

UNIVERSITY "ALEXANDRU IOAN CUZA" IAȘI
FACULTY OF ECONOMICS AND BUSINESS ADMINISTRATION
DOCTORAL SCHOOL OF ECONOMICS AND BUSINESS ADMINISTRATION

DOCTORAL THESIS

- Summary -

Thesis coordinator:

Prof. Univ. Dr. POHOAȚĂ ION

PhD candidate:

PAGUBĂ (married POPA) CRISTINA ELENA

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CAPITALISM – FROM THE LIBERAL SPIRIT TO "THE THIRD WAY"

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INTRODUCTION

Liberal capitalism was the main economic system in Europe in 18th and 19th century. Next century the military conflicts and the financial and economic crisis weakened the trust in liberal capitalism, starting some reactions meant to reform the system for a social point of view. In order to adapt to the present economic context, more and more countries embrace alternative forms of capitalism, moving away from the pure form of liberal capitalism.

I have started a doctoral research named "Capitalism – from the liberal spirit to "the third way" " in Economics, in order to find the opportunity and utility of doctrinal compromise between liberal and social measures. Without disputing the progress that the market economy has brought to the society, we stand from the outset on a centre-right position, embracing the economic dynamism of the free market and also social justice. We are not the only ones that approached this topic, however we hope to bring a plus of novelty by studying the subject in the context of the 2007-2008 financial crisis.

The main objective of our research was to argue, as convincingly as possible, the efficiency of the social market economy for the times we live and also for the future. We intuit that in time, the liberal economies will tend to adopt the values of social market economy.

Our research focused on the *hypothesis* that the social and economic performances of the market economy are higher than the ones of the market economy in the context of a financial crisis.

As far as the *methodology of research* is concerned, we made a *multidisciplinary research*; we studied the subject from an economical, historical, political and social perspective. We made a *review of the existing literature* on our subject of interest and by comparing the

contents we identified the main values of liberalism and of "the third way". Because we wanted to identify the economic and social impact of the 2007-2008 financial crisis on the USA's liberal economy and on the Germany's social market economy, we have *collected* and *analyzed* a big volume of data, made *correlations* and *interpreted* the results obtained.

Our research has a number of *limitations* that should be considered when interpreting the result. Firstly, when presenting the theoretical framework of the liberal doctrine and of the social market economy, we included a limited number of authors, the ones we considered most relevant. Certainly among the followers of the liberal doctrine and among the followers of state interventionism are many more authors that established themselves in the universal literature with works of high value. Secondly, for a greater rigor in analyzing the performances of the USA's market economy and Germany's social market economy in the context of 2007-2008 financial crisis, the number of the data and the macroeconomic indicators could have been extended. Thirdly, pure market economy and pure social market economy do not exist in the contemporary society. The USA's model of economy and Germany's, deviate from the theoretical and doctrinaire framework created by the economists in time. Both economies are mixed economies, with a different degree of influence from the state.

THESIS STRUCTURE

The thesis consists of a number of three chapters *structured* as follows:

In **Chapter I**, entitled "Capitalism in the matrix of the liberal economic doctrine" I firstly highlighted the theoretical framework that laid the foundations of the liberal doctrine. Economists have sought new

methods of economic research, able to explain society's transformations. These efforts have led to the renewal of economic thinking and the creation of a liberal economic policy that permanently changed the appearance of the world, increasing the economic development of the countries that have adopted it.

Next, we identified the *fundamental economic values of the capitalist society* in the vision of liberal doctrine: the increase of the individual's role in society, freedom of action and expression of individuals, respect for private property, free market and the contract.

The liberal doctrine supported private initiative and campaigned for freedom of action of individuals. The *individual's freedom* must not be restricted, his initiative should not be blocked, the state's role should be limited to assure the legal framework in which to act. In other words, the individual is encouraged to pursue his own interests and has full freedom, provided that he does not affect the freedom of others.

One of the core values promoted by the liberal doctrine was *private property*. It is the necessary condition for the relations between people to function effectively in modern society. Property is the primary incentive of economic action and has the great advantage of dispersing the economic power of a nation, therefore political power.

Liberals identified the *free market* with a competitive market, without protectionist or monopolistic practices. Although they were aware that such practices exist in the real economy, they were never perceived as phenomena capable of affecting long-term smooth operation of the free market. Liberals have expressed confidence that the free market and liberal economic values will prevail on the market in the end.

In the capitalist society rights are not obtained by force, but through agreements made by the parties. These conventions that are called *contracts* are a form of free cooperation of the market actors. A first form of a contract is the *social contract*, through which individuals give their consent to obey the regulations of the civilized state, meant to protect their lives and property. Another type of agreement is the *economic contract*, concluded between market actors, in the economic relations on the market.

In the last part of the first chapter, we have identified and described the *free market actors*, the ones who implement the fundamental economic values of capitalism. The representatives of the Classical School have paid a great deal of attention to the *entrepreneur*, thought to be the most dynamic and innovative actor of the free market. The free market compels entrepreneurs to innovate and develop their business permanently, that is why they are a driver of progress and growth.

Because the purpose for production is the sale, the challenge for entrepreneurs is to meet *consumers'* needs. If classical economists have focused on the entrepreneur, consumer's sovereignty in the capitalist system was one of the concerns of Ludwig von Mises. For him and other liberal economists, the entrepreneurs' market success depends solely on consumers, who will decide on the price and quantity produced.

While playing the role of a less visible actor on the stage of liberal economy, the *state* is crucial in guaranteeing that the economic values of capitalism are respected and in ensuring the order and progress of a nation. Moreover, the state should protect the nation against violence and the dangers felt inside and outside the country, should

reduce the negative externalities and make public goods that all citizens of a nation can benefit from, available to individuals.

In **Chapter II**, entitled " "The third way" between theory and reality" we highlighted the dilution of the basic liberal economic values and the formation of mixed economies.

The confidence in the free market was badly shaken in the interwar period, especially after the Great Depression that affected the world's economy between 1929-1933. The new reality called for a different logic of development and a new economic policy, thus arose a number of contesting reactions: Keynesianism, welfare economics, organized capitalism and Regulation School. The common element that emerges from among these movements is the need to grow the state's influence in the economy, in order to restore economic balance and ensure social justice. Each of these doctrines have criticized the inability of the liberal doctrine to adapt to new economic, social and political realities and pointed to the limits of liberal capitalism.

Respecting the needs of the market, the state was called to streamline economic life, reduce waste and risks and ensure social progress. Reactions against liberal doctrine came from within, among which John Stuart Mill and Leon Walras. They embraced liberal values but felt compelled to correct the system's injustices when they have observed them.

Liberal reformers have sought the middle ground between liberalism and socialism, they have rejected the "laissez-faire" and the absolute control of the state. They were bent on social justice issues and have campaigned for a state with much more powers than the State in the vision of classical liberalism. Amid these clashes of ideas and the multiple reactions to the doctrinal liberalism, arose social market

economy which was intended to be a form of market economy more just in social terms.

Theoretical foundations of the social market economy were made by ordoliberal Walter Eucken, Wilhelm Röpke, Ludwig Erhard etc. The state was seen as a superstructure which ensures the smooth running of the economy and corrects the inefficiencies of the free market in solving social problems. Called "third way", it was meant to be a less inequitable economic model compared to the greedy liberal capitalism and with a lower limitation of individual liberty than the socialist system.

The social market economy has been implemented in Germany since 1948 through a set of specific policies during the economics minister Ludwig Erhard. On the background of reducing inflation, price liberalization and fiscal relaxation, the German economy reached a higher level of development in 1960 than many of the countries that have prevailed in the Second World War. The "German miracle" was the result of both the specific social market economy reforms and the discipline and rigor of German labor.

In **Chapter III**, entitled "Free market capitalism vs social market economy capitalism before the financial crisis of 2007-2008" I primarily presented the economic models of the US and Germany.

The US free-market capitalism is focused on immediate personal benefits - gain easy and fast, focusing on the present. The autonomous individual, strong and confident identifies with the American citizen. Social state never marked the existence of US citizens, it never managed to make them see relationships between people in terms of social responsibility and obligations. Social behavior was dominated by a liberal-individualist approach and the goal of the individual became to pursue his own interest. US rejects the economic

model of extensive social benefit programs because they diminish the investments and economic opportunities, discourage entrepreneurship and reward unproductive work. The market economy is considered to be the most equitable wealth distribution mechanism.

Compared to the US model, the model of German capitalism is more bent on the country's social problems. It aims to ensure the welfare of the entire community with particular emphasis on quality of life, sustainable development and harmony. Social market economy capitalism rests on both the market and its regulation mechanism: supply and demand, as well as on the state intervention. The state plays an important role in reducing wealth and social inequalities and government redistribution in the form of transfers and payments is considered an antidote against an unfair free market.

In the second part of this chapter we presented the performances of the two models in the context of the financial crisis of 2007-2008. After the comparison and interpretation of a broad set of data and indicators, we concluded that the US economy was more affected by the financial crisis compared to the German economy.

In terms of quality of life, an indicator that is not considered in the mathematical calculation of GDP / capita, Germany's economic model records higher performance. The German state is more focused on environmental issues compared to the US. Proof of this is the ratification of the Kyoto Protocol, which the US did not want to participate, beginning the steps to join the second pillar of this agreement and the ratification of several treaties and agreements to reduce environmental risks globally.

The two models' approach towards social aid programs are very different. US encourages moderate state intervention in the economy and equal opportunities. To be poor or rich depends on the ability of

each to overcome their condition, people are responsible for their own destiny. German mentality, attributes poverty to social factors, the state is responsible for social support for the less fortunate. Unlike Germany, the US does not ensure its citizens a universal health insurance system; in 2014 about 42 million Americans did not have health insurance. Despite spending twice as much on healthcare, according to studies conducted by The Commonwealth Fund during 2007-2014, the American health system recorded much poorer performances against the German health system.

Quality of life is also reflected in the feeling of safety that citizens feel, a richer society is not automatically a peaceful one. US records a much higher number of suicides and homicides compared with Germany, leading the way globally in terms of crime rates.

CONCLUSIONS

The 2007-2008 crisis questions the efficiency of the capitalist system. The system which for over two centuries raised the living standard and the life expectancy in the countries that adopted it, has fewer followers. Over the last years, the capitalist system has been wrongly identified with the banking system and with the bankers' desire to obtain profit. Capitalism is more than that; it is the system which offers the citizens the right to own properties, to act in a competitive environment and to enjoy freedom. Capitalism is not perfect but is without a doubt the best system created by man, so far.

According to the level of state's intervention in the economy, there are more types of capitalism. In the present thesis I have analyzed the impact of the 2007-2008 financial crisis on the capitalism of the free market in USA and the impact on the capitalism of social market economy in Germany.

At the beginning of the 21st century, USA was considered a standard of economic freedom among the biggest industrialized countries. Free market capitalism promoted freedom of action, a minimal state and strong deregulation politics. The objective of economic growth and wealth accumulation was achieved; USA registered a continuous growth of GDP/capita in the last decade. However, the dynamic evolution of market economy, left free, has created some strong divergent forces that contributed to the weakening of the American financial sector and the outbreak of the 2007-2008 crisis. Reality proved the limits of the liberal doctrine regarding the market's capacity to spontaneously self-adjust, through the price mechanism. The increase of income inequality, the massive indebtedness of modern households, easy and deregulated loans, lack of transparency of the securitized products, are just a few examples of USA's market economy limits.

The level of the state interference in the market economy is growing and is moving away from the liberal values. The state controls a lot of goods and services, such as: education, justice, infrastructure, post office, health care etc, provides subsidies to domestic producers, prohibits consumption and sale of goods deemed harmful and intervenes in the mechanism free market to promote a series of national objectives. The last major intervention was conducted in the context of the financial crisis of 2007-2008. Repeated interventions in the monetary market, the rescue of financial institutions to prevent a system crisis and the laws adopted for improving financial system regulation and supervision are just some of the actions initiated by the US government to counter the limits of free market economy.

The social market economy has been implemented successfully in Germany after the Second World War, contributing to economic and

social recovery of the country in a spectacular way. It was meant to be a "third way" between liberalism and socialism, a form of market economy fairer in social terms. After 1970, too much state intervention in the economy has made Germany's social market economy to develop into a welfare state with extensive social benefits, non competitive firms and high unemployment.

After unification, for over 10 years the economy has been modest, the country was considered "the sick man of Europe". The change appeared with the reforms implemented since 2005 under the name of Agenda 2010, with strong liberal reforms which successfully transformed the German economy in a social market economy. These reforms combined with efficient social protection, have strengthened the German economy and have prepared it for the financial crisis of 2007-2008.

After the comparison and interpretation of collected data, we concluded that the impact of the crisis on the US economy was stronger, its effects have spread rapidly across the economy, leading to the phenomenon of recession. In terms of quality of life, the German economic system was more efficient, more egalitarian and more humane, so we conclude that *the hypothesis from which we started our research proved to be correct.*

USA shows one of the greatest income inequalities among developed countries. The deepening gulf between the economic elite and the ordinary citizens has inevitably entailed a vast social inequality. To reduce inequalities between citizens and increase the quality of life, US authorities have adopted a series of measures specific to social market economy. Through government programs, the state helped the poor purchase a residence, reformed the health insurance system to give more citizens access to public health insurance and repeatedly increased the

minimum wage. Government actions to mitigate income inequality and to correct the market excesses should continue, since the risk of future imbalances is likely in a society with so great divergence between social groups.

The weakness of the German economic model to the crisis consisted largely in the absence of profitability among state banks (Landesbanken) who out of desire to increase their yields, have invested in risky assets with unlimited earning potential. In a changing global financial environment after the crisis of 2007-2008, Germany's challenge is to reform the banking system so as to maintain a relatively stable financial structure, to increase profitability and reduce political influence. This could be achieved by contracting the system through mergers and acquisitions and by privatizing state banks to become more competitive and increase transparency. The German social market economy risks transformation into a welfare state. The extensive social programs will risk suffocate the economy through a level of high taxes, decrease absorption of foreign investment, undermine entrepreneurship and turn citizens dependent on the government. In this context, the continuation of liberal reforms aimed at improving employability and raising the flexibility of the workforce and of the production of goods is necessary.

To adapt to the new realities, the two forms of capitalism are constantly changing: the US market capitalism adopts interventionist measures while the social market economy capitalism embraces liberal values. Reality has shown that the relationship between the State and the economy is not fix, immutable, but changes according to the level of development and practical problems arising in time and space. The ideal economic system may be a "third way" between the two economic models, but will certainly be a form of the capitalist system.

FUTURE RESEARCH DIRECTIONS

The high performance of the German economy before the financial crisis of 2007-2008, meant that the debate between different forms of capitalism gained traction. This is a subject with a lot of potential, and it's certainly worth more research in the future.

One possible line of research could be the analysis of the performance of market economy in England compared to the Swedish social market economy, in the context of the financial crisis of 2007-2008. It is yet to see if the conclusions we reached in this thesis will prove correct in those circumstances.

Given the crises cyclicity, it is likely that in the near future a new crisis will take shape. Another possible line of research could be the impact that the crisis will have on the US and German economies. It remains to be seen which of the countries will be the most affected by the crisis, how much will the USA shift to/from the values of liberal capitalism and if Germany will cross the border between social market economy and the welfare state.