

# Social Market Economy in the context of the euro-crisis and as a feasible policy option

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## Abstract:

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*The specific model of growth of the German economy has some guiding theoretical principle in Soziale Marktwirtschaft (SMW) (Mueller-Armack, 1956). Although SMW was conceived in the context and with a particular attention to European integration, the present crisis has highlighted how it is difficult to integrate the German economy to the rest of the Europe. The expansionary and deficit-spending-pull policies of the other countries, particularly the "Latin", tend to be difficult to convert into the stability-shaped configuration of Germany. This fact is causing some worry to those who considered the framework of the SMW as a valuable and viable model of economy.*

*The first part of the paper considers in which extent the present German economy can be assimilated to the framework of the SMW. In particular, we discuss three points:*

- 1. how much abandoning income policies, i.e. the policy of blocking salary growth negotiated with trade unions (1999-2011) can be in harmony with SMW;*
- 2. How over-evaluated currency as the euro/dollar at 1,40 can be considered a strong currency in line with SMW;*
- 3. In which case a fiscal stimulus is needed and how it should be performed.*

*The second part of the paper, therefore, looks at the epistemological dimension of the SMW to highlight the fundamental principles that should inform a reform policy in this direction. Moreover, we will discuss how to transform such principles in a set of policies that fit different contexts. The actual issue is that most of the points listed by Mueller-Armack as the fundamental elements of SMW tend to be context specific. As a consequence, a broader perspective on the spirit and history of SMW should be considered, extending the insights to Wilhelm Röpke and other scholars, singling out the true objectives from the instrumental ones.*

*Finally the paper will discuss the exportability of SMW in two specific contexts: in Italy and in Argentina. It will find a relation between the structure of the economy and the reforms needed to achieve such kind of economic order. The result will be contrasted with other competing theories.*

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*Key words: Social Market Economy; Policy-making; European Union; Argentina; Italy.*

## 1. Introduction: 'Social Market Economy' vs. 'the German model'

Euro area experiments some difficulties, mostly due to the consequences that a series of asymmetric shocks had on its different economic systems. As presently conceived, the euro area stability pacts display some unexpected feedbacks, causing further financial instability. Abstracting from the contingent troubles, an interesting aspect for the scientist is the still different response of different economies to economic policies.<sup>1</sup> The countries that applied the Anglo-Saxon model of financial de-regulation with less care (in the most de-contextualised way) suffered a harder shock emphasizing pro-cyclical attitudes of that order. The more you rely on flexible and risk-prone markets in periphery of the euro-zone, the more unstable the economy. Besides that, many countries show some difficulty to cope with rigorous budget constraints and monetary policies that are generally attributed to the will of the German government and to the peculiar theories of its economic consultants. Some economist belonging to the Keynesian tradition have complained for the wrong moment of imposing restrictive policies, some accuse Germany to obtusely apply Ordoliberal principles without any attention to the context (Sapelli) but even some liberal economist accuses Germany of imposing its order to the whole Europe (Savona, 2014).<sup>2</sup> Therefore, the main issue of this paper will be how much the German style of policy-making can be exported and, in particular, what is such model and how much it really derives from *Soziale Marktwirtschaft (SMW)* model of governing the economy.

A deep-through analysis of the previous complains and accuses requires to specify what the German model of policy-making tradition is. That requires some acquaintance with the history of economic thought and with the history of policy-making as well with the theorization of the institutional dimension of the economy. On the other hand, we suspect that Germany recently changed its policies as income policies have been abandoned after 1999. Eventually, in the middle of a demand crisis, Germany applied export-oriented policies, repressing internal demand, principles surely different from the model of the '50 and '60 (Becker, 2015). As a consequence, we will distinguish SMW from Ordoliberalism and from "the German model" or from the so-called 'Rhenish capitalism'.

*Soziale Marktwirtschaft* is an economic policy style mainly popularized by Alfred Müller-Armack and Ludwig Erhard in the three decades of the German reconstruction. It incorporated a synthesis of Christian ethics and solidarism into a free-market economic perspective, recognizing the fundamental role of institutions. Christian ethics did not only supply some fundamental values, but also a method: the "practical approach" to social and economic policy. It acknowledged the fundamental social dimension of the market economy and opposed socialist economic policies.

On the other hand, Ordoliberalism is a neo-liberal movement that begun in the late 1930s mainly thanks to Walter Eucken and Franz Böhm (the Freiburg School), focussing on the constitutional order of the economy. It is called 'liberalism of the rules' as it does not believe in the self-organizing or self-equilibrating properties of the economy. Based on the German experience, it fears the self-destructing effect of free competition leading to concentration, monopolies and bad political influence of concentrated economic power. Consequently, Ordoliberalism studies the shape to impose to economic processes by appropriate rules able to institute a competition order with equal opportunities. Similarly to many scholars, Robert Boyer argues that "In one sense, the philosophy of Ordoliberalism has been transposed at the level of Europe: it was

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<sup>1</sup> Robert Boyer argued that "the resurgence of the German model initially permitted economic stability in the Eurozone, thanks to the control on inflation and a capacity to generate a strong trade surplus, but its triumph as a benchmark and strategic guide for other countries lacking the same structural advantages could well precipitate the systemic crisis in the European structure that the new trend in ECB policy, since the summer of 2012, has so far managed to contain" (Boyer, 2015, p.232).

<sup>2</sup> See also Resico (2015).

appropriate to respect strictly the rules that were negotiated and inscribed in European treaties in such a way as to avoid any one country creating negative fallout for the credibility of the euro”(Boyer, 2015, p.228).<sup>3</sup> These two theoretical positions are related and often taken as one. Actually, they do not integrate perfectly and in the second section some relevant difference will be highlighted.

The ‘German model’ is considered the macroeconomic-institutional view of the ‘Rhenish capitalism’ (which is an industrial model), that is defined as a ‘coordinated way’ of taking strategic decision by corporative arrangements (Albert, Gonenc, 1996). It consists in a growth regime based on a tough discipline concerning wage increase and public expenditure, oriented to obtain low inflation and shared decisions on investments and productivity growth. The industrial relation model is cooperative and corporative; corporate governance is dominated by universal banks as major companies’ owners or delegated in the companies’ boards by dispersed shareholders and by codetermination. A rather generous social expenditure, mostly corporative in kind, complements these institutions. The peculiar aspect of this model is the role of the Central Bank as a controller of wage bargaining and inflation. Therefore, the idea of “German model” is that of a corporative economy where major decisions are negotiated by the main representatives of the major economic interests at stake. In the variety of capitalism literature this model is opposed to the ‘liberal-market economy’ typical of the USA or UK where market prices are supposed to regulate all decisions. Actually, the ‘German model’ of capitalism is equally based on the market logic of adjustment, but through a consensus building process in which the cost and benefits of the adjustment are shared in such a way that all/most stakeholders of the decisions view it as ‘just and desirable’, or at least ‘unavoidable and necessary’. Consequently, while in the ‘liberal-market’ model ‘exit’ is the only interaction mechanism (Hirschmann), in the German model ‘voice’ is important (at least in the fundamental strategic choices)<sup>4</sup>. With enlightened-flexible interest groups, the process could end well, while with sclerotic-inflexible ones it ends badly (Mancur Olson *docet*). This aspect is never mentioned in both SMW or Ordoliberalism and we will discuss how much the actual or stylized model *Deutschland* is close to the aim of these two schools.

A further issue is that many scholars, including Streek (2009), argued that the German model was slowing exhausting. Moreover, reforms of the Red-Green Schröder coalition government (1998-2003) tended to align Germany to the liberal model (abandoning some corporative arrangements) and, in fact, welfare was reduced and inequality rose (Streek, 2015). Moreover, at the beginning of 2000s, income policies were abandoned to regain competitiveness and reduce unemployment. That consisted in three beneficial policy choices: union wage restraint, the Schröder government’s ‘Hartz’ reforms of 2005, and the expansion of short-time wage subsidies in 2009 (Sharpf, 2015). These changes let productivity increase more than wages, cancelling the previous tradition of income policies (in the sense of wage bargaining following productivity

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<sup>3</sup> Maastricht clauses lacked a convenient anti-cyclical component due to the context of the “great moderation” period in which it was drafted, the long period of smooth business cycles before the subprime crisis.

<sup>4</sup> Here, the distinction made by Röpke of three different kinds of adjustment processes in economic policy is relevant. “The first criterion is the one of *Anpassungsinterventionen* (adjustment interventions) versus *Erhaltungsvorgängen* (status quo interventions). Changes in the data of economic process often bring painful adjustment processes for the subjects involved. The government can respond in three ways: it can do nothing; it can stop the adjustment process; or it can accelerate and soften the adjustment processes. The first reaction means *laissez faire*. The second leads to *Erhaltungsvorgängen* (status quo interventions), resisting the dynamic working of price formation. The third point of view leads to adjustment interventions, which serve to soften the adjustments and help the weak groups in their struggle for existence. Through that adjustment support the market mechanism’s working is not affected. It is precisely the intention to come across with measures which make the adjustment process less painful and quicker. Röpke mentions agriculture, handicraft, the small firms, and the labourers as groups which deserve to be considered for adjustment interventions” (Backhaus, Meijer, 2001).

increase). However, Germany has not been transformed from having been the most typical “coordinated market economy” into a perfect “liberal-market economy”, even if more room has been left to finance and banks.

The German model has therefore undergone relevant changes adapting to the so called ‘neo-liberal’ age. In a certain sense, it evolved to be ‘more liberal’ than before and therefore such change is not in contrast with Ordoliberalism or SMW. Besides that, the negotiation of these reforms has been performed in the usual way. Robert Boyer (2015) argued that the German model “has changed considerably since reunification, and it derives its resilience from an ability to reform without sacrificing its logic” (Boyer, 2015, p.202). Martin Höppner affirmed that “in Germany the incentive for negotiation between partners is at the heart of the institutional architecture of Rhenish capitalism. For another, even if the two countries (France is the other) have moved to deregulate their financial system, it would seem that the management mode of German industrial companies has not been completely overturned” (Höpner, 2001 p.221; see also 2003). An interesting question may be how much the recent reforms can be in line with the Social Market Economy. Actually, they have been conceived by a large consensus and negotiation among organised interests and therefore they cannot be said to contradict it. In synthesis: Germany had an institutional model that was only in part comparable to the Ordoliberal ideal, but it has always produced policies in line to SMW.<sup>5</sup>

A final issue is stimulated by the troubles of other countries in the Eurozone and concerns the exportability of Social Market Economy to other economies. Is SMW applicable to a Union as the European? Should it be framed in the form of system competition as Blankart (2014) stated, or could it involve some coordination/solidarity between states? Moreover, as a method of policy-making and orientation of policies, can SMW be successfully applied to other economies? Has it ever been at least partially adopted as a policy perspective by some country? In particular, is SMW exportable to Southern Europe and to Latin countries? This question is difficult to be given an answer in a short paper. At the end of this writing two chapters will be devoted to Argentina and Italy.

## 2. The epistemology of Social Market Economy

German Neo-liberalism includes at least three streams, even if many do not distinguish them (e.g. Peacock and Willgerodt, 1989). The humanistic socio-economic approach of Röpke and Rüstow; the Kantian and phenomenological ‘law-and-economics’ approach of Ordoliberalism of the Freiburg School; the Social Market Economy of Müller-Armack based on Christian values and affected by solidaristic insights.<sup>6</sup> These three streams found deep convergence on ideas of economic policy emphasizing their common adhesion to free-market capitalism, with a very practical and constructive perspective. We should highlight, however, that much convergence between these scholars is due to the specific common enemies – Nazi planned economy and, after the War, the socialist planning – and to the peculiar context of German reconstruction,

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<sup>5</sup> Many aspects of SMW and corporative bargaining system could align and cooperate or deviate and obstacle the logic of the market economy. Ordoliberal institution-making tries to enforce the competition and rational economic logic but taking into account that competition is not “doing nothing” and allowing monopolies and oligopolies to thrive, and that economic rationale is not an unique final objective but is moderated by other human values and ends: ‘menschen Würdig’ economic system, according to Christian Ethics.

<sup>6</sup> Even if not directly by Pesch and von Nell-Breuning, who maintained a more radical approach compared to SMW. Goetz Briefs was a kind of bridge between the economists and the representatives of the Social Doctrine of the Church.

where some radical and fundamental choices had to be done to re-start the country.<sup>7</sup> The three groups of scholars have never been exposed to different context to test whether their answers to policy issues could be different. In fact the humanistic stream exhausted, Ordoliberal school evolved and hybridized (due to Buchanan influence on Viktor Vanberg)<sup>8</sup> and SMW gradually evolved in the personality of the heirs of Müller-Armack, but also lost its grip.

However, while the humanistic approach of Röpke, Rüstow and Müller-Armack are epistemologically fully compatible, they display some different epistemological foundation compared to Ordoliberalism. Firstly, the humanistic approach adopted a social-economic approach, while Ordoliberalism studied the interaction of the economy and the law. As a consequence, there is a different perception and categorization of reality, attributing a different relevance to different theoretical 'objects'. Secondly, the humanistic approach is 'ethical', attributing some primary value to non-economic factors, even if there is a strict interdependence between the market and ethics in Röpke.<sup>9</sup> The Ordoliberal approach avoids, as far as it can, to endogenize a social ethics or the depiction of specific social philosophy.<sup>10</sup> The Ordo approach assumes a peculiar epistemology for the analysis of existing orders inspired by the principles of phenomenology. It therefore studies the ways reality appears to understand the role of social structures as institutions and rules. It also avoids adopting an abstract rationalistic 'equilibrium' view of the markets, looking at the economy as an ordered process. Actually, some ethics remains in Ordoliberalism as rules are seen as ethical in a very Kantian sense, not only pointing to a maximum of efficiency, utility or competition, but in order to design and efficient and '*Menschen Würdig*' economic system). The contrast between Kantianism and the practical approach of Neo-Thomism is well known, the latter assigning a primary role to reasonableness and not incorporating values in rules. Röpke's thought is circumscribes the sphere of 'universal theory' and 'theoretical principles' from the realm of 'practice' where we must use 'prudential principles', i.e. principles which apply to several cases but not always, and have by their own nature an impossibility to reach universal range. Röpke thought that there are some economic theoretical principles and others, mainly in economic policy, that are prudential (Resico, 2011).<sup>11</sup> A different balance of these two epistemological approaches exists in the different schools as SMW is mainly 'practical'.

Therefore, some complementarity can be conceived between these streams of thought, but they should be treated as non totally homogeneous. Even if they share an idea of economic order as institutions governing dynamic processes, as well as they share a liberal view of free-market competition, they may diverge on how they judge situations that are far from a perfect competitive market context. As they work with different tools and aims, when coming to the evaluation of specific aims of policies they can propose different priorities. The reason is due to the different aims that constitute their reference point in practical judgement and even in the process of categorization and evaluation of facts. All this is obviously deduced from texts that had a different context and heterogeneous aims and that rarely got to the point of an open confrontation on crucial issues at stake in this paper.

Müller-Armack (1951) affirmed that the aim of SMW was the conciliation of social aims with the market form of the economy. That was also the main objective of Röpke, ascertaining the

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<sup>7</sup> There is nonetheless a connection between the Freiburg circle meetings before the War (1938) and Christian-liberal opposition to nazism, See Klump (2001) for the history of SMW and Freiburg as well as Cassel and Rauhut (1998) .

<sup>8</sup> See Helmut, (1990) and Vanberg (1988a, 1988b).

<sup>9</sup> It does not assume any procedural/deontological perspective (Vanberg, 2011).

<sup>10</sup> Eucken spoke of '*menschen würdig*' economic system, and he participated in the Christian circles, as well as other members of the 'Freiburg Kreis', so is difficult to separate him from an ethical stance, although in Husserl's or Kantian mode) Rieter and Schmolz (1993).

<sup>11</sup> Scholars closer to Aristotle as Ricardo Crespo (2013) maintain the higher relevance of prudence.

failure of classic liberalism to reach a socially sustainable society. In order to reach this end, Müller-Armack (1951) thought that a synthesis including compromises of the pretences of the different perspectives (social and economic) was necessary. He did not express any abstract model or specific rationalist theory. We would say that Müller-Armack's is a 'practical approach' to policy-making, not an economic theory (Müller-Armack, 1972). That requires a continual critique to what has been achieved (Cassel and Rauhut, 1998).

On the other hand, Röpke went much further, theorizing a reciprocal interdependence between the social and the economic dimension of society. The stability and fruitfulness of a market economy is strictly connected to its ability to keep a fragmented competition framed by social values. That was possible only in a healthy social structure based on reciprocity and solidarity. Therefore, some specific social structure would help keeping a competitive free-market as well as fragmented competition between small and medium sized enterprises (SME) would help reinforcing the values that keep a society in a viable path.

Müller-Armack (1973) defines SMW a 'style', not a receipt or a theory. Therefore, SMW is a way to cope with the complexity of society, a way to control, address and enhance the processes that characterize a political economy. It is based on a 'flexible' and context-relative theorizing as its objectives go beyond pure economic theorizing. Müller-Armack (1973), similarly to Eucken (1950) argues that there is a dualism between the pre-determined historical reality and what can be in fact programmed. Market forces include a foundation drive a historical dynamics that can be shaped and addressed, but that cannot be fundamentally contrasted. So there is a limit to intervention given by complexity of interdependencies.

Social Market Economy was immediately adopted as a 'political economy label' by Erhard that in 1948 first acknowledged it mentioning this formula in a speech. The highest point has been reached in 1972 with the book of Erhard and Müller-Armack (1972) *Soziale Marktwirtschaft Ordnung der Zukunft – Manifest '72*. The peculiarity of SMW as a political economy programme is the attention to the interdependency of freedom and bounds to human action relatively to the general economic order. Above all, a principle shared with Röpke is that concentration of power is negative for a market economy as well as for human beings in the social sphere. Dependency from market prices is the only acceptable dependency and that constitutes the reason for setting market at the core of the social framework. The argumentation by Röpke leans on the statement that market economy is the system which preserves a degree of freedom compatible with human life 'a combination of freedom and order adequate to human nature'. Moreover Röpke says that it will be wise to choose the market economy even when it could be in some cases or in the short run less efficient than other systems based on that normative assumptions. Fragmentation is the main instrument to keep markets in a socially desirable setting – contrary to the Chicago school and the contemporary received approach. Price dependency is seen as less negative than the dependency from persons or things (Müller-Armack, 1951). Economic dependency always degenerates into political and spiritual dependency (Müller-Armack, 1951). That led this approach to state the ethical nature of market relations, which is in any case framed by global end-driven value judgements tailored on the precise idea of person of a Christian society.

Social policy cannot be separated by economic policy. Therefore, the main aim of SMW is the de-proletarianisation of labour, the general rise of well-being, the diffusion of property and peace (Müller-Armack, 1972). The development of small firms and the reinforcing of the small bourgeoisie have been the instruments of this de-proletarianisation, contrary to liberal-progressive policies tending to proletarianisation due to policies favouring large companies and finance. Consequently, compared to other liberal currents, SMW is slightly interventionist and oriented to the result.

### 3. The nature of 'social' and income policy

The core issue of Social Market Economy is the exact meaning of 'social'. Certainly, it does not mean substituting private initiative for public services. It does not specify a mechanism of allocation, a way of organizing production nor a set of goods. *Social* is usually interpreted in a dynamic process perspective because it refers to some end, '*Menschen würdig*'. It may be defined as 'caring for society'. It points an economy in conformity to human nature and needs, a humane economy, that is to say, it refers to the general conditions in which economic processes take place.

As regards social policy, 1) it should be performed by instruments in conformity to the market economy; 2) it should be subsidiary to private intervention (Müller-Armack, 1950b). Müller-Armack affirmed that social policy follows an *irenica* style: conciliation between Catholic social doctrine and the social ethics of Evangelical church.<sup>12</sup> Social means that the end is external to the economy, anchored to a view of a desirable society. Such desirability is not only tied to the reduction of poverty and other social troubles, but it is connected to a positive view of responsible and autonomous individuals actively participating to the fundamental social institutions. The fundamental idea of this kind of liberalism is that a good economic order should prevent social problems to arise (Klump, 2001).

Röpke's social thought advocates a liberalism that is not against social ties. He is critical to massification and atomization of society, what we call individualism. He is in favour of the person and its 'spontaneous' social ties, or communities like the family, the village, the small enterprise, the profession, etc, what we today call *civil society*. On the other hand he made a distinction in corporativism, between one that is "top-down", as in fascism and national socialism, where the state uses or tries to use the associations to control people, and a corporativism that is 'bottom-up' (as in Encyclical letter *Quadragesimo Anno*, he poses) spontaneous and compatible with democratic participation, equality and liberalism (Röpke, 1935; 1946).

As regards German institutions, 'codetermination' is a central feature of German capitalism. However, it was not in the plans of Müller-Armack who expressed some perplexities on its introduction. On the other hand, Boyer (2015) argues that representation of workers, codetermination and collective bargaining are a central aspect of the 'German model', able to achieve objectives of competitiveness in rapid times without sacrificing participation. It has represented a way to share costs in a just way and reduce conflict. It has represented a bound to the expansion of financial capitalism – which also conflicts with SMW. Therefore, there is nothing of codetermination that contrasts with SMW. On the other hand, stabilization of labour by the guarantee of the work-place is a social end, it is highly controversial how much it can be used as a means to the same end – which seldom works well. However, it should be conciliated with other ends.

As regards 'income policies',<sup>13</sup> Müller-Armack (1970) argued that salaries should rise to spread wealth and that is a fundamental social policy. It also contributes to lower inequality. However, it should be paid attention to what salary level companies can bear. Income policy is therefore a way of conciliating social and economic ends, rightly in line with SMW.

From this perspective, the abandoning of income policy at the beginning of the 2000s can rise the suspect of Germany sacrificing SMW to face financial globalization. On the contrary, the compromise reached (to increase wages less than productivity and to make labour contracts more flexible) was reached with the approval of trade unions in sight of regaining competitiveness to reduce unemployment, therefore in sight of social ends. The index of low pay jobs increased

<sup>12</sup> Müller-Armack is nonetheless critical of *Populorum Progressio* (1967, containing aspects too far from a liberal market economy).

<sup>13</sup>The negotiated wage rise in line with productivity increase.

much, but that contributed to reduce unemployment.<sup>14</sup> This policy, seen from an international point of view, has obviously a mercantilist flavour as it was not coordinated with the other European partners, but it is not conflicting with the German internal SMW. So it might be a deviation from the phenomenology of the German model, but 'Hartz' reform remains in the spirit of SMW. It nonetheless rises the question of the proper setting for SMW and its relation to European Union. In fact, when globalization amplifies system-competition, that kind of policies, even if they are the outcome of SMW, are conducive of strains in a Union. In this case, SMW and its social pact has to be extended as much as possible in the Union if not in the international arena.

#### 4. Demand management and monetary policy

An interesting aspect of the 'German model' is the aversion to Keynesian demand management. In particular, *Ordoliberal*s are fiercely against day-to-day government intervention (as it crowds out private calculation). Even if in 1967 the law of 'stability and growth of the economy' has been seen as the end of SMW because it introduced a demand management, no relevant counter-cyclical policy was performed after the beginning of the 1970s (Cassel and Rauhut, 1998). Germany always recovered from crisis with deflationary measures without strong pains of its production structure.<sup>15</sup> This aspect, however, is not necessarily in line with the humanistic liberalism. Röpke, in fact, argued that, in case of deep crisis as that of 1929 and, presumably, that of 2009, some government spending (*Initialzündung*) was needed to restart the economy and not contrary to liberal principles (Röpke, 1932, 1942). Müller-Armack, in general, favoured active business-cycle policy. Recently, Bertram Schefold (2014) affirmed that Ordoliberalism and Keynesianism are two practically successful theories and that it is a damage that they have not managed to find some convergence (actually the aversion is rising). This reflection can be extended to SMW.

However, today, the fundamental issue in economic policy-making is monetary policy. Social Market Economy has no specific theory on this issue. That notwithstanding, we can find some references in Müller-Armack and in other (neo)liberals of the time. In German Neo-Liberal market theories, the 'monetary constitution' has an important influence on business: it supplies the necessary confidence in the currency allowing a reliable calculation of the effects of their actions. That means a 'solid money'. However, in our changed context, it is no more clear what is 'solid money' and which arrangement assures the best reliability of the monetary system.

Before and immediately after the Second World War, liberals had a firm faith in the 'gold standard'. That was in part the result of a reaction to the Nazi regime's economic planning and to the post-war economic control of prices. Müller-Armack (1951) argued in favour of the gold standard because it favours diffuse savings and not the concentration of capitals. It also prevents crisis due to 'forced savings', typical of credit-money regimes. Therefore, the true end of the monetary regime is to prevent financial concentration. That means that, in the past 25 years, a neo-liberal should have seen with perplexity the process of financialisation and the bubbles caused by money expansion to sustain the stock exchange index.

SMW scholars as well Ordoliberal increased their confidence in the 'sound currency' after the remarkable success of the German monetary reform of 1948, considered a hallmark of *Ordo*-thinking. The fundamental institutional set-up consisted on the independence of central bank and

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<sup>14</sup> Boyer wrote that the "creation of low-paid jobs and a cut in social benefits to encourage a return to work – in other words, the equivalent of the "Hartz" programmes to which the resurgence of the German model is often attributed." (Boyer, 2015, p.230).

<sup>15</sup> It should be underlined that the industrial specialisation of Germany allowed this solution. In other economies, as the Italian, that would lead to negative consequences.

rigour in monetary control to assure a low inflation. The three main concerns relatively to the solidity of the currency are related to: a) inflation; b) influence of cycles; c) relationships with the international economic order. In particular, a solid currency should allow for the correct adjustment to world market prices.

Müller-Armack has not studied much monetary problems. Nevertheless, he acknowledged the instability of bank credit. His insights are mostly derived from other liberals of the time as Friedrich Lutz and Fritz Meyer. Interestingly, Friedrich Lutz (1935) argued that a precondition to a well functioning gold standard is renunciation to an internal autonomous business-cycle policy and protectionism. Prices should be flexible and actors should have confidence in the currency. But Lutz and Meyer never considered and extended their study to flexible exchange rates systems (Bernholz, 1989). On the other hand, Walter Eucken in the *Grundlagen* (1950) acknowledges the pure credit money system. In this case, monetary instability is affected by over-expansion of credit. Therefore, a sound currency requires a relevant control of credit. According to Lutz (1935; 1936; 1949), banks create money competitively by granting credit. Excess expansion of credit-money distorts economic processes leading to over-investment (actually credit in excess to savings). This is anyway a long run perspective, but these scholars did not have the chance to observe the multiple bubbles of the contemporary financial system to draw some more specific insight. Eucken argued that an international monetary order should assure the stability of exchange rates and has to act as a stabilizer to prevent both inflation and deflation, more effectively than the gold standard (*Grundsätze*, 1955).

In general, reflections on economic policy tend to assume as a reference the dangers of an interventionist state. They assume that internal disturbances by expansionary policies distort allocation, while they assume a well-formed price system at the world economy level. They do not hypothesize that world market prices could be manoeuvred or affected by speculation.

The issue of what a 'solid currency' is today, in the present context of the supra-national currency, the euro, or of open and globalized economies where exchange rate adjustment is one of the few remaining policy measures left, is open. Monetary theories of contemporary liberal economists appear as rather unfit to the context, still very close to quantitative interpretations of the monetary variable in the economy. The consequence is a tendency to keep a quite restrictive monetary supply, limiting rules to precautionary capitalisation requirements for banks. This approach has demonstrated its incapacity to address credit in the 'right' direction and at the same time has not prevented bad investments, bubbles and hazardous speculations. The consequence is a repression of credit demand of the most meritorious production activities and an over-development of hedging and speculative financial activities. Qualitative control of credit is fundamental. In fact, the poor and counter-intuitive effects of quantitative easing in the Eurozone show that the central bank has a limited scope in this direction by means of pure monetary policy. Qualitative regulation of credit and financial investment activities is the only real instrument to avoid perverse credit booms and the developments of bubbles.<sup>16</sup>

The over-evaluation of euro that reached values of 1,40 relatively to the dollar and the over-evaluation of Argentinian peso in the beginning of 2000s are an interesting example of the fact that the appreciation of a currency does not make it more 'solid' or valuable in the sense supported by German liberals. The increasing international purchasing power of a currency is not a sign of its 'solidity' as it confuses and worsens the calculation of relevant parts of the production system. The fact that some sector is favoured at the expenses of the many is not a sign of increased solidity. The increasing purchasing power at the international level favours the stability of prices in some fundamental sector but tends to produce industrial desertification in some other sector and in some regions.<sup>17</sup> As a consequence a strong currency is not necessarily a 'solid'

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<sup>16</sup> See Resico (2013).

<sup>17</sup> The over-evaluation of the currency led to a massive de-industrialization both in Argentina and in the periphery of Europe.

currency. On the other hand, low inflation is surely a good fact for the 'solidity' of money. But when prices' increases become negative or reach a low level such that some sectors get in deflation, that is not helping producers nor the financial stability. Therefore, the definition of 'solid' currency is a compromise and should not be referred to the only interest of savers or pension funds. This idea of 'solidity' needs therefore some further reflection and theorization.

Complementary to the 'restrictive' idea of 'solid' currency, is the principle that incurring in deep crisis and deflation is a necessary step to recover from bad and over-investment. Debt deflation is sometimes a necessary step because the 'diluting' effect of bad credit performed by economic growth sometimes is difficult to achieve due to the lack of opportunities to increase productivity. Moreover, there are indisputable redistributive effects in inflationary measures to overcome stagnation or financial crises. However, the European experience of the second recession, begun in 2011, shows that, in a deregulated financial system, the costs of deflation are suffered by small and medium sized firms, which are the protagonists of the virtuous dynamics of the SMW. Small firms have, in fact, been hardly penalized by credit policies of big banks, blocking their capacity to produce, expand and create employment.

In Röpke's view, the deflationary-recession is a consequence of the investment misallocation during the boom period, the necessary process induced by market economy is the liquidation of the enterprises who invested wrongly. But this is valid only in 'primary depressions', when people who lose employment in one sector can find employment in other sectors that are not hit by the recession. On the contrary during the 'secondary recession', when the self-enforcing feedback of the recession hits almost all sectors of the economy, the extremely long time required by automatic forces of the market process makes a spontaneous adjustment difficult. That kind of depression therefore requires counter cyclical measures, including fiscal policy. Inducing deflationary-recession by means of economic policy looks nonsense when one is amidst a secondary recession. What in fact Röpke proposed, is preventive policy to moderate the previous boom, mainly through monetary policy, so as to prevent the following collapse due to bubbles' explosion. However, neo-liberals never dealt with crisis made of large global over-bad-indebtedness, therefore, they lack a adequate analysis of these situations.

We are in presence of an unprecedented conflict between managerial and financialized firms, favoured by present policies, and small patronal firms of the 'classic capitalism'. Röpke and SMW argued in favour of the latter. Certainly that happened in another context, but they would have surely doubted of policies favouring managerial and financialized economic organizations. Consequently, a correct interpretation of SMW cannot unconditionally support a deregulated financial system, nor can favour financial institutions against small firms and the real sector. A correct balance between these interests should be maintained, having in mind the word 'social'.

## 5. Hypothetical benefits of applying the 'Social Market Economy' to Argentina

The Argentinean economy, from the long-term point of view, presents a series of specific matters that have caused an impact on its development. On the one hand, this economy presents a history of high volatility, i.e. growth is not produced in a regular way, instead it suffers from a sequence of periods that depict steep highs and lows that contrast pronouncedly.<sup>18</sup> From an economic point of view, high volatility (the "stop and go" cycles) has been associated with an exogenous cause: volatility in terms of the terms of exchange of goods, and particularly of the prices of commodities which the economy exports successfully. Even though this explanation is correct, it's valid only up to a certain extent. It should be important in this sense to explain the

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<sup>18</sup> For a more detailed historical sketch and argumentation on the subject Resico Marcelo (2010) "Institutional aspects of Argentina's development: convergences, conflicts and opportunities", *Revista Cultura Económica*, XXVIII, Nº 77/78, September.

reason why other countries, which also rely heavily on the international prices of raw materials, when performing their foreign commerce, are not so volatile.

Our explanation supports the idea that there is also an endogenous factor, related to pronounced shocks in economic policy and its institutional framework. These shocks, instead of producing a 'counter-cyclical' tendency, on the contrary, exaggerate a pro-cyclical pattern, which augments the volatility. Generally speaking there is a certain pattern, characterised by a dynamic behaviour, where a significant change in the prices of commodities, not only initiates the macroeconomic cycle, but also unleashes a radical change in the economic policies, originated in changing governments with radically different political orientations.<sup>19</sup> Historically, since the first interruption of democratic continuity in 1930, these changes were associated to a pendular movement that involved democratic-interventionist, pro-internal market and pro-labour periods, generally stopped by *coups d'état* by military factions that arranged the adjustment of economic programs, monetary and fiscal stabilization and liberalization policies. But from the recuperation of democracy in the 1980s the cycle was reproduced.

Meanwhile, an hypothesis has been presented in the public debate, which states that the reason for this behaviour is due to the fact that, despite the diverse approximations that the different governments have executed, there is not a common structural base of a political consensus agenda that may be maintained, regardless of the political party which is in charge. This has been evidenced clearly in several fields, including in the economic policies and the institutions that regulate the economy. On the other hand, in the vast majority of the cases of countries where a positive performance of the economic system can be verified, a certain set of policies – economic in this case – are unchanged independently of the ideology of the government in office, granting stability amid a context of reasonable references in order to make decision and performing economic operations in the future. In the SMW, this is referred as the "Ordnungs", and is of vital relevance for a good functioning of the economic policies.

In contrast, the conventional systems of economic theory and policy tend not to consider such requirement. Although the excessive specialization has motivated the steady abandoning of the interrelationships that exists between the different areas – such as the economical, the political and the cultural, which are in fact closely related –, it is true that the discussion of opposite ideas – and their attempt to overcome each other by merely positivist schemes – has restricted the capacity to find common values which may provide a normative base for future more consensual policy decisions.

Needless to say, the task of attempting an analysis of the presence or absence of the SMW in such an unstable economic history is far from being simple. The following of different political-economical, institutional and social focuses – most of the times extremely polarised – have made the SMW impossible to be applied in Argentina in the course of the different periods in time. For instance, the market-based economy approach has been present (for example the presidency of Carlos Menem 1990-1999), though it has undermined the social elements; while in the next period the opposite has taken place (the Kirchner's administrations): an emphasis on the social elements and the presence of the State have eclipsed the formation of a viable market for an adequate functioning of the private sector, being unable to perform efficiently. The sole conclusion that may be obtained from the volatile episodes of Argentinean history is the lack of a strong institutional framework that could support a stable economic policy (including anti-cyclical measures), an essential condition for the correct performance of the SMW.

On the contrary, the SMW requires as a central aspect the existent of institutional quality, based in the effort in finding permanently an acceptable compromise between the different interest groups to adjusting and bearing equitable costs and benefits. These stable 'rules of the game', combine the ones that form the foundations of an adequate functioning market economy,

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<sup>19</sup> Although that may be parts of the same party, often Peronism but not always, which compete for power

as those which regulate the role of the State, both in the design and the enforcement of the laws. Last but not least the State should be able to perform its duties maintaining a positive approach towards subsidiarity, which favours growth and development of a healthy civil society.

Be that as it may, a characterisation through elements can be carried out, taking into consideration the mentioned historical context:<sup>20</sup>

i) regarding the market and its competition system, the Argentinean economy presents phases which oscillate from a protectionist and regulated system, in which public companies have had a significant presence in the 80s, to a period of external liberalization, deregulation and privatization in the 90s, only to return back to a voluntaristic and discretionary approach to market intervention in the 2000s, a time when some sectors were re-statized (pension funds, petroleum, etc.), high taxes (including agricultural exports), together with regulations on foreign commerce and exchange rate.

ii) as regards monetary stability, the country policy and results passed from the hyperinflation phenomena of the late 80s, caused, briefly speaking, by inconsistent monetary and fiscal policies, to an effective stabilisation during the 90s. This was achieved by the implementation of a currency board (convertibility) and granting the independence of the Central Bank, but a structural fiscal and external deficit and the deflationary bias of the approach conducted to an acute recession towards the end of the century and a new crisis. Finally, the current period in which the recession was overcome due to a first phase of devaluation and prudent monetary policies (surpluses in the fiscal and commercial account) twined a rise in commodity prices, that was turned into an expansionist internal demand policy (monetary and fiscal expansion) during the Kirchner's administrations with the return of inflation and recently economic growth and private employment stagnation.

iii) concerning the social policy included in the SMW approach, the pattern of stops and go is also evident. From social policies based on generous public social programmes and stable education and healthcare services, jeopardized by high inflation in the 80s, to a marked abandonment of all this policies in the 90s. This was a period when the trust was placed more on stability and the 'spill over' that economic growth would generate provided by a deregulated market economy, though healthcare and education services rested in public hands. At present, however, social policies and social expenditure in monetary terms has been strongly re-launched, though with an inadequate design, paving the way to suspicion over the existence of clientship and corruption. Although the results have been positive in terms of quantitative poverty and indigence reduction (in a period with high economic growth), there have been less success in coping structural poverty. Also, some of the poverty and indigence indicators have been reversed in the last years due to the slowdown of the economic growth and the rising of inflation.

iv) as regards the labour aspects of the social-economic system, the 80s have been marked by an extremely regulated labour market and by high public employment, while the 90s were known for the privatization and intended deregulation. During that period labour unions limited the labour reform oriented to increase flexibility. The privatization of public enterprises rationalized employment that was reabsorbed to certain extent during the first period associated with economic growth, but during the last period the deflationary recession around the 2000 crisis rocketed unemployment to 22%. In the current administration, the inflexibility of the labour market grew to its maximum extent. Employment and unemployment indicators improved in a significant way following the 2002 crisis as the macro economy stabilized, with a stagnation of the creation of private sector employments in the past three years. The informal employment has remained high, around 35%. The system of labour relations is strictly determined by the traditional trade-union monopolies and its relation with the Peronist Party, though with a slow generational renovation and a slight innovation of more plural movements.

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<sup>20</sup> See Resico (2015).

v) last but not least, the judicial system have been repeatedly altered. The high polarisation in the orientation of economic policies has been consistent with a high contradiction of the normative frameworks, which reinforce both the informal and pragmatic cultural traits that are opposite to the quest for the rule of law and the principle of 'equality before the law'. However, the Constitution has had some traces of structural integration principles, which might allow the development of a SMW. As happened historically for example with the integration of the individual rights of the XIX century constitution with the social rights as a result of the social achievements of the XX century through the article number 14.

The SMW approach has a wider scope than the different narrow economic policy schemes that have been implemented in Argentina's political economy for a number of reasons: It stresses both the political requirements and the institutional context in which specific economic measures can be applied. In the same way, it emphasises political dialogue in order to build consensus, and stable State policies. It is based in the collaboration and interrelationship between the principle of freedom, social justice, and of solidarity, thus establishing a base for the consensus building amongst the polarized positions and groups. In a more concrete level, the SMW states a series of economic measures which balance the positive elements that the market offers, with a coherent public regulation and a network of social policies so as to face the required economic and structural changes.

## 6. Have we ever applied SMW principles to the Italian economy?

The complementary role of formal and informal practices are the fundamental aspects of 'a model' (Schmitter and Todor, 2015, p.374). Informal practices in Italy and Germany diverge. Germans tend to be Kantian and see the respect for rules and pacts as an essential form of morality; Italians, more influenced by classical culture, believe in the good that is beyond any rule and tend to consider rules as instrumental and as relative matters to be continuously discussed. Germans remain stuck on rules even when they are manifestly bad or wrong, Italians do not respect them even when they are evidently good. That determines a difference in civil societies of the two countries.

After the Second World War, Italy has experimented Christian Democratic dominated governments up to 1992 (without any alternation that instead happened in Germany). The political culture of Christian Democrats was shaped by Social Catholicism, one of the inspiring approaches of SMW (Solari, 2007; 2010). For sure, the right-hand part of the Christian Democratic party, as well some social liberal as the President Giulio Einaudi, have been quite close to the principles of the SMW. In this context, Italy faced problems similar to Germany, although enjoying almost full political sovereignty. The policy decisions have consequently been quite similar up to the 1960s, including some consistent monetary policy. It nonetheless had to face severe problems of excess imports and inflationary pressures due to high investments and rising consumption.

Changes in the political orientation towards social democracy happened in the 1960s by changing the weight of internal currents in Christian Democracy, with some substantial change of the policy style.<sup>21</sup> Moreover, Italy had to tackle the problem of territorial dualism – a problem that Germany faced only after reunification and that has also not been well solved. This change led to more direct state intervention and to the public supply of more universalistic services as in the case of health-care. All that led Italy on a different track compared to Germany, particularly for what concerns deficit spending and wage dynamics. The fact is that Italian governments, contrary to the German, were able to keep social peace and curb conflict only by continuous excess

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<sup>21</sup> Obviously, in German the Social-democratic had some experience of government, while the Italian Communist party did not before its transformation into a social-democratic force.

government expenditure. The second main change in policy style happened in 1992, when the political crisis and the Maastricht treaty led governments to change policies in favour of a more liberal-progressive conception of the economy.<sup>22</sup> In this more progressive action, little inspiration was taken from the German model. The source of inspiration was (and still is) Anglo-Saxon liberal-progressive ideology (only a minority still takes French state-capitalism as a reference). That turn led to a major change of direction of policy, even if some heavy burden of the past (public debt and clientship) still affects policies. However, when studying the effects of policies, it is difficult to disentangle effects due to the differences in context from those due to different policy regimes.<sup>23</sup>

Reforms that followed the 1992 political crisis have attempted to turn the system in the direction of Anglo-Saxon capitalism – reforms driven by the interest of financial markets and by a vision of the economy favourable to large managerialized organizations and concentrated control of the allocation of capital. That led to a whole set of inconsistencies in the economic system dominated by SME (small and medium-sized enterprises), with low growth and a decline in productivity (Rangone, Solari, 2012). The introduction of deflationary policies, uncertainty and the fragmented and short-time oriented set of reforms have caused a disorganization of bureaucracy and a counter-intuitive explosion of corruption. Therefore, starting from the late 1960s, we have experienced a constant moving away from SMW and corporative economy, not favourable to decentralisation and fragmentation. The recent transformation of popular banks in regular capital corporations is symbolic of the attempt to centralize and re-absorb peripheral resources by the centre.

As a matter of fact, Christian Democrats favoured small firms, assured a good profit margin to small and individual production activities favouring the fragmentation of the production structure, peripheral accumulation and decentralization. That was reached in many ways, including some regulation and corporative organization (not always well fit). The role and effects of such regulation have been often misunderstood as contrary to free-market (the index of 'economic freedom' developed by the Heritage Foundation always shows a lower level than Germany), but had nonetheless the task to keep a situation of fragmented competition and high profit opportunities. That favoured small entrepreneurship as a vector of social mobility, leading to the deproletarianization of semi-rural masses. Industrial districts and the unparalleled expansion of small firms are an important achievement of this policy that, without any doubt, goes in the direction of the SMW. This structure of the economy, although not in the vanguard of R&D and surely complimentary to large organizations, constituted a kind of fly-wheel for the economy.<sup>24</sup>

For what concerns social policy, a primary role has been acknowledged to the family in managing redistribution and assistance – according to the principle of subsidiarity. Only in the 1970s some reforms pointing at the universality of services has been achieved, leading to the so called 'Mediterranean welfare state'. In general social expenditure is much lower than in Germany, with the exception of pensions, which have been more generous to support the 'male breadwinner' model of family (according to the liberal critics). Contrary to SMW principles, little recourse has been done to the private insurance mechanism, but the social and economic context was not favourable to capitalize savings. That was due to three main reasons: a) the excessively fragmented nature of Italian corporatism, b) the need to urgently redistribute resources to solve the structural transition from agriculture to industry and to c) the weakness of the capital market dominated by powerful insiders.<sup>25</sup>

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<sup>22</sup> Berlusconi's governments have been not so incisive and had more the role of slow down changes than to go back to a conservative policy style.

<sup>23</sup> Schmitter and Todor (2015) propose a good structure of the differences of Italy and Germany.

<sup>24</sup> See Marangoni and Solari (2006).

<sup>25</sup> That was certainly not due to liberal-progressive visions of welfare.

Monetary policy performed by the Bank of Italy has been rather rigorous up to the end of the Bretton Woods system.<sup>26</sup> Bank of Italy always had to counterbalance strong inflationary pressures due to many sources of tension (deficit spending, over-investment, social conflict...). In 1982, the 'separation' between the Bank of Italy and the Finance Ministry produced a formal independence that is still higher than that of the *Bundesbank* (which is still buying large amounts of un-opted Federal Bunds at their emission). That separation instead of granting a 'solidity' of the lira caused an explosion in interest rates and, consequently, in the service of the public debt. Most of the responsibility of the debt explosion is to be found the weak governments unable to control budgets. On the other hand, the menace of rising interest rates, conceived to set some discipline on governments, was not effective and the effect was a disastrous rise in public debt. Nonetheless, this is the evidence that the real monetary issue is not simply the independence of the central bank but a consistent institutional order: in order to have a 'solid' money you need a solid economy and a compact society. That aspect is still lacking in Italy, which is too heterogeneous and conflict ridden to achieve a synergetic order.

There are characteristics of the Italian government intervention that are totally incompatible with SMW. The most important is that Italian governments are prone to cheat citizens by unpredictable changes in rules and policy. Bureaucrats are convinced that: a) the only policies that work are those that surprise citizens; b) in order to have effective results, rules and policies have to constantly change and anticipate the (too) adaptive aptitude of Italians. This aspect is at the opposite of the philosophy of SMW and it is also responsible for a lack of trust in the Ministries' bureaucratic action. Tax evasion is due to both civil society lack of discipline and to chaotic legislation and bureaucratic action. In any case, such low level of tax compliance is not compatible with SMW.

In Italy income policy has been an exception. It has been attempted sometimes (Ciampi is the last) without constancy and success. The reason is due to the difficulty of mediation between the conflict-ridden confrontation of trade unions and entrepreneurs' organizations. This lack of agreement has led to inflation, unstable exchange rates and monetary disorder which are incompatible with SMW.

On the other hand, state intervention has been too extended and too generous with private capitalism. The origins of this over-intervention are rooted in fascism and in territorial dualism. However, instead of following the German model where intervention is based on some relevant local-state property of large enterprises – although not prone to assist private capital – Italy has always centralized such intervention by the bad attempt to gain a political rent by redistributing resources.

As a conclusion, Italy has only partially and not constantly adopted policies comparable to SMW. We can resume the situation in three points:

- decentralization of industry has been the most effective policy in line with SMW. On the other hand, the general policy style was not in line with it and civil society is not sufficiently disciplined to achieve a synergetic order.
- Italy had a difficulty to have a solid currency, but that was more due to real economic, political and social factors than to the policy of Bank of Italy. Recently, the imposition of deflationary policies to control inflation and the public deficit had a destructive impact on industry and, particularly, to small industry, contradicting one of the central points of SMW. Therefore, without a spontaneous discipline, deflationary policies have a non synergetic impact leading away from SMW objectives.
- The external imposition of discipline is not particularly effective. The formal European coordination through 'system competition' that assures to each country its autonomy and responsibility failed. It neglects centripetal forces and the fact that in presence of

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<sup>26</sup> In 1964 it also caused the first recession of the post-war period by rising interest rates to relent excess imports and inflation.

heterogeneous economies, different macroeconomic policies are needed to keep the economy going: too many macroeconomic ties is not a symptom of virtue, it is a deadweight for the most fragile territories.

## 7. Conclusion: is SMW exportable or possible to enact in a Union?

Liberalism is experiencing one of the most intense cleavages between the ideas of its progressive, managerial and financialized, part and its social or ethical part, closer to Social Market Economy. The latter have probably not sufficiently complained when assisting to financial-oriented reforms of the last 30 years. There is a general clash between the political economy of SMW and contemporary economic style of progressive-liberalism dominated by managerialism, large organizations and financial bubbling.

In conformity with the pessimism that Piero Bini (2014) has revealed existing among Italian liberals on the quality of Italian civil society, SMW is difficult to install in a society that has some unresolved conflicts and difficulties to reach consensus on policies. As we have discussed in this paper, SMW is not only a macroeconomic policy. It requires a coherent set of requirements going from civil society to the integration of intermediate institutions. Moreover, lack of rule-compliance is certainly not compatible with SMW. In both Argentina and Italy, the political instability makes it difficult to enact policies and enforce institutions good to proceed in the direction of SMW. Italy has even abandoned the track.

The exportability of SMW therefore is bound to a well ordered society, including the political institutions able to vehicle consensus in a non conflict-ridden way. It is a mistake to interpret the economic policies in recent times applied by the European Union as Ordoliberal or as aiming at exporting SMW. Budget constrains, compliance to rules and agreements and deflation are simply the macro-economic requirements of a SMW policy style. All the other parts of SMW, these are damaging policies in times of deep recession. Moreover, policies applied in Southern Europe contradicted Eucken's dualism (dualism between the pre-determined historical reality and what can be in fact programmed): they attempted to do what was not possible to do in reason of the past historical reality.

On the other hand, a Union that has a quite compact and ordered society at its centre (Germany) and some precarious and unbalanced economic structures in its periphery is prone to failure. Real unbalances cannot be cured with macroeconomic rigour. The separation between the Treasury and the Bank of Italy has already testified that the application of rigour to disorder tends to produce disasters.

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