate reaction was “I didn’t know we are also into social market economy?” And when I asked Al-Mustaqeem Mahmod Radhi, a friend who helps us with translations, to translate this paper into Malay, he too was surprised that we would publish a paper on this topic.

Neither of these reactions is surprising. Those who have been following our work in IDEAS may not expect us to be promoting social market economy. Most of our work up to date has been about free market capitalism.

But economic liberalism can be seen as a big tent. The basic principles of competition, free choice and limited state are shared by everyone in this tent. The difference is in the details – i.e. the exact mechanisms how to implement the shared principles and how much weight should be given to each facet. Those who believe in *laissez faire* will insist that the government stays completely out of the economy. Libertarians like myself believe that the government’s role must be limited to regulatory function only. While advocates of social market economy, as this paper will explain, argues that that role may be a bit bigger than what libertarians call for and include certain provisions for equal access.

Despite the differences in details, all are clearly in the liberal, capitalism big tent. We celebrate the diversity of opinion within this big liberal family.

The content and ideas in this paper were actually presented in an IDEAS seminar for leaders of the Islamic Party of Malaysia (PAS). As a cross-partisan organisation, we engage with parties both in Barisan Nasional and Pakatan Rakyat. When PAS reiterated their commitment to promote “Negara Berkebajikan” in the 2011 annual delegates conference (Muktamar PAS Pusat) in June 2011, we immediately realised there is an opportunity to bring liberal economic ideas to them.

We were told by Dr Siti Mariah Mahmud MP (PAS central committee member), Dato Kamaruddin Jaffar MP (PAS Central committee and IDEAS Advisor) and Salahuddin Ayob MP (PAS Vice President) that the party draws a clear line between a Caring Nation (Negara Berkebajikan) and a Welfare State (Negara Kebajikan). They insisted that they are in no way promoting a Welfare State. Upon further discussions with them, we became convinced that to propose a free market capitalist model would be too big a jump for a party that has for so long emphasised the importance of solidarity and equality.

The series of conversations with these PAS leaders eventually gave birth to our seminar themed “Merealisasikan Negara Berkebajikan” (Realising a

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Caring Nation) which was held on 13 July 2011. Dr Robert Haas presented the case of Germany, while Poltak Hotradero (Head Economist at Indonesian Stock Exchange) presented the Scandinavian Model and Dr Ong Kian Ming (UCSI University) spoke about Reviving a Caring Society. Both Salahuddin Ayob MP and Dr Dzulkefly Ahmad MP provided an outline of the policy ideas they had at that time for critical debates with the resource persons. About 20 senior leaders of PAS, many of whom were directly involved in PAS' committee tasked with defining "Negara Berkeadilan", actively took part in the seminar.

As an economic school that developed in Germany, social market economy is rich with its own history. Dr Haas explains eloquently in this paper that it is all about creating an integrated economy where individuals are able to flourish in the open market, but the poorest are protected by a social safety net. It is a system that tries to balance liberty with equality.

Social market economy is also one in which a large amount of public services could be carried out by private civil society bodies like charities, foundations and non-governmental organisations. These bodies are generally more efficient and more effective than government.

But the system is also a costly one. Public provisions and income replacement schemes for the poor and unemployed cause tax levels of almost 51% of

revenue of individuals and companies. This paper provides a critical discussion on the pros and cons of social market economy, as well as some suggestion for Malaysia.

As Dr Haas rightly hinted, attempting to replicate the German model in its entirety would be the wrong approach. To state the obvious, Malaysia is very different from Germany. What we need to do is to look at the various models practiced by different countries, take the best practices and sift out the weaknesses.

By publishing this paper, we hope the liberal economic ideas we shared with PAS leaders in the July 2011 seminar can also be shared with others, including those in other parties in Pakatan Rakyat and Barisan Nasional. After all, as a cross-partisan free market think tank, we are committed to providing ideas and inputs to parties from all sides of the political spectrum.

IDEAS is grateful to Friedrich Naumann Foundation for Freedom for their generous support in the publication of this paper, as well in supporting our seminar with PAS in July. The foundation is a long time supporter of IDEAS. We would not be where we are today without them.

Wan Saiful Wan Jan
Chief Executive
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Section I:
Introduction

Malaysia has experienced great economic growth and modernisation over the past few years. Nevertheless, it faces significant challenges in making this remarkable progress sustainable, especially in addressing outstanding issues of social and ecological development. To be fair, Malaysia has already developed some institutional capacities to effect much-needed reforms in various sectors. For instance, it is encouraging that local parties, like the Islamist PAS, are demonstrating an interest in examining the best practices and case studies from the political economies of other countries and regions. While all countries are different, such exercises can only be beneficial in the long-run as they give leaders and policymakers the chance not only to see how things are done differently elsewhere, but also learn from the mistakes of others and perhaps avoid them.

Towards this end, this paper will attempt to outline some features of the German social and ecological market economy which perhaps could be of some relevance for those involved in politics and policymaking in Malaysia. Critics might perhaps question the necessity of such a project given the very impressive successes Malaysia has enjoyed in recent years, particularly where economic development is concerned. Nevertheless one cannot

help but notice the increased rhetoric for “reform” in the discourse of Malaysian leaders and by scholars these days.

This predilection towards the notion that some form of “reform” is necessary in Malaysia indicates that a great many Malaysians—including the political class and academia—find its current situation unsatisfying despite the material progress which their government claims to have achieved. This, if anything is a clear indication that, the uncontested and undeniable economic growth of the last decades notwithstanding, there is a wide perception that the process has at the same time led to grave socio-economic distortions in the country that have left considerable parts of Malaysia’s population feeling left out, so much so that it is said to pose a risk to its peace and order.

With this in mind, it may be appropriate to examine how other countries have met similar challenges, in this case Germany. Here, a brief summary on the historical development of the German political economy and system of social security would be appropriate.

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Section 2: The German Context

The states that eventually became modern Germany witnessed in the 19th Century both economic and social developments which to a certain extent have some similarities to what is occurring in Malaysia right now. Compared to England Germany was a latecomer in industrialisation because of political turmoil in the first half of the 19th century, but then soon became the strongest force in what is called the European Industrial Revolution, wherein markets developed very fast and without restraint (i.e., the so-called “Manchester Capitalism”). There was also an abundance of labour, as traditional trades were no longer competitive, which in tandem with an extraordinary population growth – from 24.5 million in 1800 to 56.4 million in 1900 - led to strong urban migration.

There was, however, not enough work for this surplus labour, resulting in very low wages, as well as poor working conditions and heavy exploitation of the workers. This led to multiple incidents of unrest and political dislocation. These may not necessarily be a feature in Malaysia today, but it cannot be denied that a similar population transfer to the cities—with all its political, social and economic implications—is taking place in Malaysia and indeed all over the Southeast Asian region.

To return to Germany, in particular the rapid growth of the economy after the rebirth of the German empire in 1871 also exacerbated the socio-economic divisions between rich and poor, and indeed the latter group was found to have increased in absolute figures. Uprooted people and whole families lived in utmost misery; many tried their luck by emigrating to America (circa 6 million people between 1850 and 1950).

It became increasingly apparent that something had to be done in order to ease the plight of the disadvantaged sectors of the population and corresponding social movements and political forces grew stronger. This was, after all, the era when terms like “the workers movement”, “Christian social doctrine”, “trade unions”, “political parties” and “free press” entered public consciousness and became forces to be reckoned with in their own right. Indeed, there was a notion that the new and military strong Germany, which came into existence after winning wars against the Austrian empire and France, was under threat as far as its inner stability was concerned unless concrete steps were taken.

It soon came to pass that two distinct approaches to solving the problem emerged:

1. The first was classical Marxism with its emphasis on total equality that was to be achieved after the overthrow of the ruling classes and

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- the establishment of the dictatorship of the proletariat.
2. The second was to continue subscribing to the market economy, but providing in tandem some kind of a limiting framework for the market forces, including the possibility of limited state intervention.

The first of these alternatives initially became popular among the German working classes. This led to the establishment of a Social Democratic Party (SPD) that initially subscribed strongly to Marxism. In turn, it heightened the sense of threat that the German authorities felt over the increase of revolutionary tendencies.

The second alternative developed more slowly. The-then German chancellor Otto von Bismarck, who was a highly-intelligent conservative, but also a reformer for strategic reasons, came to the conclusion that something had to be done to address the social insecurity of the working classes in order to prevent further political instability. On his initiative therefore, a general health insurance scheme was introduced in 1884 and a pension scheme for workers soon followed in 1889. The aim was to re-integrate the alienated workers into society, thereby safeguarding political stability and undercutting the nascent social democratic movement. Bismarck's stratagem did not quite work out as planned, as the self-confidence of the workers continued to grow, leading them to continue to call for greater changes

to the system. Nonetheless, the "Iron Chancellor's" reforms were in a sense a great success: they laid the foundations for the modern social security system Germany enjoys today and to a certain extent helped shift the Empire's working classes away from notions of revolution and instead seek reform within a constitutional framework. It should also be noted that with this reform Germany became the forerunner worldwide for establishing social security systems on a national scale.

This historical anecdote, therefore, demonstrates that alleviating the plight of the underprivileged via social security stabilised Germany and allowed it to be reformed gradually, instead of through violent overthrows. Indeed, it can be said that if other countries would have pursued similar reforms, they might also have avoided political turmoil and the attendant suffering of their people.

It should be mentioned here that it would be simplistic for anyone to assume that the history of industrialising Germany was solely one of permanent conflict between capital and labour, between entrepreneur and worker. As a matter of fact, there were also quite some enlightened and far sighted entrepreneurs like e.g. Alfred Krupp and perhaps even more so Robert Bosch, founder of the iconic Bosch group of companies, who out of ethical convictions did their best to provide benefits for their workers, thereby also setting an example to others. Thus, Corporate Social Responsibility (CSR)

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was practised in Germany by some more than a hundred years before the term was coined. Bosch, for example, provided his workers with decent housing and took a keen interest in their overall living conditions.

Fast forward to the 20th Century and we find this tradition continued in the Federal Republic of Germany's post-WWII Constitution which declared it to be a democratic and social state. It is striking that the Basic Law stated that private wealth exists not only to for the aggrandisement of individual or institutional owners, but also carries responsibilities on their side towards the community. This became the basis for the principle and the ethics of the German social market economy.

Under this dispensation, the market economy is still seen as the most efficient way to create more value within society—ideally for everybody living in it. However, it also acknowledges that a pure market economy lacks effective controls for market forces. This in turn may expose societies to monopolies and cartels, which in the end can be suicidal to the market principle.

The tendency towards striving for the highest possible profit without any checks and balances can lead to the exploitation of the workers, the misuse of economic power, extremely uneven distributions of wealth, as well as misery and unrest. Therein lays

a serious contradiction: on the one hand, a well-meaning state will try to look after all of its citizens, seeing that everybody gets his or her share. On the other hand there are the demands of the market and its dynamic system, which are characterised by permanent competition that rewards people unevenly. Resolving this quandary requires reconciling the classical dilemma on what is the right balance between freedom and equality in a society.

The German solution to this question was the principle of the Social Market Economy. To put it succinctly, the main theoretical elements of this system are:

1. An acknowledgement that the state and its institutions have an active role to play in shaping economic and social life - in order to balance economic freedom and to mitigate negative side-effects on the general public from the market forces.
2. Furthermore, that there should be a combination of various elements and traditions, i.e. of competition, economic and fiscal stability, social balance and participation.
3. The understanding that individuals and corporations have certain legal and social obligations towards their community.
4. Finally, self-regulatory mechanisms within society, provided by the various arms of civil society like associations or foundations, should be widely made use of, in order to allow

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widespread participation from citizens and to relieve the state of certain functions.

All of this was not just theoretical but put into practice, not dogmatically either, but as a general guideline with the understanding that the state should retain its ability to react flexibly to the challenges of ever-changing times. This dispensation worked well: labourers and entrepreneurs worked closely together to speedily rebuild Germany after WWII, bringing about the so-called “German economic miracle”, and making their country a leader in world economy.

This would not have been possible in a situation of permanent conflict between “classes”, but it would also be disingenuous to assume that there were no disagreements or controversies between labour and capital in this period. Still, labour conflicts on the whole were settled via hard, but peaceful negotiations, whereby both sides aimed to achieve acceptable compromises rather than defeat the other: the reformist German politician Eduard Bernstein already wrote in the late 19th Century that “Democracy is the High School of compromise” and with that attitude exercised great influence on the workers movement. This spirit then became dominant in Germany after WWII. Indeed, strikes in the Federal Republic happened much less in this period than in most other industrialised countries.

This section should be concluded with further discussion on the ideological underpinnings of the Social

Market Economy. Karl Marx and Friedrich Engels famously proclaimed in their *Communist Manifesto* that the workers have nothing to lose but their chains, and therefore they should not hesitate to revolt. The underlying truth, however, is that people who have more to lose, e.g. their work, property and lives will not be so eager to risk losing all of that in unrest. Societies, therefore, will be more stable if their people feel integrated and satisfied with their lot.

Achieving this goal corresponds with the ethical demands deriving from the Christian faith and traditions, which are still deeply-rooted in the minds of people, even if they are no longer religious in the formal sense. Indeed, many of the socially-responsible entrepreneurs mentioned earlier were likewise inspired by this imperative. The importance of an ethical foundation for the principles of a society should not be underestimated. A state that propagates sophisticated moral aims which are not supported by the mindsets of the population or which the leaders themselves do not credibly epitomize will realise that its efforts are futile simply because its key stakeholders will not feel committed to the cause.

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Section 3:
The German Social Security
System in Practice

Now it may be appropriate to give some details of how the modern German social system works. It is important to note that the socio-economic gaps between rich and poor in post-WWII Germany were significantly reduced by the state exercising a distributive function. This was exercised not via taking from the rich to give to the poor, but mainly in developing capacities whereby the lower strata of society was better able to obtain a greater share of the new wealth which was being created. This was accomplished via a progressive tax structure whose rates increased with rising income as well as a variety of means-tested financial benefits, paid out of taxes and other contributions.

Through this system, the wealthier part of the population subsidises the needier parts quite considerably—a fact which often escapes political discussion. It should also be stated that the premiums paid for Germany’s compulsory health insurance is not calculated in equal amounts for every person, but depends on the income of the individual, although the services provided are the same for everybody.

In the field of education, university students from less well-off families can claim state scholarships and/

or subsidised loans in order to being able to finance their studies. This is based on the principle that no one who has the necessary talent and qualifications should be prevented from graduating only because of financial reasons. This draws attention to another element of the Social Market Economy: the state does not aim to make the people equal – at least insofar as their income and wealth is concerned – but to create greater equality of opportunities for everybody to succeed in life. Access to education is therefore necessarily a prominent cornerstone for this.

Thus, social security in Germany is geared towards the creation of wealth and property amongst the general population. For instance, the state supports savings amongst the populace by providing schemes that allow the latter to save money in fixed rates over several years in order to receive an interest-reduced loan for building or buying a house, or, most recently, to acquire supplemental old age pension payments to complement the general pension scheme.

Nevertheless as mentioned above, social benefits are mostly dependent on the economic status of the pertinent person. The definition of poverty in Germany is not static but calculated taking into account developments in society. According to this definition, a person is poor when he or she has an income of less than 60% of the average income in Germany. This means that poverty is seen as a relative state. At present, the threshold lies at a monthly income

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of EUR 939.83 (as per 2010), i.e. whoever earns less than this is considered poor.

The implication of this is that the number of poor people will automatically rise when the divide between high-, middle- and low-income earners increase, even in cases when, in absolute terms, the incomes of the latter group increases. Receiving welfare funds, however, is not solely dependent on this definition, but again as mentioned before, each individual case is means-tested. Roughly 6.5 million people (out of a total population of 81 million) receive some sort of *Sozialgeld* (“social money”) or basic unemployment benefits (called *Arbeitslosengeld II* or *Hartz IV*) in one form or the other.

For those people who are in employment, monthly contributions to the social security network are made based on the actual gross salaries. These include 19.9% for the state-run pension scheme (when introduced in 1891, the rate was 1.4%), 15.5% for health insurance plus 1.95% for social long term care insurance, and 3% for unemployment insurance. These contributions are borne at an equal rate between employee and employer. The cost of the services, however, which are actually provided are often higher than the accumulated funds resulting from these contributions meaning that the balance is paid for by the state, in other words by the taxpayers. In order of being able to make up for this shortfall – which last time amounting to EUR 56 billion p.a.—the VAT had to be increased several times and now

stands at 19%. Another problem is that the pension scheme is based not on funds accumulated from contributions during one’s working life, but what is taken in will immediately be paid through prorated contributions to those who already can claim pensions. The complication of this method is that in an ageing society like Germany, it is inevitable that in coming years either the contributions to the scheme will have to rise strongly or the individual pensions have to be dropped – both will result in heavier burdens for citizens and therefore are highly-sensitive politically.

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Section 4:
The Role of the Non-Govern-
mental/ Not-for-Profit Sector

This quandary is not new in any welfare state in the world, but Germany is unique in the role that its civil society plays in the social security system. The organisation of social services and welfare in Germany is characterized by a symbiotic relationship between the state which is in charge of creating the legal frameworks as well as providing funds and control mechanisms, and a complex network of autonomous non-state organisations, associations and companies which to a great extent are actually running the services on the spot.

For example, institutions like hospitals and retire-
ment homes are run by voluntary groups like the *German Red Cross (DRK)*, the *Association for the Well-Being of the Workers (AWO)*, *Caritas* (the Catholic Church charity), the *Diakonisches Werk* (the Protestant Church counterpart) and *Paritaetischer Wohlfahrtsverband* (Association for Welfare) – to name just a few, and similar organisations are to be found in practically all spheres of the social system. German citizens mostly regard them just as benevolent institutions funded by donations, unaware that some 90% of their overall annual budgets of EUR 45 billion (turnover 2007: € 89 billion) are contributed by the state. This support makes sense, as these NGOs relieve the state of a lot of the organisational burdens which it would not be able to discharge efficiently on its own.

The above mentioned social institutions are autonomous in their internal affairs, but submit to strict legal and professional control by the public authorities. In spite of this, cases of misuse of funds emerge and as usual draw hefty criticism from the media and the public. It is probably impossible to prevent these cases completely as the network is complicated and huge, employing some 1.5 million people.

Still, there is no reason to believe that a purely state-run system would be any better. The role of the voluntary organizations is now being supplemented by private companies run for profit. For instance, there is a growing trend for private entities to take over ailing hospitals run by welfare organisations, which then are modernised with private investment and strict cost control is introduced. The background to this development is that the welfare organisations have become so big and bureaucratic that they in some cases cannot handle all of their affairs on the same level of quality and efficiency. In these cases, handing over hospitals to private investors may be the only way to keep them running. It also brings an element of competition in this traditionally quite inflexible sector. These private companies, too, get state subventions in accordance with a detailed scheme.

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Section 5:
Ecology as a New Element

The antecedent text gave a very brief overview of elements within the Social Market Economy as it had developed over the last decades. Let us now turn to ecology.

In recent years views have evolved and a growing consensus indicates that the traditional understanding of socio-economic facts within the Social Market Economy has to be widened, because the factor of ecology was missing. The growth of the economy, industrialisation and increased traffic had put a heavy burden on the environment, resulting in a decrease of the quality of life in several respects, in spite of seemingly rising general wealth. It was consequently felt that the system of the Social Market Economy was incomplete without taking into account sustainability. There was, therefore, a growing desire that the ecological principle should be integrated into it, in order to motivate the decision makers and the society at large into taking better care of the sustainability of development.

The implications of the ecological principle are additional duties for state and society. These are, among others:

1. The preservation of basic resources and of the performance of the eco system.

2. The setting of pertinent incentives by the state to the private sector and civil society for environmental conservation.
3. Adherence to international standards of ecology.
4. Resource-efficient production.
5. Creating an ecological consciousness within society which makes people modify their behaviour accordingly.

The German case study is evidence that eco-efficient economic activity and the use of renewable energies are not, as some people argue, automatically a burden for the economy. In Germany they have in fact become an increasingly important competitive advantage. To give just one simple example: the number of highly qualified specialists in any given professional field is limited. Thus, they have the privilege of being able to choose where they want to work. Surveys have shown again and again that the ecological and cultural conditions of the area under consideration play a very important role in making their decisions.

Another example: ecologically-motivated measures for waste reduction and energy-saving production have uncovered hidden potentials for cost reduction. It is simply a fact that the attitudes of people change: more and more care about how things are produced and they prefer to buy an ecologically sound product even when it is more expensive than other options. Those who took this development into their

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business model at an early stage are now better positioned than those whose cost calculations left out environmental aspects. It is no coincidence that biological farming in Germany is now booming.

Finally, it is not a legitimate way of calculating economic growth, if the cost of rehabilitating destroyed habitats, as well as the value of the destroyed places of historic and cultural importance, is not taken into account. Taking care of the environment is a prerequisite for sustainable value added and thus also for an economy that is fit for the future.

Section 6: The Challenges of the Social Market Economy

In spite of all the good-will which is embodied in the principle of Social and Ecological Market Economy it has to be conceded, nonetheless, that some of its elements also have led to negative results. We had earlier discussed the question of cost and this bears further investigation.

First, Social Market Economy had from the earliest times subscribed to the principles of subsidiarity, i.e. that the state should only take over duties which it can do better than the private sector and that duties and services wherever possible should be provided at the level closest to the people. This means restricting the state to providing basic public goods, and to allow autonomous forces in society and economy to develop their own dynamism.

Nevertheless, the resolution of any one social problem does not lead to a perfect world. The more social problems that are tackled, the more new ones are to be found clamouring for attention. New sensitivities for previously unnoticed distortions are created – resulting in never-ending cycles. Furthermore, political ambitions mean that leaders often promise more and more social benefits to voters, which ultimately have to be borne by citizens and enterprises as tax payers.

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According to the influential German taxpayer association *Bund der Steuerzahler (BdSt)* the German state is taking at least 51% of the income of its citizens and companies via taxes and deductions for social purposes. Indeed, the BdSt estimates that of every Euro a German citizen earns, 10.2 cents is deducted for income tax, 7.1 cents for VAT, 2 cents for energy tax, 11.3 cents for other taxes and levies like heritage tax, car tax, insurance tax, coffee tax etc., 10.1 cents for the pension scheme, 1.5 cents for unemployment insurance, 7.8 cents for health insurance and 1 cent for old age insurance etc.

As a matter of fact, according to recent OECD figures, Germany spends 11.6% of its gross national income (GDP) for health – which is considerably higher than the international average within the industrialised countries of 9.5%. This is only exceeded by USA with 17.4%, the Netherlands at 12% and France at 11.8%. At the same time, studies show that the life expectancy and health status of a particular population does not necessarily correlate to the amount of money spent for the health by its government.

It is no wonder then that some experts in Germany see the state as overburdened with duties and unable to efficiently handle its undertakings as well as to continue paying for all the benefits. This negatively impacts the economy, not only due to the heavy tax burden, but also in that companies thinking of employing new staff are often forced to do so

carefully due to the heavy additional costs in social security payments (e.g. 50% of the payment of social security insurance has to come from employers) that this entails.

Indeed, ancillary wage costs for employers are estimated to now amount to an equivalent of around 40% of the wage sum. This development, combined with wage rises which in most years were higher than the rise of productivity, continuously increased the cost of labour and threatened to decrease the competitiveness of German goods on the world market. Employers have tended to react by replacing, as far as possible, human labour by machines or work by capital. So rising wages and better social security, while improving the quality of life of the population, also inadvertently killed off job opportunities and contributed to a rise in unemployment whose victims would inevitably have to be subsidised by unemployment benefits and public welfare.

The Social Market also had implications for mentality of the population, too. While individual initiative was still the backbone of economic development in the initial post-WWII years, this was later supplanted by an increasing dependency on the state as the provider of benefits. Germany became a welfare state and most, if not the majority of the population turned into passive recipients who expected to be cared for by a paternalistic state from the cradle to the grave.

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The dangers of these developments have been recognised and attempts have been made to address them over the last couple of years. Reforms which promise to empower individual initiative and proposed and put into effect, and also policies aimed at creating positive incentives for the economy. On the other hand, some voices consider the all-encompassing social system that has developed within Germany as an achievement which should not be changed in substance, but tweaked to make it work better. The political discussions about the pros and cons as well as the extent of such changes are strongly ongoing even today.

Section 7:
Reforming the Social Market

In 2003 the then Chancellor Gerhard Schroeder from the left-of-centre Social Democratic Party (SPD) proposed an ambitious reform package called Agenda 2010 (introduced in conjunction with the Green Party). Its aim was to modernise the structures of the economy and social security system in the widest sense, with the aim of reducing burdens on state and company finances, as well as to improve overall efficiency. It proposed replacing benefits with tax reliefs in some cases but generally safeguarded the stability of the premiums for health and pension insurances. This was to be financed and complemented, along with other measures, by reductions in unemployment benefits and payments of the health- and pension schemes. Furthermore, the protection employees enjoyed against dismissal was to be lowered. It would be useful to here discuss why such changes were thought to be necessary in the first place.

Before this, people who lost their jobs could claim for unemployment payments, based on how much they had earned before. Furthermore, he or she was only required to accept another job if the new position was roughly equal in status and salary to the old one. This regulation was said to be the cause of many Germans seeing joblessness as a kind of early

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retirement and hampered the incentive to look for work.

Under the new regulation, however, in most cases these benefits, which amount to 60-67% of previous salaries, are now to be paid for about only one year and the jobless persons are now required to prove that they are actively searching for new employment. When this period is over, they have to accept any reasonable job offer, even if it is for a much lower rank than their previous positions. The rate of payments will furthermore now not depend on their previous income but according to welfare rates and they will first have to make use of their own assets before they can turn to the state. This reform was meant to provide strong incentives for citizens to not become apathetic about their personal future but instead encourage them to find their way back into employment as soon as possible.

This new rule was regarded as revolutionary, because it represented a radical switch of tendency. Many people demonstrated against the new law in the streets and discontent continued for a long time. Still, the law was accepted in the German Bundestag and even received some support from both the liberal and conservative opposition parties which welcomed the Agenda 2010 as a first step in the right direction.

In fact, when Angela Merkel replaced Gerhard Schroeder as chancellor, she, in a speech at parliament in 2005, explicitly thanked him for Agenda

2010 and for the benefit it had brought to the German economy. Her gratitude was appropriate because only a leftist government could have carried out such painful reforms. Had it originated from the centre-right, such as Merkel's Christian Democratic Union (CDU) or its liberal coalition partner Free Democratic Party (FDP), it would almost certainly have been accused of being anti-social and faced more bitter protests in the streets. The reforms simply could not have happened otherwise.

On the other hand, most economists have argued that Agenda 2010 has contributed to making Germany more competitive in the world market and in reducing the levels of unemployment. The challenge now is that the reforms are losing the support of various parties wanting to shore up their electoral support, forcing the present government to dilute it here and there. There is a grave risk therefore that the spirit of the reforms is vanishing and that Germany will again return to the old situation where unsustainable social benefits are being offered to the populace in exchange for votes.

The key takeaways from these anecdotes are that painful socioeconomic reforms are sometimes necessary to reduce inefficiency in a country's economy, and that these inefficiencies, if unchecked will negatively impact on social security anyway. Another lesson is that one has to be aware that in a democracy, politicians are often not governed by economic rationality but rather political expediency,

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and that this situation can again be detrimental for the country.

To be fair, voters rarely reward policies or initiatives which provide no immediate, measurable advantages for them; most citizens are not interested in the complicated details of how to create lasting growth but vote for those who promise them most money immediately. Populism sells and how to solve this dilemma is a perpetual challenge for every responsible politician, for which no easy solution can be prescribed.

Nevertheless, as citizens mature, they will likewise become more critical of the promises of politicians. At the same time, people simply need to wise up to the fact that growth and progress do not come through 'quick fixes'. Bringing this realization about requires an independent media which provides objective, as well as responsible reporting and commentary on economic issues. Press freedom should therefore be seen as an important component to the process of reform.

Section 8:

Conclusion - A Social Market Economy for Malaysia?

How is the case of Germany and the social market relevant for Malaysia? Let us first examine this Southeast Asian nation currently stands.

First, it is an undeniable fact that the speedily and far-reaching changes of the last couple of decades have unfortunately led to significant distortions. People in Malaysia's developed urban areas earn on an average several times as much as inhabitants of the rural areas; the country's Gini coefficient confirms that Malaysia is still a country in which wealth is distributed very unevenly. Malaysia's Gini figure for 2009 was 44.1, which was an improvement from the 1997 figure of 49.2, but still very much towards the low end within Asia (Germany's Gini, by way of comparison, was 29.0 in 2010).

Second, as economic growth was the overwhelming objective of past policy decisions, environmental conservation did not count for much. The results can be seen everywhere in the country. Much of the damage can now only be reversible, if at all, by spending huge amounts of money. The country's water and air were polluted, causing health risks for the population, abandoned mining sites leave gaping holes in the landscape and flora and fauna were gratuitously destroyed everywhere. The total cost of this devastation is uncountable.

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As mentioned at the beginning, these inequities and degradations have led to an outburst of criticism, not only from civil society but both sides of the political spectrum, leading to a general consensus Malaysia cannot go on as it has. The question is *how* such changes might take place: no one is disputing that they *must* if the country is to survive. The idea of a Social Market Economy offers some solutions in this regard.

Of course, it is outwardly difficult to reconcile the German Social Market Economy with local contexts, for instance, the Islamic idea of a harmonious society of the believers (*the ummah*). For mainstream modern European thinking, such harmony is a religious and not a practical political concept, as it perhaps can be achieved in heaven but not on earth. Sociologists, for example, see conflict as an inevitable feature in any community of people. Some groups can simply never be reconciled. Forcing them into some sort of artificial unity will certainly not lead to harmony, but to greater conflicts. It may provide some short-term quietness, but all this would ultimately signify autocracy or even dictatorship, unstable in the long-run and prone to unrest in its core. This would be a blunt contradiction to the ideals which I see as governing true Islamic thinking, and as recent events in the Arabic world have shown, also cannot be sustained in practise indefinitely.

Malaysians should therefore realize, that progress is very often, if not mostly a result of differences and

conflicts, as distasteful as these may seem. When Copernicus and later on Galileo Galilei proposed their theory that the earth rotates around the sun, this immediately contradicted the long-standing idea amongst the European elites that fervently believed that the exact opposite was true. Harmony was destroyed, resulting in shockwaves that impacted upon Church, State, Science and Society of the time— but can anyone fathom where we would be if these men had stayed silent?

Striving for harmony is therefore to be understood not as an excuse to squelch dissent but rather as trying to create mechanisms that achieve a bearable balance between conflicting interests. The aim is to not let these differences become destructive, but to channel developments into a positive and progressive way, making them useful for the population at large, which in the Malaysian context also includes its non-Muslim communities. If we see the aim of a harmonious society this way, we automatically have a link to what was described in the context of the Social Market Economy on the one hand, and also creates common ground and better understanding of the ongoing reform discussions in Malaysia today.

To avoid tearing society apart and instead foster social cohesion, the necessary reforms have to be carried out. If this reform process is implemented in time and energetically enough, the transition between the old and new will likewise be smooth. An obvious practical example is the environment,

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where the Malaysian top leadership seems to be giving signals that they realise how critical the actual situation is and that they may be willing to carry out pertinent reforms in order to prevent the situation from becoming even worse. How extremely difficult, tedious and time-consuming this process is, however, can also be seen every day.

That further reforms have to happen in the field of the social security system is also evident. Huge tasks lie ahead: financial and not least organisational obstacles need to be overcome as at present some of the responsibility for this issue is divided between various ministries and other institutions. This in turn means that potential rivalries need to be identified and addressed lest they block the reform process.

Any reforms in this sector, anyhow, need to be embedded into a functioning system of justice (meaning an efficient rule of law), and into the work of a civil service which is motivated and qualified to work for the benefit of the whole people rather than political and/or personal interest. Furthermore, it is essential for Malaysian leaders to empower the nation's civil society so that it can work independently for the reasons stated above. Malaysia's social security system therefore cannot be reformed in isolation, but its supporting structures have to be made resilient enough to meet future challenges.

If Malaysia does adopt some form of the Social Market, it would be wise for it to keep the following principles in mind:

1. Creating incentives for employment is much more social than just giving away benefits.
2. It is also important to take into account the legitimate interests of consumers. Consumer protection is therefore just as much a key task for the state as developing an effective administration and effectively fighting corruption.
3. An institutional framework that particularly encourages market transparency and free and open market access prevents cartels from developing.
4. There is still vast room for creating a feeling of responsibility for society amongst the private sector— a recent survey has found that many Malaysian companies have never donated to either social (e.g. scholarships) or cultural (e.g. conservation efforts) causes—in most industrialised countries this kind of engagement is now an integral and indeed normal part of corporate identity and corporate social responsibility. In Malaysia perhaps some ethnic traditions from Islam and other religions may be suitable in inspiring more activism in this context.
5. Providing better education for everyone makes people fit for the labour market, and innovative ideas from well-trained individuals have a strong tendency towards creating new initiatives which then lead to additional employment opportunities and increased income. This is a self-supporting process which also serves the

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whole economy through increased private consumption, and ought to be encouraged.

In nearly all of these elements a high degree of citizen's participation is highly desirable in order to make the system work properly. Indeed, it is far easier to move a country forward by strengthening its people capacities, and removing bureaucratic stumbling blocks would be preferential compared to more state intervention and stifling regulatory frameworks.

Beyond economic considerations, Malaysian policymakers also have to ask themselves as to what the aims of the proposed reforms should be, as far as the well-being of the people is concerned. In this context experts and politicians often talk of equity, which should not be confused with equality and indeed mainly means fairness.

But fairness is an intangible concept, as it means different things to different people. A lot of the present discussion in Malaysia is focused on the continuing social divide in the country, i.e. such as the income disparities between ethnic groups or classes. It has to be realised, however, that this cannot be viewed in isolation, as people normally compare their own situation with that of others and when they realize a negative difference of some magnitude, this leads to adverse reactions.

A study carried out amongst different cultural groups in several countries found a strong sense and longing

for equality everywhere. Even children were said to be able to fathom concepts of injustice and inequality. For instance if another child has more toys than others, the same pattern can be found also in the attitude of adults: one compares and it is not taken well when the distribution of wealth is uneven. The authors of this study came to the conclusion that there is an inherited sense of economic justice which is based upon a sense that people should be equal, at least as far as wealth is concerned. If this truly is the case then the best advice to government, when it wants to achieve harmony is to look towards achieving the greatest equality possible.

Nevertheless, there must be strong reservations to such a conclusion stating that there is in fact a natural, inherited strive for equality. The examples that were given above show something else which is very typical: people tend to react negatively when they compare and find that others have more than them. But when the same people, for whatever reason, become richer than others do they distribute their wealth in order to achieve equality? That happens only in extremely rare cases.

It is not a sense of equality therefore, but of envy which explains the described phenomena. One could go so far as saying that humans have an inbuilt wish not to be too equal to others but rather that we want to improve our own situation. It satisfies most of the people if by this manner they can distinguish themselves from others, being proud of having

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achieved something more. Their desires are in most cases material, but immaterial incentives like public recognition can often also fulfil the same purpose - and recognition, for example, can also be achieved by doing something for the poor. The wish to excel in one way or the other is a powerful force in inciting ambition, an ambition which also can have positive effects for the society at large.

Recent studies by the University of Bonn support this finding. Without going into the details of the study's methodology, the conclusion can be summarised as follows: if several people do the same task and one among them gets informed that the reward which he or she received for his or her endeavours was higher or better than what the others got, this person feels motivated to work even harder. Conversely, if everybody receives the same reward, the motivation of individual participants in the test was clearly lower.

So what we find is yet another complex situation: Seeing others earn more than us makes us feel envious and if that feeling becomes too strong in a society, destructive reactions may occur. On the other hand, positive incentives to achieve more come from selfish motives and to block them may make people more equal, but altogether on a lower material level. Competition is obviously desirable but it can come at great costs. Therefore, there is no simple answer on which ideological underpinning a government should adopt. All the same, two aims have to be fulfilled simultaneously:

1. There is a need to improve the social and economical situation of the less well-off strata of society, in particular by fostering broad-based growth and to install an affordable system of social security. This is because the deficiencies of the current system are manifestly obvious, and because it is regarded as the duty of any civilized state to look after the well-being of its citizens. Furthermore, it goes without saying that it is dangerous for the peace and stability of any country if large parts of its people feel neglected and left out.

2. Both the state and private sector must at the same time provide incentives for individuals to excel and to be innovative for their own benefit, which can then also be of benefit, whether directly or indirectly, to their societies.

The logical solution to this seemingly-endless list of contradictions would be to strike a "middle path" between the various competing social, political and economic demands or visions. For good or ill, Germany's Social and Ecological Market Economy is an attempt to forge such an approach and—its many flaws notwithstanding—it has largely served its purpose well.

It is necessary at the close to repeat the earlier disclaimer that a simple, universal formula towards achieving such equilibrium is not at hand, but

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that government must constantly work towards finding the right balance between these two tasks, in accordance with the changing times. Therefore, Malaysia may be able to draw practical examples and lessons from Germany's experience in creating its own Social and Ecological Market Economy should it wish to embark on a similar path moving forward. I wholeheartedly wish Malaysia and the Malaysians to have a full success on the difficult way towards reform.

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