

## 21 KEY FACTORS OF THE DEVELOPMENT AND RENEWAL OF THE SOCIAL MARKET ECONOMY IN THE EU

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### **Keywords**

Europe 2020 strategy, social market economy, eco-social market economy, social welfare systems, EU structural funds

### **Abstract**

The purpose of this study is to present the principles, strategy and operation of the social market economy, based on legal, political and economic considerations. The first social market economy, West Germany – followed by Austria, the Netherlands, as well as other countries in Northern and Western Europe –, mustered a positive overall performance from the post-World War II years to the early 1970s. Since then, however, we have been witnessing the erosion, distortion and decline of efficiency of the social market economy. There are four main issues to be addressed: (i) What are the main theoretical and conceptual, ‘eternal’ elements of the social market economy? (ii) What economic policy was built on this theoretical foundation and why did the system work well in Western Europe after World War II? (iii) What factors eroded this system? (iv) Can social market economy be renewed in the second decade of the 21st century and, if it can, what are the preconditions of it? In my analysis, I highlight some key areas: EU policies, Lisbon Agenda and Europe 2020 strategy, growth, financial disequilibria and competitiveness, innovation and employment, the relation of state and market.

### 21.1 INTRODUCTION

The social market economy is an economic and social policy system whose theoretical, strategic, social and economic policy objectives form the basis of long-term sustainable development. The main objective is to ensure the competitiveness of the economy through the proper functioning of the market economy, enforcement of performance and fair

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competition. Ensuring social peace in the society requires the realization of the objectives of subsidiarity and solidarity. It should be mentioned that, unfortunately, there are serious negative tendencies in the economy, in the society and in the environment that threaten the existence of humanity. The basic principle of social market economy is that market freedom must be linked to social compensation. In parallel to the synthesis of these two, they wanted to achieve good economic performance and social well-being based on the principle of performance, social justice and fair redistribution. They said yes to justice, but egalitarianism was rejected. Both the centralized planned economy and the *'laissez-faire'* capitalism were rejected. According to the creators, the social market economy is an economic system that seeks to achieve economic efficiency based on the principles of performance and social justice through redistribution. This concept is based on the well-being and integrity of individuals and companies in a fair competition. Individual interests and public good are compatible. The means of coordination is fair competition, the rules of which are fixed, monitored and guaranteed by the state (competition law and competition policy).

The results of the social market economy of the developed countries in the period 1950-1973 were relatively fast economic growth, relatively high employment level, improvement of living standards, modernization of the economic structure and social growth. However, since the early 1970s, deepening of the crisis, escalation of economic and financial imbalances, rise in social tensions, very high level of unemployment, decline in labor income to new added value gave rise to the erosion of the social market economy. The reports of the Club of Rome state that humanity endangers its own survival and future by over-exploiting natural resources. The factors of the social market crisis are still present. What are the most important ones? Reaching the fundamental goals of the system was based on free initiative, performance enhancement and social development. These goals cannot be achieved without adequate growth and financial stability. The impact of globalization is coming from the outside world, from the global economy, and within countries where the TNC's global optimization strategy crosses or contradicts the country, it has had a very negative impact on the established system of social market economy. The implementation of both elements (order and freedom) of the social market economy has become very difficult and contradictory in many European countries. The 'order' was covered by the crisis, and freedom was limited by the 'stability culture' crisis. Previously, competition was more balanced, it was later replaced by the overcrowding, overweight and dictating role of multinational companies.

Globalization is a major challenge for Europe. The American technological superiority has not only survived but has intensified since the mid-1970s to the present day. Exports from China and emerging countries show an extraordinary expansion, and this continues. Europe's spatial loss has become a constant trend in the world economy. The realization of national economic policies is greatly hampered by the forces of globalization. The

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functioning of the European social market economy is costly and, of course, greater than that of the US, China and the Far East, where social welfare systems spend much less. (The deployment of social systems has also begun in the mentioned countries, which will mean increasing costs for them in the future). Financing social welfare systems in Europe is costly, but it is worth spending these costs in the interests of a greater prosperity and social security. International law, European law and national legal systems play an important role in regulating these processes.

### 21.2 ESTABLISHING THE SOCIAL MARKET ECONOMY

The system of social market economy was elaborated during World War II. Christian social teaching, the Freiburg School and the Ordoliberal System of Ideas were developed by Müller-Armack, Eucken, Röpke, Rüstow and their peers. Social market economy is both a 'systems theory' and a 'systems policy' (*Ordnungstheorie und Ordnungspolitik*). The implementation of the system's strategy in Germany can be attributed to Konrad Adenauer and Ludwig Erhard. The construction of the social market economy in the 1950s and 1960s was ubiquitous in the western part of Europe, and its implementation was linked to the welfare state, which became an important element of the system of social market economy. Different models of the social market economy and the welfare state have emerged: the Rhine model (especially in Germany, the Netherlands, Austria), the Scandinavian, the Anglo-American and the Southern European models.<sup>1</sup> The social market economy and welfare systems have been incorporated into the constitutions and legal systems of these regions and countries, forming their core element. The legal framework at the level of the EU is incorporated into certain provisions of the TEU.<sup>2</sup> The direction of the further development of the social market economy is increasingly pointing towards an eco-social market economy, which makes actions in international dimensions indispensable.<sup>3</sup>

1 For a detailed analysis, see Katalin Botos, 'Globalizáció és szociális piacgazdaság', *Heller Farkas Füzetek*, 2011/1, pp. 3-13; László Csaba, 'Életképes modell-e a szociális piacgazdaság?', *Távlatok*, Issue 80, 2008, pp. 79-81; István Körösi, 'A fenntartható fejlődést ösztönző állam', *Polgári Szemle*, 2010/2, pp. 95-111; Béla Tomka, *A jóléti állam Európában és Magyarországon*, Corvina, Budapest, 2008, p. 115.

2 Articles 3(3), 5(1) and (2) TEU.

3 Article 21(2)(d)-(f) TEU.

### 21.3 EU POLICIES

The development of EU policies is a key area for the successful renewal of the EU and the social market economy.<sup>4</sup> In terms of content, EU policies can be divided into constitutional, regulatory, distribution and redistribution policies. In these areas, legal regulation is becoming more sophisticated, since political, economic as well as financial aspects need to be enforced. Regional, structural and cohesion development have high priority in the EU, which is supported by separate funds. These are the European Regional Development Fund (ERDF), the Cohesion Fund, the European Social Fund (ESF), the European Agricultural Fund for Rural Development (EAFRD), the European Maritime and Fisheries Fund (EMFF), the EU Solidarity Fund and the Instrument for Pre-Accession Assistance (IPA).

The main objective of ERDF is to strengthen economic and social cohesion by reducing regional disparities. The grants are focused on four main areas: innovation and research, digitalization, support for small and medium-sized enterprises, low carbon management.<sup>5</sup>

The Cohesion Fund is currently supporting those Member States where the GNI per capita is below 90% of the EU average. It aims to reduce economic and social disparities and promote sustainable development. Between 2014 and 2020, a total of 15 Member States will benefit from its support.<sup>6</sup>

The European Social Fund is the oldest of the Structural Funds: its creation dates back to 1960. In the period 2014-20, the ESF focuses on four main objectives: (i) promoting employment and supporting labor mobility, (ii) combating poverty and strengthening social inclusion, (iii) investing in education, training and lifelong learning, and (iv) improving the capacity of the institutions and the efficiency of public administration.<sup>7</sup>

The EU Solidarity Fund<sup>8</sup> was created in 2002 in response to major floods. Since then, there have been 80 cases of disaster relief: granting aid to those affected by major floods, earthquakes, forest fires, storms and droughts.<sup>9</sup>

4 An excellent summary analysis of these is provided by Marcel Szabó *et al.* (eds.), *Uniók szakpolitikák*, Szent István Társulat, Budapest, 2014, p. 260.

5 Regulation (EU) No 1301/2013 of the European Parliament and of the Council of 17 December 2013 on the European Regional Development Fund and on specific provisions concerning the Investment for growth and jobs goal and repealing Regulation (EC) No 1080/2006.

6 Regulation (EU) No 1300/2013 of the European Parliament and of the Council of 17 December 2013 on the Cohesion Fund and repealing Council Regulation (EC) No 1084/2006.

7 Regulation (EU) No 1304/2013 of the European Parliament and of the Council of 17 December 2013 on the European Social Fund and repealing Council Regulation (EC) No 1081/2006.

8 Regulation (EU) No 661/2014 of the European Parliament and of the Council of 15 May 2014 amending Council Regulation (EC) No 2012/2002 establishing the European Union Solidarity Fund.

9 See Petra Lea Láncoš, 'Az európai strukturális és kohéziós politika', in Marcel Szabó *et al.* (eds.), 2014, pp. 229-242.

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In 2007, under the Instrument for Pre-Accession Assistance (IPA), community programs and financial instruments received by candidate and potential candidate countries were merged (former PHARE, ISPA, SAPARD, CARDS programs). During the 2014-2020 period, IPA II entered into force as a legal framework and financial support system.<sup>10</sup>

Among the EU policies, the EU's Common Commercial Policy, Competition Policy and migration policy are of paramount importance for the development of the EU and for the progress of its external relations.

#### 21.4 THE LISBON AGENDA AND THE EUROPE 2020 STRATEGY

The current processes of the world economy take place in four areas: (i) globalization, (ii) integration, (iii) upgrading of regionalism and sub-regionalism, and (iv) crucial change in the role of the state, especially in its activity in the economy.

The active adaptation and its quality and effectivity, as well as the enhancement of competitiveness have been upgraded. Nowadays, there are basic negative tendencies in both the operation of the state and that of the economy. There is a need for genuine structural reforms in order to put an end to these tendencies.

At the beginning of the 21st century we are the witnesses of the upgrading of human resources. In most part of the 20th century the key elements of development were the capital and its materialized form, the investment. After both world wars, there was an obvious lack of the dollar. The main obstacle of growth was the lack of capital, the scarcest factor in production. Therefore, it had to be paid on the highest level. Due to this fact, the share of capital-owners increased and remained high as for the value of production.

Nevertheless, as early as the mid-60s, the lack of dollar transformed into an overabundance of dollar and financial capital. A sort of international financial 'balloon' had been created. Due to this fact, the dollar lost its value, the trust in it diminished, and these processes led to the crisis of the Bretton Woods system, and later on to several other crises on the financial market. In the developed countries, the market of standard consumer goods became saturated, the possibilities for profitable investments decreased, the rate of net profit decreased several times, taxes and incidental charges increased. All these negative tendencies created negative effects. The fall in real investments and an increasing rate in unemployment caused a significant withdrawal of working capital in most industrially developed countries, especially in those EU countries which were rich in capital. Problems have been worsened by the fact that on long term the net, after-tax profit reached in the real economy by investment, was much lower than the result of investments in the speculative, financial market. These investments bear more risk but may bring more yield. This

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10 See the legal framework of IPA at [https://ec.europa.eu/regional\\_policy/en/funding/ipa/framework/](https://ec.europa.eu/regional_policy/en/funding/ipa/framework/).

fact can be well observed at the events of the autumn of 2008. Actually, interests and dividends can/could be paid only from profits and incomes produced in the real economy. Therefore, it is impossible to overcome financial crisis without them.

There are four crucial areas which are undeniable for the development of economy and human resources: human resources, health care system, education, infrastructure and environment policy. The quality and the development tendencies in these four areas determine changes in each country concerning their future, quality of life and competitiveness on the world market. Countries which develop in a normal way can concentrate on these areas and thus, they can increase their competitiveness, while underdeveloped or regressing countries will be in a hopeless situation for a long period. Therefore, financing these areas should be increased in absolute value; moreover, their relative proportion in the national budget has to be grown. It is an essential condition for development and catching-up.

The Lisbon Agenda<sup>11</sup> accepted in March 2000 set the ambitious goal for the EU to “be the most competitive, knowledge-based economy of the world on the global market” by 2010. Certain economic policy makers and media experts interpret it as reaching the American economy. Nevertheless, in my opinion, the above-mentioned aim cannot be interpreted like that. (Comparison with the US did not even appear in the original concept.) In order to reach the crucial aim of competitiveness, all of Europe’s competitors had to be taken into consideration with a special attention to Japan, China, India, the small, Far Eastern countries as well and other regions too.

In 2001, the strategy of the Lisbon Agenda has been elaborated in the Lisbon Program and the requirement of sustainable development was added. In 2004, following the Sapir and Kok reports the revision of the Lisbon process was initiated and, in 2010, completed in the framework of the Europe 2020 strategy. The completion of the Lisbon Agenda with the national action plans for catching-up was also accepted.

The four strategic areas of the Europe 2020 strategy are the following:<sup>12</sup> (i) extension of knowledge and innovation, (ii) realization of a homogenous inner market, (iii) creation of new workplaces and a new European social model and (iv) stabilization policies for the macroeconomy. The enhancement of competitiveness based on the knowledge-based economy could be the only basis on which the decrease of the role of Europe can be reversed.

This approach requires the elaboration of a totally new and steady economic policy in the EU countries. These policies are able to ensure sustainable development, renewal of institutional network, financing and creation of new models for socially sensitive market economies which meet the requirements of the 21st century. Obtaining the goals of

11 See [www.europarl.europa.eu/summits/lis1\\_en.htm](http://www.europarl.europa.eu/summits/lis1_en.htm).

12 See [https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/framework/europe-2020-strategy\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/framework/europe-2020-strategy_en).

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development is essentially influenced by the changes of power factors in world politics and economy.

The main aims of the Europe 2020 program are: (i) creation of knowledge-based community, (ii) dynamic economic growth by enhancing achievement in macroeconomy, (iii) ensuring the economic competitiveness on the global market of the world, (iv) sustainability of the economic growth with attention to the environmental aspects and (v) social integration including full employment as much as possible, and the creation of a new European model for social welfare.

In the framework of the Lisbon Agenda, common targets were set up in areas determining future development, which earlier had not been included in the regulation of the integration. These are the following: education, R+D, innovation, stimulation of enterprises, labor market and social security. In these areas, coordinated cooperation was targeted instead of central regulation.

Basic structural reforms are needed in the following areas in order to realize the development set-up in the Lisbon Agenda and the Europe 2020 program: (i) capital and goods market, (ii) investments in the knowledge-based economy, (iii) transformation of the labor-market, (iv) environment policy and (v) social welfare policy and institutions. The main strategic aims, the key areas of the program and the crucial reforms are closely intertwined with each other, but it is difficult to realize all of them at the same time, because, due to scarce resources, controversial tendencies can appear when determining the priorities in development. Basically, both making the programs tangible and implementing them can be realized on a national level according to the different and unique economic and financing policy of each member country. Nevertheless, the EU community policy projects, R+D framework programs can contribute significantly to the above-mentioned processes.

## 21.5 GROWTH, FINANCIAL DISEQUILIBRIA, COMPETITIVENESS – THE ROLE OF HUMAN RESOURCES

Nowadays, crucial social and economic issues are closely connected with each other. The pace, quality and structure of economic growth, the way of tackling financial disequilibria, perspectives of their decrease, the changes in competitiveness, as well as gaining or losing ground in the world economy depend mainly on the quality of human resources.

If we look at the following line: demography – training of human resources – ability to generate income, we will face the problems concerning the prospects of economic development and the ways of tackling financial disequilibria on a long term.

Demographic processes determine the human resources and the proportion of different age groups. Due to the decrease in birth, the number of students will also decrease, first

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in elementary schools, then in the secondary and higher education. Therefore, the number of new employees also falls, thus, the capacity of human resource also diminishes hindering future development.

The quantity, quality and structure of human resource and its ability to generate income determine the basis on which sustainable development can be founded. Human resource is crucial and undeniable, but it is not enough for development. It has to be combined with the implementation of high technology and innovation. Moreover, there would be a need for a social and economic policy focusing on human resource development. It is also necessary to create a well-functioning institutional network, as well as a suitable, steady legal system, and its effective implementation with a community control.

In order to understand the above-mentioned factors, we should add some basic remarks. The words 'growth' and 'development' appear very often as synonyms in analyses, strategies and programs. Statistics always show the growth of GDP, although production and consumption may have either useful or harmful effects. For example: the pollution of environment or the usage of non-renewable energy cost more than the value of production itself. It is the same case when statistics show growth in consumption if there is a growth in petrol consumption due to traffic jams. However, it is a harmful consumption because it spoils the quality of life and welfare. Nowadays, there are index systems which reflect very well the quality of life and environmental influences. Nevertheless, it is difficult to create short-term indices, and they are hardly ever available on time only with a significant delay especially on an international level. From the point of view of economic strategy, we accept only such a real growth which means a sustainable, environmentally friendly development enhancing the quality of life. Any other type of development can be considered as a harmful one.

As for the financial disequilibria, there is a worry about their absolute size and proportion in comparison with the income-growth of the economy, not to mention the dramatic speed they are growing by. There is a big gap between real and financial economy. Creating money by speculation and its flow have multiplied as compared to the production and the trade of goods and services.

Competitiveness is a crucial element from the point of view of the success of national economies, companies, and employees. Competitiveness as a category has been interpreted many times and in many ways. Another interpretation suggests that competitiveness expresses

“who is able to produce the best product, who has the disposal of the best educated workforce with the best knowledge, who is on the top-list concerning investments in machines, equipments, R+D, and infrastructure, who is the best



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organizer, whose institutions (government, education, business) lead the worldwide list of effectivity.”<sup>13</sup>

Competitiveness shows how effectively a nation can make use of the available human, financial and natural resources.

Gaining and losing ground in the world economy are the result of the influence of several factors. In my opinion, the evaluation by the world market is expressed by two excellent indicators: (i) the changes in exchange rates indicate that the international market upgrades or underrates the work of a nation and (ii) the growth or fall of the export on the international market on mid-term and long-term (it can be indicated in national economies, branches of economy and products). At the same time, I should mention that in case of fuels, enhancement and gaining ground can happen without improving competitiveness as a result of scarceness of natural resources, fluctuation and growth of demand, speculation and exploitation of oligopol situations.<sup>14</sup>

The Lisbon process focuses on the enhancement of competitiveness in the EU. In the 21st century, the key element of it is the development and utilization of human resource. However, it is more difficult to map and analyze the notion of human resource than other key elements. Human resource can be interpreted as the collectivity of people who create values in a society, cooperate with each other, represent a value system, have an appropriate knowledge and skills which they utilize in their work during their economic and social activity. Accumulated knowledge, heritage of the past, achievements of culture and civilization, know-how, inventions and patterns, ability for innovation and its usage, they all belong to the human capital of the society. It is not only the sum of individual knowledge but the multiplication of it. One of the main characteristics of the human resource is that it improves during the usage, instead of being consumed. Therefore, the improvement of human resource is a key element in sustainable development and employment policy. Thus, it is a key factor in enhancing competitiveness according to the aims of the Lisbon process.

## 21.6 INNOVATION AND ITS CONNECTION WITH EMPLOYMENT

The direction of development in the EU labor market is aimed at the creation of workplaces which have special advantages in location and unify highly qualified workforce with advanced technology.

13 For definition and further analysis see György Csáki, *A nemzetközi gazdaságtan és a világgazdaságtan alapjai*, Napvilág, Budapest, 2006, p. 156.

14 Concerning the factors of competitiveness and the role of human capital, see Magdolna Csáth, *Honnan-hová?*, Kairosz, Budapest, 2013, p. 382.

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R+D costs in the EU make 1/4 of the whole innovation costs. Other innovation costs require three times the R+D expenses until it has a success on the market. It is a proof of the fact that R+D activity is a crucial but not sufficient element in technical-economic development. The share of R+D costs has decreased in the innovation expenses, but the share of technological development and preparation of production has increased.

Data procession will be on the top of innovational investments (even) during the next years. Then, automation of production, introduction of new technologies and development of new functions for old products follow each other on the list. The introduction and spread of communication technology results in developing communication systems which work within the company and between companies. It is expected that the integration of data processing, information and communication technologies will strengthen the technical position of the EU on the international market.

The state policy of research-development can take only a smaller risk in innovation; therefore, the main task falls to companies. The main direction of the policy for technical development in the EU is supposed to provide the most favorable framework for the technical-economic development in order to enhance the spread of technical-economic information towards the participants of the economy to help them to improve their ability to cope with the risks. Besides, it is important to give the most precise picture of orientation about the possible future of technical development and opportunities on the market. It is completed by a diffusion-oriented stimulation in the technical development, which uses project-orientation as a medium.

Analyses about economic policy expect that the improvement of the framework of economic policy in the field of innovation activity may strengthen the position of technical development and competitiveness of the EU countries on the international market. It is also expected that fiscal and competition policies can regulate the activity which helps to enhance the effectivity of technical development.

Modernization and employment partly depend on the multinational companies, partly on regional and local institutions, because new workplaces are created mainly by small and medium-sized companies. These companies provide work for 70% of the employees in the developed EU-15 countries.

The EU provides resources for obtaining technologies needed for modernization, and its homogenous inner market is the main target for the export of the companies of the EU countries. The import following the operating assets from the 15 old EU countries dominates the structure of the production and the export. Concerning the export, the importance

of return must be emphasized. The need for modernization and transformation of workplaces has extremely increased after the accession to the EU.<sup>15</sup>

In the Central and Eastern European countries, including Hungary too, the quality of workforce is relatively high, the human resource is comparatively developed, but its utilization is far below the EU average, and far from the requirements of a stable, knowledge-based society. This situation is worsened by the problems of the health care system and the education. Therefore, we get far away from creating a knowledge-based society or from the realization of the Lisbon Agenda. It is a worrying fact that, in several transition countries – including Hungary –, R+D expenditures have been seriously affected by the transformation crisis and their proportion as compared to the GDP, has fallen dramatically. The Lisbon Agenda proposes 3% expenditures in comparison with the GDP. However, only the Scandinavian countries surpass it, the EU average is far below of this goal. This proportion is nearly 3% in the US and much more than 3% in Japan. In Hungary, the proportion of R+D expenses in comparison with the GDP does not reach 2%, although the R+D expenditures of the foreign companies are also included. This feature stabilizes our dramatic backwardness.<sup>16</sup>

Fiscal policy and changes in taxes and other additional charges play an important role in the realization of the Lisbon Agenda and in the improvement of competitiveness. In the Central and Eastern European countries, the policies stimulating investments preferred mainly the investments of multinational and foreign companies. It resulted in positive effects for the foreign operating assets, stimulated the modernization of technology. However, the small and medium-sized companies have remained at a disadvantage, moreover, their backwardness has strengthened, their integration as suppliers has not been realized (except for some well-known examples). The implementation of the Lisbon Agenda requires complex, far-reaching technological and structure-developing programs. When elaborating the requirements of changes in the economic structures, several factors have to be taken into consideration, such as the priority of the development and effective utilization of the human resources, as well as the requirements of a stable, future-oriented profitable employment and the fact that these factors can be provided only by an effective improvement of education, professional training and adult education. The active role of the state is undeniable in this development, because future-oriented investments cannot be increased if public financing does not appear in education and professional training.

The Lisbon process and strategy focuses on the improvement of public administration, health care system, usage of Internet, development of infrastructural networks, especially

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15 The effects of foreign trade on growth and development are analyzed in detail by Péter Farkas, *Behind the Figures. The Main Foreign Trade-Related Factors Affecting World Economic Growth Since 1990*, Institute of World Economics, Budapest, 2007, p. 25.

16 The R+D data are detailed in international comparison at [www.oecd.org/sdd/08\\_Science\\_and\\_technology.pdf](http://www.oecd.org/sdd/08_Science_and_technology.pdf).

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in transport and communication. These areas are given high priority in financing. According to past experiences, the countries which gave high priorities to these areas developed quickly and got in the forefront. The countries which neglected them degenerated on long-term. A knowledge-based society can be built only by healthy and educated population. Modernization and up-to-date structural changes can be realized on the basis of the development and effective utilization of human resource.

Research-development and the improvement of innovation can be realized on the basis of excellent higher education and scientific training. The participation of companies with solid capital in the R+D expenses should be raised, but basic researches at universities and research institutes should not be damaged, moreover, they should be strengthened. In the EU-28 the companies have 55 % share in the R+D expenditures, but this proportion is much lower in the Central and Eastern European countries. The US and Japan are able to involve their companies in R+D in a much higher proportion.

In order to realize the Lisbon aims and to improve human resource, it is necessary to harmonize the increase of labor productivity and employment. As for the allocation of resources, there is a need for an increasing efficiency. Enhancing labor productivity requires the development of technology instead of providing less workforce for the same production. The increase of competitiveness means that the participants of the market should invest more in the innovation of the product and the production procedure. The markets of services definitely have to be developed. However, it is not enough to open the markets, but the accession has to be regulated in a sensible way. It means that it is necessary to create a reasonable, public regulation of competition.

In the EU, the number and proportion of those who take part in training and professional training has been increasing. This fact has a significant influence on economic growth, labor productivity and partly on employment. Lengthening the average time of public education with one year can provide a steady 0.3-0.5 % growth of the GDP. In the EU an average 5% of the GDP is spent on education expenditures, in budgets it has about 10-11% share. Quickly developing countries have performed a much higher proportion.

The appropriate utilization of human resource and reaching the Lisbon aims for competitiveness can be realized only by an active labor market policy and it obviously requires institutional reforms. Finland, Sweden, and Denmark could unify active labor market policy with the system of education and adult education, labor exchange and creation of R+D workplaces.

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21.7 **DEVELOPMENT OF RESEARCH, HUMAN RESOURCE, INNOVATION AND  
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In the 21st century, human resource, education, training, professional training and especially development of research and innovation have been upgraded among the key factors of economic development. The proportion of innovation in increasing added value, the competition of patterns, the competition for employing the best scholars and researchers (worldwide brain-drain) have increased. In this area the US was and still is in the best position due to its financial resources, research possibilities and institutions. On the other hand, Europe is a constant loser in this process, because its scholars and leading researchers, whose education costs a huge amount, are obtained and utilized by the US, while it means a continuous financial loss for Europe.<sup>17</sup>

The scientific and technical development is quicker and quicker and thus, both in relative and absolute number there is a lack of leading scholars and researchers as compared to the requirements.

Good organization of R+D activity, shortening the way from research to innovative investments are determining elements in the improvement of economic performance. At the beginning of the millennium, the good utilization of R+D, the strengthening of innovation and competitiveness in Scandinavia, the Benelux countries and Ireland can be explained by the above-mentioned approach.

The most important factors which determine the effectivity of R+D activity are the following: the number of employees working in the area, their qualification and creativity. The number of scientists and engineers is more than one million in the EU. European researchers have had outstanding achievements in the field of discoveries.

In R+D, the role of the state has changed, it should put emphasis on the induction of technical development, creation of operational framework based on indirect stimulation. Direct state expenditure is realized in regional support, as well as in some big projects of high risk and public projects with special goals (for example environment protection, management of water supplies, waste liquidation and recycling).

The basic dilemmas of innovations are rising innovation costs and shorten life cycles on the market. Because of the shorter life cycles of the new products, companies have to get returns of their expenditure more and more quickly. The growth of per-unit expenses creates a better situation for the big companies with lots of capital in the fields which require much technology. Meanwhile, the general use of developed technologies improves the chances for the closing-up of small and medium-sized firms.

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17 The global competitiveness is presented in a comprehensive manner annually at [www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf](http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf).

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In the EU, information-technology (data processing) is on the first place in innovational investments. Automation of production, implementation of new manufacturing technologies, developing the functions of existing products complete the list in company planning. The integration of data processing, information and communication technologies is expected to strengthen the position of the EU on the international market, what can significantly moderate the former disadvantage of medium-sized companies. Moreover, some of these drawbacks can even disappear in some areas.

Future-oriented technological development requires more and more cooperation between developers and users. Time and expenditure can be diminished significantly in case of developments requiring lots of research if there is a cooperation. The capital and know-how of certain companies are often not sufficient to realize alone their projects. Cooperations for long-term contractual technological developments are mainly led by big companies.

The technical development policy of the EU contributes significantly to overcome obstacles and risks in innovation. According to some data, support of innovation in the manufacturing industry of the EU is very important both in size and sphere of activity, although the market operates as a liberal one. Beside an indirect, market-oriented support, there is a high proportion of direct project support that refers to the fact that the means of development are not distributed by the 'watering can' idea, *i.e.* distributing the same amount to everybody, but instead, they are distributed after investigating the aims of development. Technical development is more and more based mainly on innovational investments of private companies. However, basic research, financing and developing the infrastructure of research and education are carried out mainly by public (state) means.

Nowadays and in the near future, the main direction of modernization is the technological investment in informatics and communication. Investments in information technology are especially high in the production of office and informatics equipment, as well as at banks and in the insurance business. Branches of industry coping with problems try to overcome their difficulties by investing in informatics more and more vigorously.

Europe has lost ground during the last twenty years, mainly because it was not able to provide dynamic and attractive conditions neither for R+D, nor for the quick realization of innovations, especially not in structural changes of technology, as it has happened in the US.

In these areas, the US and the multinational companies have gained ground not only by using their power of capital, but by using their strategic superiority in spreading capital and technology, while Europe has fallen behind.

In the 21st century, we have arrived at a new technological turning point. Nowadays, not only the conditions of development are changing, but there are also new opportunities for closing-up concerning technological competitiveness. In the globalization process, there is a must for adaptation, we can also observe in this process that innovation-friendly

environment, community and economy policies, as well as R+D and highly qualified workforce are appreciated. Therefore, countries which are able to react to the changes will be able to find a point to break free and to rise. As the above-mentioned factors depend mainly on economic, R+D and technology-development policies, countries which are small and not rich in traditional resources for production can also have a chance for development. In the framework of the European integration, regional R+D policies are more and more appreciated on the markets of goods, capital and services.

Since we can find national policies and systems in education and professional training, the education system works basically in a national framework. Therefore, its content and its stage of development are different in each country. As traditional production possibilities and conditions are getting closer and closer, and markets are unifying gradually in the European countries, therefore, the importance of the most effective factors in competition has increased, namely the importance of the human capital and that of the potential of technology and development. Thus, it is a crucial question for Hungary too if it would like to improve its international competitiveness, whether it is able and willing to concentrate on the development of human capital in its economic and development policy and in its choice of priorities.

The R+D policies of the European countries are different from each other not because of the volume of expenses and its proportion compared to the GDP, but because the creation of innovation-friendly environment, the organizational level of R+D possibilities, the existence or non-existence of an innovation chain and its quality are very different in each country. The success of technological development depends more and more on different relationships, the quality of forward and backward relationships and the diffusion of R+D and innovation.<sup>18</sup>

Enhancing the competitiveness of Europe requires the liquidation of several disadvantages. There is a serious backwardness in general use of information and communication technologies in comparison with the US. It is partly due to the fact that the tangible means of ICT are not widely spread (density of PCs, electronic trade, news service, telecommunication). Partly, it is also due to the facts that the human resource is not qualified enough, the economic policy is rigid and there are also structural disadvantages. These problems should be tackled.

Since the role of innovation has been upgraded, the relationship among R+D policies, effectivity of technical development, ability for innovation in the economy and the position on the international market become more and more important during the period of 1998-

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18 The EU's research and development and innovation policy is analyzed in detail at <https://rio.jrc.ec.europa.eu/en/library/research-innovation-and-economic-growth-rd-policy-reforms-and-strategies>.

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2017. The EU countries spend different amounts on R+D compared to their GDP, the effectivity of research development is even more different.

In the last twenty years, the technical development of the EU has fallen behind the achievement of the US and Japan in the global competition. It is not necessarily caused by the lack of initiatives in innovation, because there are several inventions in Western Europe, especially in the machine industry, production of vehicles and chemical industry. The causes of backwardness are much more likely the relatively lower R+D expenses, the lower number of employees in the R+D sector, the heterogeneity of investments, the different regulation system, the lack of synergy, the low growth rate in the first part of the 1990s and the integration program of Eastern Europe. These factors contributed to the backwardness of the EU and, in many cases, it meant that the region has become dependent on the big competitors.

Certainly, there is a mixed situation in Europe. The United Kingdom, Finland, Ireland, Sweden and the Netherlands have a good performance due to good capital provision, effective human resource, and state policy, as well as initiatives of companies. The lack of any of the abovementioned elements worsens the chances of catching-up for the other member states. Thus, in the EU, a double aim has been set: it is important to improve the competitiveness of the EU on the international market, and to liquidate the technological gaps inside the EU at the same time.

Increasing R+D expenditures and provision of human resources for R+D are very important elements, but not enough at all. It is undeniable in the Central and Eastern European countries to enhance the utilization of R+D expenses and to implement the achievements more quickly. One of the main problems of the Central and Eastern European countries is the slow introduction of innovations.

Improving the environment for investments, reliable and steady economic policy have a crucial role in closing-up of the Central and Eastern European countries. More and more emphasis have to be put on the effects of new technologies and their acceptance. Acceleration of the technical development can result in significant saving of workforce. Therefore, if future-oriented, steady workplaces are not created successfully, the issue of unemployment will become very serious. Due to the crisis of 2008-2009, there is a significant rise in unemployment, what means that in the Lisbon Agenda the aim to extend employment has failed.

The R+D potential of the EU has grown significantly by the accessions, not in the fields of expenses, but due to scientific capacity and human capital working in R+D. All these elements are the 'dowry' of the Central and Eastern European countries.

The backwardnesses of the new member countries are less in education, professional training and adult education than in the production of GDP per capita. Moreover, there are some disadvantages in some fields in comparison with some old member countries. Qualitative and quantitative improvement of human capital is the most important factor



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in economic closing-up, therefore, it should be given high priority both in economic policy and finance. Education and training of human capital have a key role in the rise of the Central and Eastern European countries, and thus, the enhancement of the quality of workforce is the base of steady growth. One-year increase in education can increase the labor productivity with an average of 6% in the EU, but we can find even higher numbers too. In order to improve competitiveness, beside economic conditions, there is a need for the acceptance of innovation in the society, for an open environment and for a value-oriented society.

21.8 THE RELATION BETWEEN STATE AND MARKET – PRIORITIES OF ECONOMIC POLICIES AND THEIR APPLICATION

Social market economy assumes a strong and active state. In many fields, self-regulating markets function badly, or do not function at all. Market competition, even with proper competition policies, can function properly only if the following criteria are met: (i) there is a great number of producers and consumers, (ii) there is no unilateral market supremacy and vulnerability, (iii) there are proper information- and decision-making possibilities, and (iv) the control of actors and the bargaining positions among them are balanced. In principle, the state should intervene only if any one of these conditions is missing. In the past decades, there has been a substantial deterioration of these factors. The power of transnational companies has drastically increased, and the growth of oligopolistic relations has shaken the foundations of social market economy.

For the sake of public welfare, the state should increase its role in public health, education, R+D, the protection of environment or the development of public infrastructure. As the share of these sectors is fortunately increasing, this should be reflected in the financing of the state budget. It would be appropriate to both keep and place a part of the public services or some of the infrastructure into public ownership. The state has system policy duties, and it should be a matter of concern how these can be better served.

In social market economy, the state has an eminent role in finances, development policies or policies related to external relations and integration. An active cyclical policy has particular importance. According to Müller-Armack, cyclical fluctuations are necessary concomitants of any development. Since the crises of the 1970s, the state has been less able to influence these changes.<sup>19</sup> In the development of infrastructure, a larger state role would be needed. The best examples for this are road constructions, the development of public transport or energy systems (gas and oil pipelines, electric networks *etc.*)

19 Alfred Müller-Armack, *Wirtschaftslenkung und Marktwirtschaft*, Verlag Wirtschaft und Finanzen, Hamburg, 1947, p. 144.

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The achievements of the most important economic policy objectives cannot be simply left to market automatism, and this is especially the case nowadays. The transparency, reliability and consistency of economic policies have rather deteriorated, and, in the EU countries, this contributed to the deepening of the crisis both in the 1970s and after 2008. It is no question that this calls for the renewal of social market economy. Various elements of economic policy (price policy, market policy, trade policy, agricultural policy, monetary policy) should be harmonized with one another; they should follow the same principles and should constitute a unified whole that is free of internal contradictions and does not eliminate itself.<sup>20</sup>

The principal theoretical and economic policy content of social market economy is unambiguous, although there are differences among its theoreticians and economic policymakers. The differences are particularly substantial on which countries can be considered social market economies. Germany is the model state, followed by Austria and the Netherlands. Scandinavia is a special case, particularly due to its individual welfare models. France, and in general Western Europe, can be considered as a social market economy, but in terms of the extent, proportions and directions of state intervention, there are great differences. The EU defines itself as a social market economy, and since 2007, the idea of the globally competitive social market economy has been fixed in the Lisbon Treaty. Beyond this commitment, the practical question still remains whether divergence or convergence is greater among the 28 countries. In order to answer this question, one needs to consider whether differences in the systems are more important than those in the levels of development.

The question arises as to what the main causes of erosion and recent unsatisfactory functionings of social market economy are.

## 21.9 THE FACTORS OF EROSION AND THE CRISIS OF SOCIAL MARKET ECONOMY

The main internal reasons for the loss in dynamism of social market economy were the following: the slowing down of economic growth, particularly the reduction of the rate of growth of productivity, and the emergence of the deficit of state budgets leading to an internal debt which was due to an increase of the extent and burdens of social contributions, particularly that of wage contribution. The costs of administration in state expenditures accelerated, while the efficiency of state investments decreased. The increase of individual and company real incomes slowed down. As a result, by the first part of the 1970s, serious and permanent crisis issues emerged both in the German economy and all over Europe.

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20 Wilhelm Röpke, *The Moral Foundation of Civil Society*, Transaction Publishers, New Brunswick-London, 1996, p. 239.

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In the world economy, a new era started independently of the 1973 oil price explosions, which only provoked and aggravated the crisis processes.

The crisis factors of social market economy have remained with us ever since. The system was built on free initiatives, the increase of performance and social progress. These, however, assume a satisfactory economic growth and financial stability. In their absence, social market economy is doomed to failure. From the outside, the impacts of globalization had the same negative consequences. The global optimization strategies of TNCs are in contrast to national social strategies and policies. The two key elements of social market economy (order and freedom) have been eroded. Order was replaced by crises, and freedom was reduced by the crisis of 'culture of stability'.<sup>21</sup> The formerly more-or-less balanced competition was limited by the excessive power of TNCs, sometimes dictating market conditions. Globalization created a trap for Europe, and Europe's losing ground became a long-term trend. The competitive advantages of the US remained, while Europe had to face growing expansion and competition from China and the other emerging countries.

Under globalization, the scope and possibilities of national economic policies have been greatly reduced.<sup>22</sup> The unit costs of the functioning of social market economy have greatly increased, and have proved to be much higher than that of the US, Chinese or Far Eastern economies, where the costs of the social security systems are minimal or much lower. The gradual building up of these systems has already started, and these costs will continue to grow in the future. Europe was forced to pay these costs, which reduced the competitiveness of the Continent in sectors with lower value added. This constraint can be made advantageous, but under the conditions of low economic growth it is by no means easy.

As a program of the humanization of society, the elimination of poverty, the treatment of migration or the role of social policy has always received a great emphasis in the policy of social market economy. The Freiburg School considered labor as important in two aspects: as sources of value creation on the one hand and as an area of human development and self-realization on the other. They attributed particular importance to individual entrepreneurs and family-owned and small companies in the humanization and development of the economy. In practice, however, the possibilities of self-employment were reduced by the expansion of big industrial and service companies, and the possibilities of increasing productivities and income were diminished.

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21 Walter Eucken, *Grundsätze der Wirtschaftspolitik*, Francke und Mohr Verlag, Tübingen, 1952, p. 396.

22 Botos 2011, pp. 3-13.

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## 21.10 THE PROSPECTS AND CONDITIONS OF RENEWING SOCIAL MARKET ECONOMY – IN THE CONTEXT OF GLOBALIZATION AND NATIONAL INTERESTS

The key factor of the renewal of social market economy is the creation of a knowledge- and work-based economy and society. One of its main and most challenging tasks is the harmonization of individual and public welfare. Economic growth and fiscal balance should be jointly secured; they need an interactive approach. Instead of the former unilateral economic policies, *i.e.* prioritizing either demand or supply, emphasis should now be placed on their balancing and simultaneous implementation. Technology policies can play an important role of how companies can identify and then satisfy the new possibilities of markets. Sustainability needs a complex approach; the economic, financial and environmental aspects should be harmonized, combined with social acceptance.

The badly deteriorated balance between the real economic and financial spheres can be gradually restored only through the total mobilization of all the means of social market economy. This assumes a return to performance-orientation and the oppression of speculation, particularly in those financial sectors which were the starting points of the crisis. Emphasis should be given to national policies, and the building of the Europe of Nations can only be carried out through policy coordination. This coordination should be achieved through the acceptance and recognition of differences in cultures, national traditions, historical heritages and values. The basic principle of social market economy is the humanization of economy.

Social market economy is not an artificially created ideology or a fabricated construction. It is a pragmatic and value-oriented approach, built upon the analysis of circumstances and necessities of our age. Instead of artificially constructing a system, it focuses on the motivations of human attitudes and action, on the accepted values of society and on the policies aiming to harmonize the aspects of economic development and social justice. It tries to mobilize the primary movers of development and to keep them in motion. The final objective is not an ideal state, but rather a gradual progress in responding to the actual possibilities and requirements. Economy is not just for itself; it should serve the individual.

The social market economy of the 21st century is still based on market factors, but it rejects the omnipotence of the self-regulatory automatism of the markets. It accounts for the limitations of market forces; it considers it important to keep its destructive forces in check. The role of the state has remained unchanged in the regulation and maintenance of market order, in defense of the collective social aspects and public welfare, and in the generation of modernization. This assumes the combination of direct or indirect interventions depending on conditions. Direct interventions can be preferred when it is obvious that public solutions are more advantageous than private ones. Subsidiarity and solidarity are unchanged principles.

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The renewal of social market economy depends to a large extent on the restoration and strengthening of value systems. New and consistent economic strategies and economic policies are needed, similarly to those which proved to be the engines of development in the middle of the 20th century. We are faced with multiple deficits which hinder development, and which should be eliminated. What are these obstacles and deficits? In the Hungarian economy and society these multiple deficits are numerous, and they are inherited from the period before the systemic change. According to Béla Kádár's inaugural lecture at the Hungarian Academy of Sciences, these deficits were rooted

“in the low functional efficiency and irrationality of state-owned economy, in a related resource scarcity, in the relative expansion of consumption aiming at forgetting 1956 and the legitimization of the regime ('goulash communism'), which lead to heavy external indebtedness. The per capita external debt was the highest in the region, and it was twice as high as the regional average.”<sup>23</sup>

Later, Hungary integrated into the global economy, and the integration of the financial sector was particularly rapid.

Globalization is the main characteristic and determining factor of our age. We are experiencing a rapid and fundamental transformation in world politics, world economy, international power relations, the growth of population, technological progress and the relation between humanity and the environment. From the perspective of the development of social market economy, the fundamental changes were the following: the emergence of transnational companies, changes in the international financial system, the acceleration of global capital flows and the loss of control over speculative financial movements. The share of the speculative financial sphere has expanded in extraordinary proportions, particularly in relation to real economy. The gains from financial speculation were far above the possible net profits realized in the sectors of real economy. In the 21st century, this is an acute problem; it is a crisis factor which largely threatens the normal functioning of economies (international financial bubbles).

Economic policy has decisive impacts on competitiveness, catching up and welfare. From this point of view, the participation of Hungary in the European integration had extraordinary importance. As it has been indicated, the balance of membership in terms of the exploitation of factors of convergence and the success of adjustment was largely dependent on the quality and efficiency of economic policies.<sup>24</sup>

As a result of liberalization in the GATT and other trade organizations, international markets have become more open, while the parallel development of international institu-

23 Béla Kádár, 'Deficitjeink', *Pénzügyi Szemle*, 2008/2, p. 172.

24 Tibor Palánkai (ed.), *The Economics of Global and Regional Integration*, Akadémiai, Budapest, 2014, p. 409.

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tional and regulatory mechanisms was lagging behind or, often, they were simply missing. The TNCs and the big banks were strongly counter-interested in the development of any international regulation, and neo-liberalism (ultra-liberalism) served the political and ideological background. It became clear that the basic elements of the Washington Consensus were contrary to the requirements of 21st century development. The reduction of the role of the state (de-etatization) contradicts social market economy, as it calls for a rational, well-functioning and strong state. No one denies that an oversized and exuberant state is undesirable and creates more damage than good, but there are broad fields which call for rational regulation. The connection of global information networks should be technologically, legally and economically regulated.

In terms of international integration, the renewal of social market economy should be closely connected to the revitalization of the European model, originally supported by Konrad Adenauer, Robert Schuman or Alcide de Gasperi among others. The principle of performance and social justice should be once again related to one another, whether it is the economy, the legal system or governance. In the 21st century, these require more complex and better composed policy mixes than any time before.

In the 21st century, rationally regulated and, in terms of the provision of public services, well-functioning market economies are needed. All the main state functions have been unambiguously ameliorated. The regulatory functions have remained important (legal, economic or institutional aspects of market regulation). Service provision is supported by the growing role of public services. Development function, among others, serves the renewal and operation of broad fields of public infrastructure. Cohesion is important from the point of view of strengthening the social character of market economy through solidarity and redistribution. Between 1970-2017, as a result of the increasing role of the state, the share of redistribution in the GDP increased in all of the developed countries.

From the point of view of development, what matters, in fact, is not the size, but the efficiency of state regulation. With regard to the process of the renewal of social market economy, the question arises as to how the state can efficiently operate under the conditions of the challenges of globalization. Under the circumstances of open markets and the free flow of capital, the importance of efficiency of national policies has greatly increased. The favorable international economic positions of Scandinavian countries demonstrate the importance of good economic and development policies, which has made possible the maintenance of financing a highly developed social service system. Experiences of the consolidation of the Swedish budget, as result of the correction of the negative anomalies of the welfare state in the middle of 1990s.

According to Béla Kádár, “the main driving forces of development in our age are not the natural resources or the abundance of capital, but the availability of human capital.”<sup>25</sup>

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25 Kádár 2008, p. 173.

European or Hungarian economies should be built on a value- and knowledge-based economy, and on the qualification of labor. The quality of human resources has an utmost importance. It depends basically on the quality of education and training and the existence of networks of initiatives and innovation. Europe and Hungary were successful primarily in the quantitative development of general and higher education, while in qualitative improvement they lagged behind. Education and training are investments into the future; they equally serve the enrichment of the individuals, the family or the whole of society. Those who fall out of education are usually pushed out of the labor market as well.

For the sake of promotion of human development, human ecological aspects should be particularly stressed: the relation of man and nature and the protection of the living environment. This type of attitude would support the objectives of sustainable development as well. In the process of increasing the value creating capacities of human capital, the state, the companies or the individuals have an equal role and responsibility.<sup>26</sup>

In research and development, a large part of Europe is behind the US, Japan or South Korea. In this respect, only the Scandinavian countries have a good international position. Hungary's lagging behind is larger in terms of the level of human resources than in material production. Within transformation into information society, man, culture and creativity are more important than technologies or financing. The content, quality and strength of the value system are the most important components of social capital. In this respect, the deficits are serious. Besides the elimination of the deficiencies of the education and health system, the quality of development policies and governance ('good governance') is equally important. Social and economic problems can only be solved together. The upgrading of human capital is a key factor of the renewal of social market economy. According to Kahane, "Information and knowledge are new production factors. They are unlimited, renewable, infinitely inter-changeable and re-usable resources."<sup>27</sup> Development no longer depends on average labor and capital, rather on knowledge and well-trained human resources.

In our age, the performance and prospects of countries (economic growth, inflation, employment or financial position) are primarily determined by the impacts of global integration and systems of international economic relations. Therefore, the success of the renewal of social market economy, to a great extent, is dependent on the success of integration into the system of international economic relations. In this process, the quality of national economic strategies and policies can play a decisive role. In our age, social market economy should be competitive under the conditions of global and regional integrations. It is by no means accidental that several elements of the European models have now been

26 Körösi 2010, pp. 95-111.

27 Yehuda Kahane, 'Technological Changes, the Reversal of Age Pyramids and the Future of Retirement Systems', *European Papers on the New Welfare*, Issue 4, 2006, pp. 17-47.

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introduced in the US or China (the extension of health care and pension systems, the development of social institutions *etc.*).

The erosion and crisis of social market economy were caused by the malfunctioning of the state and the market. From the 1970s, the consequences of growth and financial deficits lead to a substantial change in the course of economic policies and thinking. In the EU, the control of inflation became a priority even before the introduction of the euro. Following the 2008-2009 crisis, the consolidation of state households became unavoidable. In the years after 2010, in many countries, the reduction of budget deficits did start successfully, but the consolidation of accumulated indebtedness takes more time. The deficit of the state household is still striking in France, Italy, Britain or Spain, not to mention the unsustainable indebtedness of Greece. In terms of indebtedness, Central Europe is in a better position than Western Europe. The stock of debt of the Visegrad countries (except Hungary) is below 60% of the Maastricht threshold. Hungary was also successful in the reduction of deficit after 2010. The share of indebtedness to the GDP is around 72% in 2019, which is below that of several other EU countries. From the point of view of the future of social market economy in Europe, the reduction of financial imbalances and remaining on the path of durable and sustainable economic growth is a basic criterion.

The globalization, integration, regionalism and transformation of the economic role of the nation state are processes of fundamental importance in 21st-century Europe. The impacts of external factors are increasing as the global factor plays a growing role. Regionalization is based on the exploitation of organic energies, and it contributes to increasing competitiveness in Europe. The increase of competitiveness assumes joint impacts in human capital, modernizing investments, exploitation of local advantages and good infrastructure. Economic policy favoring training and education, encouraging innovation and securing quality human capital are the main factors of development. The role and responsibility of such policies in generating development is increasing.

In the second half of the 20th century, the former European models of social market economy gave adequate answers to the challenges of the epoch. The resumption of a new and viable model of social market economy in the 21st century requires for the coordination of values and development demands of states, civil organizations or individuals. It assumes the professional analysis of crisis factors how they can be reduced and eliminated. The different demands of subsidiarity, solidarity and competitiveness should be harmonized desirably in a way that they end in a positive sum game.

#### 21.11 FEDERATION – CONFEDERATION – EUROPE OF NATIONS?

The policy of integration, the dimension of the policies, economy and law, affect both. It is very much up to political and economic advocacy and rational reconciliation at the



beginning of the 2020s. There are three main directions of the concepts of the further development of integration: federalism, confederalism and the concept of Europe of nations. There is a further version and a partial concept of these. Elements of all three basic trends can be found in both policy strategies and legislation. These fundamentally affect the levels and distribution of community decision-making and the exercise of competences.

Federalism appears in supranational decision-making, elements of confederation appear among others in the management of Community policies and intergovernmental decisions, and the 'Europe of nations' concept manifested itself in national powers and decision-making competences. The fundamental issues of further development of integration and the enlargement of the EU are decided at the summits of the heads of state or government; EU law takes into account the fundamental fact that several decisive areas of the operation of nation states are of strictly national character. National economies are interconnected but they are independent entities. Redistribution of the GDP produced, education, health care and pension systems are basically operated through national policies, but they are increasingly interlinked. Within the framework of international education, training and R+D cooperation programs, countries cooperate, recognize each other's diplomas, and acknowledge and record the pension entitlements acquired in different Member States. The federalists support the expansion of the EU's centralized decision-making powers and the extension of the scope of supranational decisions. Their ultimate goal is a centralized EU that takes the form of a political union.

Confederalists want to build a more relaxed alliance of sovereign nation states according to specific criteria. In the confederation, Member States delegate certain elements of their sovereignty to the Alliance, but the participating countries retain their international legal personality. Famous examples of the Confederation in history include Switzerland (especially between 1291-1848), the Polish-Lithuanian Union (between 1447-1492 and 1501-1569), the German Confederation (between 1815-1866) and the Confederate States of America (1861-1865). The Europe of Nations – a wording coined by Charles de Gaulle – suggests that nation states are the primary subjects and drivers of integration. Europe must express the interests, values, political will and legal relations of the participating nations.

One of the causes of Brexit, one of the most serious problems of our days in the EU, is the fundamental differences between common law and continental law. These differences have deep political, governmental, decision-making roots. A good combination of sovereignty and interdependence can best be achieved in a Europe of nations, according to the advocates of this concept. The advocates of the further development of integration argue primarily for the advantages of economic and financial openness, but this can be done well in a Europe of nations because the parallel process of breaking down barriers and representing and protecting national interests can be well-linked. *E.g.* euro accounts

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can be set up outside the Euro zone as well, and contracts can be signed, and sums paid in Euro, and there is no obstacle to the free flow of capital.

## 21.12 FUTURE IMPLICATIONS – THE EMU AND ITS FUTURE

On 25 March 2017 (the 60th anniversary of the signing of the Treaty of Rome), White Paper on the future of Europe (the 27-member EU's road map to 2025) was adopted.<sup>28</sup> This summarizes five possible paths for Europe by 2025.

- i. *Carrying on.* The EU continues to focus on economic growth, job creation and investment. The Community will strengthen the single market and increase investment in digital, transport and energy infrastructure. The EU will strengthen the supervision of financial markets, ensure the sustainability of public finances and develop capital markets.
- ii. *Nothing but the single market.* In this case, the EU is increasingly focusing its efforts on deepening the single market. The single market for goods and capital is at the heart of the development of integration.
- iii. *Those who want more do more.* One group of member states builds closer cooperation on some issues. In such areas, common legal and financial regulations are adopted. These are likely to be: defense, internal security, taxation and social policy.
- iv. *Doing less more efficiently.* The EU-27 focuses its attention and limited resources on a few selected areas. The EU deals more with areas such as innovation, trade and defense. It focuses on excellence in research and development. State aid control is transferred to national authorities to a greater extent. They are investing in new EU projects in the area of digitalization and environmental protection (e.g. reducing carbon dioxide emissions).
- v. *Doing much more together.* In this scenario, the EU decides to implement much more in all policy areas. The text mentions the EU, but in fact it is the EU Member States who have to decide what new powers they have and how much they have transferred to the EU. The proposal states that “cooperation between all Member States goes further than ever before in all domains.”

The Maastricht Treaty signed on 7 February 1992 is of paramount importance for the development of integration, as it created the EU as a continuation of the European Community. I would like to emphasize the importance of economic and monetary union. The Maastricht criteria for financial stability clearly fix the requirements that must be met.

28 White Paper on the Future of Europe, COM(2017)2025, at [https://ec.europa.eu/commission/sites/beta-political/files/white\\_paper\\_on\\_the\\_future\\_of\\_europe\\_en.pdf](https://ec.europa.eu/commission/sites/beta-political/files/white_paper_on_the_future_of_europe_en.pdf).

In 1988, the Council of the EU invited a committee chaired by Jacques Delors to draw up a program for the establishment of the Economic and Monetary Union and the introduction of the single currency. The Delors Report was completed, and then EMU was implemented in three stages.<sup>29</sup>

The creation and use of a single currency (since 1999 as account money and since 2002 as cash) is of great economic, monetary and legal importance. Numerous analyses have been prepared on how adequately the euro is playing its role. Taking into account the experience of the euro area, it can be concluded that it cannot be considered an optimal currency area according to Mundell's criteria, primarily due to economic divergences and lack of real convergence. One of the fundamental problems of the EMU is that there is a clear tension between the two main areas of finance. Monetary policy is common in the euro area, but fiscal policies are different and predominantly national, their harmonization is not yet envisaged. It is also hardly conceivable because Member States stick to their national fiscal competences. This can be considered justified as national economic policies compete with each other and the existence and pursue of national fiscal policies is an important factor influencing the international competitiveness of countries. Therefore, the money created under the EMU by the ECB is mainly spent within nation-state frameworks.

As far as the general budget of the EU is concerned, it can be stated that net contributors do not intend to pay more than 1% of their GNI. With the withdrawal of the United Kingdom, the revenues of the general budget will shrink by nearly 10 percent. In the current financial regulation, the main focus is on the joint banking supervision, the common regulation of the safe operation of banks and the single deposit insurance system in order to ensure the good functioning of the banking union. After the banking union, the next major step will be the creation of a capital market union. In order to better integrate capital markets, the legal framework for risk management in financial markets needs to be strengthened: the macro-prudential legal toolbox. Overall, in the field of price stability, the euro area and the EU have performed well over the past 20 years, but there are serious deficiencies in public deficits and debt developments. In the period 2013-18, Central and Eastern European countries performed better concerning fiscal discipline and debt management than most Western European countries. In Central and Eastern Europe, the debt-to-GDP ratio is also below the euro area average. Indebtedness in Hungary is also much lower than the euro area average and at the same time the debt-to-GDP ratio has continuously and substantially decreased over the past five years. In the EU, sustainable fiscal policies that promote sustainable development and responsibility are needed because the

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29 Jacques Delors, 'Report on Economic and Monetary Union in the European Community', presented 17 April 1989, p. 38, at [http://aei.pitt.edu/1007/1/monetary\\_delors.pdf](http://aei.pitt.edu/1007/1/monetary_delors.pdf).

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renewal and good functioning of the social market economy require real economic development and simultaneous financial stability.

### 21.13 THE RENEWAL OF SOCIAL MARKET ECONOMY – CONCLUSIONS

The renewal of social market economy is a long-term objective, but it requires permanent short-term management (taking into account the different time horizons of politics and economic policy decisions). Nowadays, economic structures to a large extent are shaped by the decisions of transnational companies. In order to renew the system, the role of national strategies and policies should be increased. In a well-functioning social market economy, a responsible and ethical way of thinking and action on all levels of the individual, companies or states are indispensable, and that is the only way by which public confidence can be restored. Social market economy can be renewed only on the basis of realities and fundamentals, by strengthening the human and civil value systems and the role of families in the society.

The basic idea of an eco-social market economy is to change the relationship between production and market, the direction of economic policy, the formation of costs and prices. Production technologies, products and management procedures that are compatible with the principle of sustainability should be given priority. The practical application of this principle means, first and foremost, that (i) the full costs of using and polluting the environment must be included in the prices, (ii) the ‘ecologicalization’ of the tax system, (iii) precise product declarations and (iv) comprehensive international co-operation in the field of environment protection. The negative externalities of the exploitation of the environment must be internalized and the full costs must be incorporated into prices. In addition to strict legal requirements, ecological standards must be enforced with economic-financial regulations and incentives. Legal and economic measures play an interdependent, common role in solving these tasks.

The ‘ecologicalization’ of the tax system means that tax burdens should be reallocated in a way that fosters sustainable development: labor should be taxed less, but the fiscal burden of the use of natural resources and capital income should be increased. Renewable resources must be taxed less than non-renewable ones. Accurate environmental product declarations contribute significantly to health and consumer protection, environmental management and fair competition.

Ecological aspects should be consistently applied in the fields of tax loads, subsidies and development. Revenues from environmental taxes should be redistributed in a rational way, so that, besides environmental considerations, the requirements of economic development and social justice can also be taken into account. The basic types of capital are natural capital, physical and financial capital, as well as human capital. Until the advent

of the 21st century, both economic policy and investors focused on the development and increase of physical and financial capital. In the 21st century, the role of human and natural capital has grown enormously in ensuring sustainable development and building an eco-social market economy. The role of human capital can also be detected in the rise or decline of countries. The eco-social market economy is a European model. The most successful types are the Rhine model (German, Austrian, Benelux), Swiss and Scandinavian ones. The eco-social market economy is being challenged by globalization and global problems (in particular migration, terrorism), so we need to find the right answers to the destruction caused by globalization.

Building an eco-social market economy is a long and difficult process both in Europe and Hungary. The original goal of the social market economy was “Prosperity for all!”<sup>30</sup> The motto of today’s eco-social market economy is “A better quality of life for everyone!” – which can, of course, only be attained gradually. Its feasibility depends on economic, social, cultural values as well as factors of civilization, environmental policy and, at the same time, responsiveness to external impacts.

The model of the social market economy of the 21st century has remained viable and renewable.<sup>31</sup> The objective should not be utopian and idealistic; it should aim the creation of a “humanistic economy and humanistic society”, as it was defined by Röpke.<sup>32</sup> We should bear in mind, however, that the economic and social circumstances of the present are fundamentally different from those prevailing in ‘classical’ times. The negative impacts of globalization should be consciously mitigated, and economic policies should find ways of rational assertion and the protection of national interests both in the European integration and, generally, in the system of international relations.

A clear relationship between the legislative, executive and judicial branches of government, their separation and autonomy is currently more important than ever before. Therefore, the quality of the functioning of the EU and national legal systems is even more decisive. Structures, institutions and human behavior are regularly and extensively analyzed by various schools. The combined knowledge and interconnection of the results of structuralism, institutionalism, and behaviorism can play an important role in bringing together legal and state sciences, economics and public administration for an effective reconciliation of well-functioning states representing national values, based on a solid set of common rules of law.

The renewal of the social market economy and the development of European integration are closely interlinked. In this, the development of politics, law and economy has an important, interconnected role. Europe has its roots and core values in the more than

30 Ludwig Erhard, *Wohlstand für Alle*, Econ-Verlag, Dusseldorf, 1957, p. 390.

31 László Csaba, *Európai közgazdaságtan*, Akadémiai, Budapest, 2014, p. 198.

32 Röpke 1996, p. 239.

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2000-year old Christianity and an organic development of its culture, civilization, a common system of fundamental values, as the basis of development. Maintaining and enforcing the fundamental values is essential for preserving European identity.