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THE ECONOMIC POLICY BALANCE SHEET OF THE ERA MERKEL

AN ERHARDIAN PERSPECTIVE

INTRODUCTION

In the September 24, 2017 federal election Chancellor Angela Merkel's Christian democratic political alliance of Christian Democratic Union (*CDU*) and Christian Social Union (*CSU*) emerged again with the largest portion of the vote although it was the worst result since 1949, the first time national elections were held in post-war Germany. She will therefore most likely serve her fourth term in office making her Europe's longest serving leader.

One of the most important reasons for her re-election is seen in the strength of the German economy (McRae 2017). During her 12 years of chancellorship Germany turned from Europe's sick man into its powerhouse and economic locomotive. Some even speak of a second economic miracle (e.g. Economist 2011). Since she took office in 2005 unemployment has halved from 11% to 6%, trade surpluses have been soaring reaching 8.5% of GDP in 2017 and since 2014 the country is also running a budget surplus that increased from 0.3% in 2004 to 1.0% of GDP in 2017 (Sachverständigenrat 2017, p. 22). This development is even more surprising as it has been happening against the background of several crises: the global financial and eurozone crises of 2008, and since 2015 in addition the migration crisis as well as the general crisis of the European Union following the United Kingdom's Brexit vote of June 2016.

This raises the question whether this surprisingly positive economic development must be attributed to an extraordinarily sophisticated economic policy of Angela Merkel's chancellorship. Angela Merkel's *CDU* is the party to which the father of (West) Germany's first post-war economic miracle (*Wirtschaftswunder*) was affiliated, Ludwig Erhard. He was the Federal Republic's Economics Minister from 1949-63, and Chancellor from 1963-66 and kick-started West Germany's post-war impressive economic recovery with the introduction of the social market economy – Germany's post-war economic system. And in fact, in the election campaign of 2003 leading to her first chancellorship, Angela Merkel and her *CDU* were often referring to Ludwig Erhard and advocating a reorientation of economic policy towards a new social market economy (see *KAS* 2003). Therefore it could be expected that the positive economic indicators of Merkel's chancellorship is related to the implementation of economic policy principles characteristic for Ludwig Erhard.

The aim of this article is to examine to what extent this assumption holds. In doing so the paper not only takes stock of Angela Merkel's economic policy, but also attempts to explain her economic policy choices. Theoretically the paper refers primarily on insights of a variety of schools of economic thoughts that build the theoretical foundation of the social market economy and provide explanations for policy choices. These are in particular: the ordoliberal Freiburg School, the Austrian School, New Institutional Economics as well as Public Choice Theory. Empirically the analysis draws mainly on media reports, web-sources and descriptive official statistics. The paper contributes to the literature in two ways. First, it adds to the debate on the balance sheet of Angela Merkel's three chancellorships by focusing on the economic policy. Second and related to that, for the evaluation and explanation of this area of policy the study highlights theories and strains of economic thinking that substantiate the importance of competition as a means to cope most effectively with epistemological and political economy problems in order to ensure freedom, prosperity and peace.

Tracing the influence of Ludwig Erhard on Merkel's economic policy requires understanding what principles of economic policy were characteristic for his understanding of a social market economy. Therefore, the paper first works out these traits in order to specify the normative reference model of the subsequent analysis (section 2). Section 3 discusses to what extent major economic policy decisions of Merkel are in line with it. Then section 4 provides explanations of her policy decisions. The paper ends with concluding remarks (section 5).

NORMATIVE BENCHMARK: LUDWIG ERHARD'S PRINCIPALS OF ECONOMIC POLICY

The tremendous success of Germany's post war economic development is related to the implementation of an economic system by Ludwig Erhard that became known as the social market economy (*soziale Marktwirtschaft*). This term was coined by the economist and sociologist Alfred Müller-Armack (1901-1978) in 1945, who worked in Erhard's ministry for the economy as state secretary for European Affairs. He sought a "new synthesis" of market freedom and social protection and at the same time a reconciliation of different ideologies. The fundamental problem of this concept is its vagueness, because the importance of the adjective "social" and its relation to the noun "market economy" has never been specified. This makes it actually an empty slogan, because diametrically opposed economic policies such as a free market *laissez-faire* policy and heavy welfare state interventionism can both principally refer to it.[1] Already in the early days even between Müller-Armack and Erhard there were different views on how market freedom has to be reconciled with social protection. Alfred Müller-Armack, who consciously has written the adjective "social" in the

[1] In fact, even the socialist left-wing party "The Left" (*Die Linke*) refers to Erhard in defence of its policy propositions (see. e.g. *Spiegel Online*, 30 January 2013).

term social market economy with a capital letter (*Soziale Marktwirtschaft*), viewed economic freedom and social security as conflicting objectives. Therefore, he (1952) advocated a separate active social policy based on the redistribution of income produced on the "free" market. This view of social market economy became popular in West Germany from the late 1960s on.

By contrast, Ludwig Erhard did not consider market freedom and social security opposing ends. Instead he (1966, p. 320) was convinced that "the freer an economy is, the more social it is", because only economic growth can eliminate poverty and make inequality of income distribution irrelevant. Hence, for him the solution to social problems "is not to be found in dividing but in multiplying the national income" (Erhard 1958a, p. 163). Consequently, Erhard (1958a, p. 186) regarded economic and social policy closely related stating "The more successful economic policy can be made the fewer measures of social policy will be necessary." For him the social market economy was first and foremost a market economic system that actually does not need any by-word.[2]

If social support is needed, it should be provided following the principle of subsidiarity. It gives priority to individual over collective provision of social assistance. Erhard (1958b) viewed nothing more unsocial than the so called welfare state, which erodes human responsibility, individual efforts and performance. Instead, the ideal he (1958a) cherished "is based on the strength with which the individual can say, 'I want to meet the risks of life myself; I want to be responsible for my own fate. You, the state, must see to it that I shall be in a position to do so.' The cry must not be 'You, the state, come to my aid, protect me and help me,' but the other way around: 'Don't bother with my affairs, but give me sufficient freedom and leave me enough from the results of my labors so I can shape my own existence, and that of my family.' "

Hence, central to Erhard's understanding of the social market economy is a high degree of individual freedom, private initiative, responsibility as well as entrepreneurship and competition unleashed, maintained and protected by an appropriate institutional framework (see also Erhard 1958a 7/64, p. 117ff). The task to create and ensure these institutional preconditions for such a competitive order is conferred to the government and its role should be limited to this and only this function. Such a policy is called in German *Ordnungspolitik* (a "policy of order"). But the government should not intervene in the economic process to favour particular sectors, firms, or groups of society, but leave price-setting and resource allocation to market participants. It is therefore not by mistake, that in the English version of Erhard's famous book "Wohlstand für alle" the title has been translated into "Prosperity through competition". It is thus against this benchmark of a competitive market order based on a maximum degree of individual freedom, initiative and responsibil-

[2] This becomes obvious in the following statement of Erhard from a conversation with Friedrich August von Hayek in which he emphasized: "I hope you don't get me wrong when I speak of the social market economy. I do not mean that the market has to be made social but that it is social in itself." Quoted in Hayek (1988, p. 117).

ity that the economic policy of the era Angela Merkel will have to be assessed. This requires investigating if and to what extent her policy decisions strengthen competition and individual freedom.

These normative conclusions of Ludwig Erhard rest on theoretical insights that have been and still are put forward by several related schools of economic thought – most prominently by economic thinkers from the ordoliberal Freiburg School, from which some of the most known scholars formed Erhard's inner circle (Walter Eucken, Wilhelm Röpke and Alexander Rüstow), but also from the Austrian School around F. A. von Hayek and Ludwig von Mises as well as more recent approaches of New Institutional Economics and Public Choice Theory. Individual freedom is crucial for two reasons. First it is a value of its own that constitutes each person's dignity which the Freiburg ordoliberals derived mainly from a Christian perspective (e.g. Eucken, Röpke, Rüstow, Müller-Armack).[3] Second, it is valued from an utilitarian stance as the best way to unleash people's creativity and so to boost welfare of individual as well as of society as a whole (Eucken 1952/90, p. 155ff).

Competition is central in the Erhard understanding of a social market economy both as an instrument to constrain power and as a discovery procedure. Competition curbs economic as well as ensuing political power and so safeguards individual freedom by giving the opportunity to choose and run away from bad to better transaction partners. That is why Böhm (1961, p. 22) called competition as "the most genial disempowering instrument." Hayek (1978, p. 179) has highlighted competition's function as a discovery procedure of what's needed, who needs it, and who has the means to meet these needs. Through the changes in relative prices along with the lure of pure profit and the disciplining penalty of loss competition mobilize the available bits of scattered knowledge which are fragmented among the millions of individuals who compose society to ensure a high level of prosperity.

Institutional economists confirm and advanced the insights of the Freiburg and Austrian School about the fundamental importance of the institutional framework for the nature of the economic and societal system as they determine the range of individual freedom of action and structure the incentives underlying individual action. Empirical studies widely underscore the positive impact of economic freedom on economic development and prosperity (e.g. North 1990; North et al. 2012; Olson 2000; de Soto 2000; Acemoglu and Robinson 2012; Hodgson 2015). Public Choice theory shows that politicians are no benevolent social wealth maximizers but as much as economic agents self-interested actors. Policy-makers are not only exposed to the pressure of interest groups seeking selective benefits that provide them advantages over rival firms. They have themselves an incentive to supply rents to secure re-election and retain power (Buchanan 1987). Hence, this, too, necessitates appropriate rules of the game to prevent and limit the arbitrary use of political power.

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[3] For more detail see e.g. Goldschmidt (1998) and Hien (2017).

MAJOR ECONOMIC POLICY DECISIONS

Two years before her first chancellorship in 2005 Angela Merkel advocated on the party convention of the *CDU* in 2003 in Leipzig an economic policy that appeared much in line with the principles Ludwig Erhard stood for. She called for a reorientation of the social market economy towards more market that strengthens individual initiative and responsibility. Among other she promoted a market oriented health care reform and supported the proposal of Paul Kirchhof, a no party-affiliated legal scholar, and of *CDU* party mate Friedrich Merz of a radically simplified tax reform with a flat income tax and the abolition of most exemptions, so that the tax declaration could be made on a "beermat" (*KAS* 2003; SZ 2014; Geppert 2017; Koerfer 2017). However, when she had become chancellor in 2005 her major economic policy decisions pointed more and more to the opposite direction. Table 1 depicts the key policy measures of Merkel's three cabinets. It shows that only the first cabinet based on the grand coalition of *CDU* and *SPD* has undertaken some minor reforms towards strengthening market forces. Since then all important policy decisions stifled market forces and strengthened redistribution. This is in stark contrast to the normative benchmark set by Ludwig Erhard (see also Horstmann 2015).

Table 1

Major economic policy decisions of Merkel's three cabinets

Cabinet	Strengthening market forces	Stifling market forces	Redistribution
Cabinet I *CDU/SPD* 11/2005 – 9/2009	Pension at the age of 67 (2006) Business tax reform (2008/2009) Debt break (2009)	Increase of VAT to 19% extensions of short-time working arrangement stimulus packages (2008-2010) credit and guarantee scheme (2009)	
Cabinet II *CDU/FDP* 10/2009 – 10/2013		Acceleration of the energy transition (2010/2011) National development plan e- mobility (2009)	
Cabinet III *CDU/SPD* 10/2013 – 9/2017		women's quota (30%) (2013) nationwide minimum wage (2014) rent break (2015) Reform of the employee lending law (4/2017) Premium for the purchase of e-cars (5/2017) Wage adjustment law (07/2017)	Care allowance (2013) Pension at 63 (2014) Pension payments for mothers (2014)

Source: Own depiction

Restraining market freedom: Taxation and price regulation

The only steps towards more market freedom in all three cabinets of Angela Merkel were the 2008 tax reform and the 2009 debt break. While pointing in the right direction in view of the demographic challenge, the 2006 decision to prolong the working age until pension to 67 years has been repealed in 2014 by the second grand coalition. However, even the tax reform of 2008 falls short of the radical reform plans of Paul Kirchhof and Friedrich Merz. The main goal of the 2008 reform was to reduce the tax burden in tandem with diminishing tax exemptions and broadening the taxable base in order to make Germany more competitive and to keep taxable profits in the country. The most important decision was the reduction of the corporation tax rate from 25% to 15%, the adjustment of the taxation of retained profits of enterprises subject to the income tax to the taxation of retained profits of corporations to a rate of 28.25% plus solidarity surcharge (and not with the individual income tax rate which can be up to 45%), the reduction of the basic tax rate for the trade tax from maximum 5% to 3.5% of the earnings, and a flat tax of 25% plus solidarity surcharge and church tax for income on capital.

Despite the reduction of the corporate tax, the German tax system has lost nothing of its complexity and did not increase noticeably the attractiveness of Germany for investment (ZWE 2012). Corporate taxation in Germany is relatively high compared to other EU member countries. From the big four EU member states only France has a higher tax burden on corporations. With its corporate tax rate of 30% since 2010 Germany ranks only 25 out of 28 member countries and quite below the EU average of 23% (*Bundesministerium der Finanzen* 2017a). The debt brake generally requires a self-restraint of the ruling politicians to restrict indebtedness. This can improve the predictability of economic policy while at the same time reduce crowing out effects on the capital market and so strengthen private investment. However, it remains to be seen to what extent the debt brake will really be applied, in particular when in times of crisis the call for Keynesian fiscal stimulus intensifies (Klodt and Klooths 2017).

The most drastic interventions into the free market were the introduction of the nationwide minimum wage and the rent break. They attack the heart of the market economy, namely the free price mechanism in pursuit of specific market outcomes (Erlei 2014). In doing so, the government distorts price signals, and with it the economic incentives and economic signals that actors use to coordinate their behaviour. This causes misallocation of resources as well as redistribution of income which is all well-known from textbooks on basic economics.

So far the minimum wage has not yet led to a noticeable increase of unemployment of low-skilled workers. However, it must be taken into account that the identification of the effects of a nationwide minimum wage is difficult due to methodological problems (for more details see *Sachverständigenrat* 2015, p. 253ff), and with only two years after the introduction of the minimum wage there are not enough data available for a comprehensive assessment. Moreover, adjustments on the firm level take time, and finally, the current economic boom may have offset the negative incentives for employment of the minimum wage. Nevertheless, according to the 2015/16 annual report of the German Council of Economic Experts (*Sachverständigenrat*), the reduction of the working time for part-time workers and higher consumer prices in services branches mostly affected by the minimum wage are tentative indications for evasive responses. In the medium and long run the minimum wage may become a high entry barrier for the high number of migrants with low qualification. Likewise the price ceiling in the rental market will worsen rather than alleviate the scarcity of affordable housing as reports confirm (*FAZ*, 2017; *IW* Köln 2017). A similar assault on economic freedom, in particular on freedom to contract and on private property rights is the obligatory quota of women on boards of large corporations and the wage adjustment law. All these interventions resulted in a regulated economy that worldwide places 26th (down from 17 in 2015) and in Europe 15th (down from 7 in 2015) in the latest 2017 Index of Economic Freedom Ranking of the Heritage Foundation (2017).

The pretence of knowledge: energy transition and electromobility

Free market forces have almost completely been liquidated in the energy sector in the context of Germany's energy transition to renewables (*Energiewende*). This policy is not only a further example of the distrust into market forces of Angela Merkel's cabinets but also of what Hayek (1989) called pretence of knowledge and an extreme case of rent-provision and rent-seeking.

Although the transition of Germany's energy system from nuclear and fossil fuels to renewables has been initiated in 2000 under Gerhard Schröder's red-green government, it has been speeded up after the Fukushima disaster in March 2011 by Angela Merkel. The so called "Energy Packet 2011" of the same year set the ambitious target for Germany to increase the share of renewable energy in gross energy consumption to 60% and in gross electrical consumption to 80% until 2050 without using nuclear power. Similar to EU's Common Agricultural Policy (CAP) until the 1992 the German government supports renewable energies based on a combination of above-market minimum prices and guaranteed sale. More than 5,000 feed-in tariffs based on the cost-plus principle above-market price for electricity production from renewable sources, differentiated by type of technology and other provisions (e.g. site, system services, etc.) are guaranteed for a period of 20 years. Since renewable sources have by law always grid priority producers do not have to care how to market their electricity. This support for renewable energies is financed by a surcharge on the final consumer of electricity. So it is politicians and not market competition in its function as a discovery process that determine the future energy mix using financial incentives and coercive legal measures.

As all cases of interventionism Germany's renewable energy policy has a number of cobra effects such as a surge in renewable energy production, yet with uncontrolled loop flows, the reward of the most inefficient technology, which proved to be internationally uncompetitive, perverse redistribution of income from poor to rich households, the highest electricity costs in Europe and no effects on CO^2 emissions reductions. Instead there are ecological backlashes on the landscape, flora and fauna as well as the creation and strengthening of a host of interest groups with vested interests that make it extremely difficult to implement profound reforms in the near future (Haucap 2017).

In spite of these well-known negative effects a similar policy scheme is currently discussed with regard to the automotive industry under the motto *Verkehrswende* to promote e-cars (see e.g. Gastel 2017). According to the national development plan of electromobility of 2009 one million e-cars shall be put on the street by 2020. In April 2016 Angela Merkel's grand coalition decided to provide subsidies to promote sales of plug-in electric vehicles with a budget of €1 billion. Electric car buyers get a €4000 discount while buyers of plug-in hybrid vehicles get a discount of €3000. Yet, so far consumers in Germany have been reluctant to buy battery-powered models amid concerns about driving range and charging times so that the Merkel one million e-car target is far out of reach (Tichy 2017).

In many other fields of economic live the government tries to stir activities and behaviour with direct subsidies and tax reliefs. According to the Kiel Institute for the World Economy (*IfW*), rent-provision through various forms of subsidies reached its highest level in 2015 since 2000 with a total volume of 168 billion euros. That is an increase by 20 billion (Laaser and Rosenschon 2016). In particular subsidization in the social and non-profit sphere (e.g. health system, childcare) increased from a share of 30% to 46% in 2015.

Redistribution of income

In fact, most economic policy measures of all Angela Merkel's government aim at redistributing income and maintaining the welfare state. This includes the reduction of the retirement age from 67 to 63, the payment of retirement for mothers and about 160 family policy measures.

Payments for social matters in the federal budget remain at a constantly high level accounting for on average 40% of all expenditures. Between 2006 and 2017 their volume doubled from 63 to 137.6 billion euros. It is expected that the share of expenses for social matters might rise until 2020 to 50%, especially due to rising pension entitlements (*Bundesministerium der Finanzen* 2017b). According to Klodt and Kooths (2017) meanwhile almost 900 billion euros per year are redistributed in Germany's social security system. This is nearly 100 billion more than three years ago and equals 30 cent of each euro earned by the German citizens. As a result the tax and social contribution burden and the share of *GDP* claimed by the government stagnate at a relatively high level. The overall expenditure-to-*GDP* ratio has remained almost constant at 44% since Angela Merkel took office in 2005. This is slightly below the EU 28 average of 46% in 2017 (*Bundesministerium der Finanzen* 2017c). However, the tax and social contribution ratio to *GDP* has continuously increased during Merkel's three governments from 38.5% in 2005 to 40.6% in 2017 (see table 2). Only in 2010 it slightly decreased due to temporary tax relieves in the context of the government's short-term anti-crises measures. While this is almost equal to the EU-28 average it is 6 percentage points above the OECD average and places Germany 12th out of 35 OECD countries (OECD 2017a).

Table 2

Tax and social contribution ratio to GDP in selected OECD countries 2000-2017

	2000	2005	2010	2013	2014	2015	2016	2017
European Union – 28	*:*	*38,7*	*38,4*	*39,9*	*39,9*	*39,7*	*40,0*	*40.2*
Eurozone (19 countries)	*40,8*	*39,5*	*39,2*	*41,3*	*41,4*	*41,2*	*41,3*	*41.1*
OECD average	*33.9*	*33.5*	*32.5*	*33.6*	*33.9*	*34.0*	*34.3*	-
Germany	*41,5*	*38,5*	*38,2*	*39,6*	*39,6*	*39,8*	*40,4*	*40.6*
Estonia	31,2	30,1	33,5	31,8	32,8	34,0	34,7	33.7
Ireland	32,0	31,4	28,4	29,5	29,7	23,9	23,8	23.8
Spain	34,1	35,9	32,1	34,0	34,5	34,5	34,1	34.4
France	44,6	44,5	44,0	47,4	47,6	47,6	47,6	47.8
Italy	40,2	39,2	41,7	43,8	43,4	43,3	42,9	42.8
Poland	33,9	33,9	32,4	32,9	32,9	33,3	34,4	35.1
Sweden	49,4	47,2	43,8	43,5	43,2	43,6	44,6	44.0
United Kingdom	34,5	34,8	35,0	34,5	34,0	34,5	35,1	35.0
USA	28.5	26.3	24.0	26.1	26.5	26.8	26.4	26.3

Source: *OECD* (2017b); *Bundesministerium der Finanzen* (2017a, pp 10-12),

Like in most EU member countries, except for the Baltic countries, the Czech Republic, Hungary, Bulgaria and Romania, personal income is taxed in Germany with progressive rates ranging from 14% as the starting to maximum 47.48% (including solidarity tax). This is eight percentage points above the EU-28 average rate and ranks the country 15th of all member countries (*Bundesministerium der Finanzen* (2017a, p. 33). What is problematic about it is that Germany's steeply progressive tax rates hurt in particular middle income households. Already an annual income of 35,700 euros is taxed with a total rate of 45% including solidarity tax and a yearly income of 54.058 euros with the maximum total tax rate of 47.48%. This sudden push into a higher tax bracket occurs automatically when pay rises only to compensate for inflation. This effect is called "cold progression" or bracket creep. As a result taxpayers can buy less with their net income (*Sachverständigenrat* 2017, p. 24).

This taxation system is also one reason why private wealth creation through asset ownership is small in Germany. Most prominently the Household Finance and Consumption Survey (*HFCS*) by the European Central Bank of 2013 showed that German households have fewer assets than eurozone households have on average and even fewer than those in the troubled peripheral nations of Greece, Spain and Italy. Germans not only own relatively little real estate but also less financial assets than it is commonly the case in the eurozone. Rather, German households put their money on the bank account for zero or even negative interest rates. This makes them later in an age when they become pensioners increasingly dependent on government support. However, given the demographic imbalance with an ageing population these state pensions will not be sufficient to make ends meet.

This is precisely what Erhard wanted to prevent. He viewed private wealth formation through ownership of assets (real estates, stocks) the best insurance against social emergencies and from becoming depended from the state. Therefore, he always advocated far less state involvement and redistribution than today's high level. Instead he called for individual self-responsibility to make provisions against unforeseen hardships. Erhard (1958a, p. 187f.) warned that "if we increasingly adopt a way of life in which everyone seeks security in collectivism "we shall slide into a social order under which everyone has one hand in the pocket of another*"*, that slowly but surely will "kill the real human virtues – joy in assuming responsibility, love for one's fellow being, an urge to prove oneself and a readiness to provide for oneself – and in the end there will probably ensue not a classless but a soulless mechanical society".

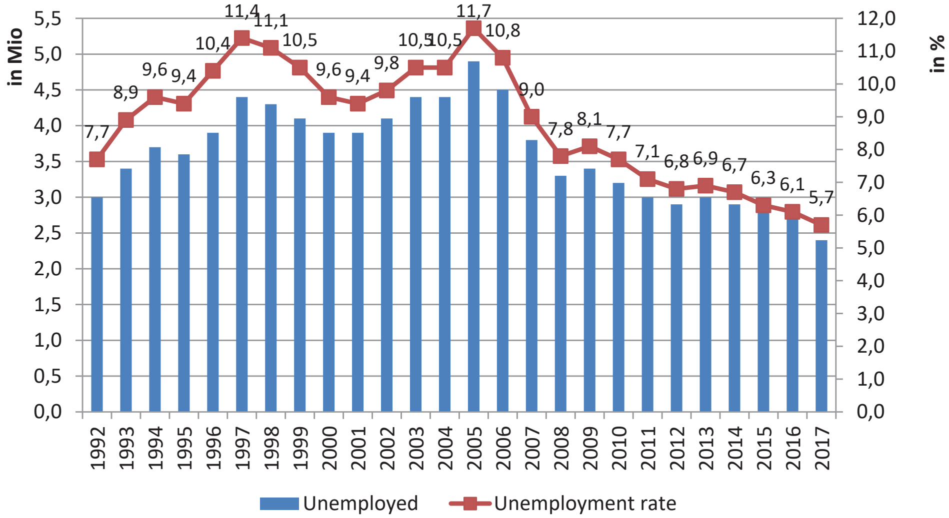
The impact of external forces on Germany's economic situation

An economic policy that stifles marked freedom cannot be expected to boost sustainable economic growth in the long run. Therefore, there is much agreement among economists that Germany's positive economic indicators on the labour market, the current account and state budget are largely attributed to forces not related to Merkel's economic policy. These are in particular the long-term effects of the labour market reforms of the red-green coalition government under the previous Chancellor Gerhard Schröder, the adjustment processes by the enterprises, and in particular of the eurozone rescue policy.

The labour reforms, which are called the *Hartz IV* reforms after the chairman of the commission that devised them, the senior *VW* executive Peter Hartz, were introduced at the beginning of 2003 on a rolling basis, culminating in 2005. They cut unemployment benefits, and more important, pushed people to look actively for work to get their benefits. The enhanced possibility of fixed-term contracts, temporary agency work and of so-called "mini-jobs" with few benefits helped to create a more flexible labour market: for a couple of years unemployment continued to climb. It reached nearly 11% in 2005, but by the time Angela Merkel was elected the tide had turned. Her Christian Democrats reaped the benefit of the unpopularity of the Social Democrats (see figure 1).

Figure 1

Unemployment in Germany 1992 -2017



Quelle: *Sachverständigenrat*, *Statistik*, http://www.sachverstaendigenrat-wirtschaft.de/zr_deutschland.html#c181.

Parallel to the reforms of the Schröder government German enterprises had undertaken substantial restructuring efforts. In particular, entrepreneurs, trade unions and work councils had agreed to let wage rates increase only moderately and at a slower pace than increases in productivity and so managed to keep nominal unit labour costs low and make German products competitive (Dustmann et al. 2014). With innovative products in particular for investment goods the manufacturing sector met the demand of catching-up emerging economies which more than off-set the weaker demand from the eurozone since the beginning of the European sovereign debt crisis (Wandel 2016). Finally, the low external value of the euro caused by ECB's continuous expansion of the quantitative easing program with negative interest rates in the wake of its anti-crisis measures adds to the continued boom of German exports while an appreciation of the currency, which normally followed German export successes before the introduction of the euro, is no longer possible as this exchange rate mechanism is turned off in a single currency. The low interest rates are also a major reason for the state budget surplus as this drastically reduced the interest expenses (*Sachverständingenrat* 2017).

According to the Austrian business cycle theory a boom triggered by an artificial expansion of money supply which pushes interest rates for bank credit below what would have been determined on the free market by time preferences is unsustainable that inevitably must end in a bust, because the low interest rates discourage saving to a level not enough to sustain the newly started investments (Mises 1998). The longer such an expansionary monetary policy is pursued the more enterprises stay in business that are actually unprofitable with higher free market interest rates. This cements the economic structure and impedes the most important feature of the market system – creative destruction and the constant reallocation of resources.

While the German government has relatively limited influence on monetary policy in a single currency given the decision-making rule of one country one vote (Wandel 2016) it surely does have on its national institutional preconditions for sustainable economic development. The German Council of Economic Experts has repeatedly and almost desperately called upon the government to restore trust into market forces (see in particular *Sachverständigenrat* 2013, 2014 and 2016). So far Merkel has been reluctant to follow this advice and instead departed more and more from the principles of Ludwig Erhard.

EXPLAINING MERKEL'S TURN AWAY FROM ERHARD

Theoretical insights from Public Choice Theory and Institutional Economics can provide tentative, though not exhausting explanations for the renunciation of hitherto genuine positions of the centre-right *CDU* in favour of socially and ecologically motivated regulations of the market process and the expansion of the welfare state.

Striving for the median voter

According to the median voter theorem developed by Duncan Black (1948) the best chance of politicians in political parties to get the votes they need to win power is to adopt policies that appeal to the large mass of voters in the centre – the 'median voter', hoping that its more extreme followers will stay with it while simultaneously gathering up some of the large mass of moderate voters. As a result parties party programs tend to become similar. However, if parties drift too freely from one policy to another, just because they think they will win, even though they are generally not consistent with its broad world view the danger rises that both their own activists and the electorate may reject a lurch to the centre as unprincipled opportunism (Butler 2012). This then might give rise to new parties.

Prior to Angela Merkel's first chancellorship in 2005 in the debate in the *Bundestag* on 14 March 2003 following Schröder's announcement of the Agenda 2010 with its pro-market labour market reforms Merkel as opposition leader recommended even more far-reaching reforms in taxation, de-bureaucratization and privatization (see *KAS* 2003). From the perspective of the median voter theorem she obviously must have seen the median voter being pro-market oriented.

Yet, as table 3 shows, after the 2005 elections, neither Schröder's *SPD-Grüne* coalition nor the alliance between *CDU/CSU* and the *FDP* led by Angela Merkel achieved a majority in parliament. Although the *CDU/CSU* had become the strongest party with 35.2% of the popular vote, i.e. one percentage point ahead of the *SPD*, this outcome was less than the *CDU* had expected based on optimistic opinion polls during the election campaign that had estimated 42% (Koerfer 2017). In the new parliament,

Table 3

Results of the federal elections 2005-2017

	2002		2005		2009		2013		2017	
Party	Number of votes (%)	Seats	Number of votes (%)	Seats	Number of votes (%)	Seats	Number of votes (%)	Seats	Number of votes (%)	Seats
CDU	29.5	190	27.8	180	27.3	194	34,1	255	26,8	200
CSU	9.0	58	7.4	46	6.5	45	7,4	56	6,2	46
CDU/ CSU	38.5	248	35.2	226	33,8	239	41,5	311	33,0	246
SPD	38.5	251	34.2	222	23.0	146	25,7	193	**20,5**	153
LINKE	4.0	2	8.7	54	11.9	76	8,6	64	**9,2**	69
GRÜNE	8.6	55	8.1	51	10.7	68	8,4	63	**8,9**	67
FDP	7.4	47	9.8	61	14.6	93	4,8	---	**10,7**	80
AfD	-	-	-	-	-	-	4,7	---	**12,6**	92*
others	3.0	-	3.9	-	6.0	-	6,2	---	**5,0**	---
Govern-ment	SPD/ Grüne	306	Grand coali-tion	448	CDU/ FDP	332	Grand coali-tion	504	Grand coali-tion	399

Source: *Der Bundeswahlleiter* (https://www.bundeswahlleiter.de/).

it was the block of leftist parties (*SPD*, Grüne and *PDS*/*Die Linke*) that had actually a small majority of together 297 compared to 287 seats of the conservative-liberal block. As Koerfer (2017) argues this disappointing election outcome in combination with the fate of Chancellor Schröder, whose market-oriented reforms drove him out of office and led to the rise of a new left-wing party – *Die Linke* (The Left) – must have caused Merkel to reverse her conviction that it is possible to win elections with a pro-market economic policy course. Instead she concluded the German electorate prefers as much state as possible and as much freedom as necessary rather than "as much freedom as possible and as much state as necessary" what Erhard had advocated (Heller 2015). And for her this meant to turn-away from liberal principles à la Erhard towards social democratic and green positions and hence to dispense further market-oriented reforms.

The need for compromise in coalition governments

In addition, this drift to the left might have been favoured by the necessity to govern twice in a grand coalition with the *SPD*: Coalition governments require compromise between the parties involved often producing a hybrid policy program that nobody actually voted for. Interestingly, in the first cabinet of Angela Merkel the *SPD* held with eight of 15 ministers the majority of government posts although it had finished second in the election. Among these offices were those crucial for shaping economic policy such as the ministry of finance, labour and social affairs, health and environment. This composition of the government was the precondition of Gerhard Schröder to concede the chancellorship to Merkel. As a result the *SPD* retained considerable control of government policy. Remarkably, the social democratic influence in Merkel's economic policy prevailed even after the liberal pro-market *FDP* had replaced the *SPD* as coalition partner in the second cabinet and even after the *CDU* had strengthened its position vis-à-vis the *SPD* in terms of seats in the second grand coalition from 2013 to 2017.

Usually this prevalence is related to the impact of the crises that peaked during the second chancellorship – the global financial and eurozone crisis as well as the Fukushima disaster of 2011. In particular the first two crises were blamed by large parts of the public, media and politicians on unrestricted market forces and greed. This further nurtured the distrust in the workability of free markets and the call for greater government control over private market interactions (Koerfer 2017) although it was actually government interventions that caused the financial crisis through its perverse incentive structure it had created, as a number of studies show (see e.g. Boettke and Horwitz 2009; Roberts 2010), and the misconstruction of the European Monetary Union (EMU) that incentivizes over-indebtedness at the expense of other member countries (Bagus 2012; Starbatty 2013).

Although the German government resisted large-scale Keynesian fiscal stimulus Angela Merkel's policy decisions driven by pragmatism rather than economic principles nevertheless further stifled market forces. Her statement "if the Euro fails, the EU fails" opened the door for the continuous bail out of banks and governments through the establishment of a permanent rescue fond (the ESM) and the unconventional monetary policy of the European Central Bank (ECB). These steps bring the eurozone closer to a transfer union thereby liquidating the accountability of economic agents for their actions, a core principle of the market system, as well as the incentives for consolidation. At the same time the tendency toward centralization in the eurozone increases as the creation of the ESM as a new central institution and the calls for an economic government with a eurozone budget, federal taxes and a EU finance minister show. In particular, France's new president Emmanuel Macron advocates this proposal which in Germany is largely supported by the *CDU*'s hitherto coalition partner *SPD*, and *Die Grünen*. While the *FDP* categorially rejects such a proposal the *CDU* has taken no clear position (Wohlgemuth 2017). Yet Ludwig Erhard (1958a, p. 214f) has always been very skeptical about any efforts towards centralization and harmonization in the European integration process, as "it would lead to economic death" and "disintegration of the worst kind", because it suffocates human initiative and creative forces. As he points out, "such demands rest on an utterly fallacious interpretation of economic laws and facts" and, "the illusion that these natural factors can be changed, and the structural conditions artificially balanced between country and country until every country will work in every sector with the same costs".

The Fukushima-disaster prompted Angela Merkel to accelerate the anti-market energy transition without nuclear energy and so to occupy positions characteristic for *Die Grünen* party. As Geppert (2017) explains this reveals the political tactic typical for Merkel. She quickly occupies and implements ideas of the opposition parties. The opposition, then, does not oppose these projects because they get what they have advocated while her own party does not resist these decisions in order not to undermine the authority of its leader.

In the 2013 election, the liberal *FDP* was dropped out of parliament, as it had failed to recommend itself as a credible a pro-market corrective while being in government in Angela Merkel's second cabinet (Mann 2015). At the same time the left wing of the *CDU* has gained considerable influence at the expense of the business and market oriented wing. Consequently, the second grand coalition between a *CDU* that had drifted to the left and the *SPD* controlled nearly 80% of the seats in parliament. The two small opposition parties of *Die Grünen* and *Die Linke*, which are both traditionally left oriented, did not really oppose the general direction of government policy, but usually demanded even more of the same (Heller 2015). It was in this constellation that the most interventionist and redistributional measures had been passed.

However, the outcome of the latest September 24, 2017 federal election showed that Merkel had obviously drifted too far to the left, leaving ever greater parts of the core electorate unrepresented. Her party suffered the worst losses since 1949. At the same time not only the liberal *FDP* re-entered parliament with almost 10% of the votes. With the *Alternative für Deutschland* (*AfD*) a new party entered parliament by taking 12.6% of votes that filled the space the *CDU* had left by moving too far to the left. According to analyzes carried out after the polls the *CDU/CSU* lost almost 20% of its voters to the *AfD* and even one third to the *FDP* (Zeit 2017).

The prevalence of history: embedded institutions

Besides the peculiarities of the political and voting system the predominance of regulative an distributional interventions over free market policies might also be attributed to path dependencies of a paternalistic legacy of governing and a relatively deep engrained distrust in markets in wide parts of the population and in the so called intellectual elite that tries to shape public opinion with a strong public sentiment for the benevolent state. As Ludwig von Mises (1998, p. 850) argues, "no government, whether democratic or dictatorial, can free itself from the sway of the generally accepted ideology." In fact, according to a survey of 2013 carried out by the opinion research institute *Institut für Demoskopie Allensbach* (published in Petersen 2013) a majority of the surveyed favoured a state-regulated economic system. The market economy is associated with greed, ruthlessness, exploitation and high prices. By contrast a state-organized economic system is expected to provide security understood as the guarantee of a certain level of standard of living as well as ecological security (environmental protection), social justice and humanity. In an interview with journal "Wirtschaftswoche" from September 2016 the director of the Allensbach Institute Renate Köcher confirmed that this anti-market attitude has remained largely unchanged.

State interference in the economic life has actually a longer tradition in Germany than Erhard's liberal *Ordnungspolitik* for the social market economy. It goes back to

18th century's Prussia and the concept of the police and welfare state where a strong omnipresent government was not only responsible for the enforcement of law and order, but also for the social-well-being of its citizens and therefore regulated in detail economic and social life through "enlighted" bureaucrats and kings (for more detail see Habermann 2013). In fact, only in the first phase of the social market economy from 1948 to 1966 under Ludwig Erhard liberal free-market policies came to dominate (Habermann 2013). However, Erhard and his ordoliberals advisors did not succeed in making the reforms long-lasting. Many far-reaching regulations of markets and industries prevailed (e.g. in agriculture, housing, transportation, energy, services and crafts) In the subsequent years the ordoliberal component of economic policy has progressively diminished with the rise of Keynesianism and the persistence of egalitarian ideas. As a result socially, and in recent times ecologically motivated interventions increased and gradually displaced the market (see for more detail Bökenkamp 2010). Like in Prussia's police and welfare state, the view came to prevail that enlightened benevolent policymakers must and can engineer the free market to produce desirable results in the name of social justice and ecology (Habermann 2013).

Mises (1981/2006, p. 325) attributes the persistence of the belief in state interventions to the pervasiveness of erroneous ideas about economics in the public, as e.g. the alleged immorality of the unhampered market system. Therefore, the democratic process "guarantees a system of government in accordance with the wishes and plans of the majority. But it cannot prevent majorities from falling victim to erroneous ideas and from adopting inappropriate policies which not only fail to realize the ends aimed at but result in disaster" (Mises 1998, p. 193).

CONCLUDING REMARKS

Under Angela Merkel's three chancellorships economic policy has drifted increasingly away from the legacy of Ludwig Erhard. He unequivocally stood and relentlessly fought for a free market economic policy both on the national and European level that enhances individual liberty and responsibility both as the recognition of each person's dignity and as the driving force for wealth creation that would make the social question irrelevant. Instead all three cabinets have moved deeper into neo-interventionism. This policy choice has been favoured by the incentives structure of the political process and system and is backed by the prevalence of the widespread belief in the population in the inevitability and positive implication of market regulations and redistribution. The current positive economic development with low unemployment, capital account and budget surpluses which results from the reforms of her predecessor Gerhard Schröder and the undervalued euro camouflages the lacking robustness and the long-term negative implication of heavy regulation and a large welfare state. Because they stifle economic dynamism, they make Germany increasingly ill-equipped to tackle its demographic challenges in face of an ageing population, the integration of millions of migrants with low qualifications, the need for more investment and unleash the growth and employment potential of a service-based economy.

If and to what extent Angela Merkel and her party alliance of *CDU/CSU* draws a lesson after the severe losses of the ruling coalition parties in the latest federal election of September 2017 and moves back towards the economic policy principles of Ludwig Erhard remains to be seen. After the failure to form a so called Jamaica coalition government of *CDU*, *FDP* and *Die Grünen*, and additional four months of tortuous negotiations, Angela Merkel's *CDU* managed to reach a deal for another, third grand coalition with the social democrats in early February 2018. Since only this constellation assures Angela Merkel a stable majority in parliament, the *SPD* had again much incentives and power to implement their policy priorities which are detrimental to those of Ludwig Erhard. As in her first cabinet the *SPD* managed again to get the lead over key ministries, among them the powerful ministry of finance as well as the ministries of labour, environment and foreign affairs. This surrender might have been facilitated by Angela Merkel's lack of firm economic principles. This is a big difference to Ludwig Erhard, who fought for what he was convinced was right against the resistance in his own party, the opposition as well as vested interest groups, namely a liberal economic system. It was precisely these attitudes that made him popular and win elections. Therefore, for the time being a return to Ludwig Erhard in Germany's economic policy seems unlikely. Only a crisis could produce real change. And in fact, this also seems to be a German legacy as Erhard noted (1956, p. 121ff): "it has always been the Germans' historical tragedy that they unfolded their best virtues in times of need, but proved unable to act responsibly in hours of fortune and joy."

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Słowa kluczowe: Niemcy, polityka gospodarcza, społeczna gospodarka rynkowa, ekonomia polityczna

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ABSTRACT

The paper takes stock of the economic policy balance sheet of the era Angela Merkel. It analyzes to what extent the positive economic indicators of her chancellorship is related to principles of economic policy Ludwig Erhard stood for and explains Merkel's economic policy choices from a public choice perspective. The study shows that economic policy under Angela Merkel has drifted increasingly away from the legacy of Ludwig Erhard's free market policy towards socially and ecologically motivated interventionism. It is contended that Germany's current positive economic development is, therefore, actually the result of the labour market reforms of the previous chancellor Gerhard Schröder and the undervalued euro. The paper argues that Angela Merkel's policy choices have been favoured by the incentives structure of the political system and the prevalence of the widespread belief of the population in the need and good of market regulations and redistribution. Yet, because of their stifling effects on economic dynamism these policies make Germany increasingly ill-equipped to tackle urgent economic challenges.

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Polskie elity polityczne wobec stosunków z Niemcami w ramach Unii Europejskiej

Praca zbiorowa pod redakcją Krzysztofa Malinowskiego

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Poznań 2017, 342 ss.

Zbadanie poglądów i opinii polskich elit politycznych na temat relacji Polski z Niemcami w ramach Unii Europejskiej, ważne zarówno ze względów naukowych, jak i praktycznych, było celem projektu realizowanego w Instytucie Zachodnim w latach 2013-2016 (*Polskie elity polityczne wobec stosunków Polski z Niemcami w ramach Unii Europejskiej*). Chodziło o przeanalizowanie stanowiska polskich elit politycznych wobec istotnych zagadnień związanych z UE (wizje przekształceń, polityka wschodnia, sprawy bezpieczeństwa, problematyka energetyczno-klimatyczna) w okresie od początku kryzysu w strefie euro w 2009 r. do 2015 r., czyli do pojawienia się kryzysu migracyjnego. W ramach projektu przeanalizowano dyskurs elit parlamentarnych i środowisk eksperckich, a także przeprowadzono badania ankietowe i wywiady.

Stanowisko elit wobec stosunków Polski z Niemcami w krytycznej fazie rozwoju UE nacechowane było rozbieżnościami świadczącymi o braku konsensu politycznego. Miały one głębsze podłoże i wynikały z odrębnych podstawowych orientacji politycznych występujących wśród elit. Odmienne wyobrażenia o roli Polski w Europie i UE łączyły się z różnym podejściem do Niemiec i koncepcjami wzajemnych stosunków, a w tym przede wszystkim z kwestią, jak dalece strategiczne znaczenie mają Niemcy dla Polski w Europie. Można też zauważyć, że polaryzacja opinii i poglądów polskich elit na temat stosunków Polski z Niemcami następowała w korelacji z różnicowaniem się ocen coraz bardziej prominentnej, przywódczej roli, jaką Niemcy zaczęły odgrywać w UE w następstwie kryzysu zadłużenia w strefie euro oraz w obliczu konfliktu na Ukrainie. Różne interpretacje zachowania Niemiec korespondowały z brakiem konsensu w polskich elitach na temat oceny szans i perspektyw Polski w ramach Unii Europejskiej.