

SHARED MENTAL MODELS, CATCH-UP DEVELOPMENT AND ECONOMIC POLICY-MAKING:

THE CASE OF GERMANY AFTER WORLD WAR II AND ITS SIGNIFICANCE FOR CONTEMPORARY RUSSIA

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INTRODUCTION

Whereas in the early nineties economists tended to deal with the economic aspects of transition isolated from the other spheres of society, today our guild has “come to appreciate the multiplicity of institutional, political and cultural factors that influence the economic reform process” [Pickel, 1997, 221]. Yet special research into the interactions between the different social spheres in the process of transition has only just begun. On the basis of a historical comparison between the German economic reforms after World-War II and the Russian transition in the 1990s, this paper deals with the relations between prevailing patterns of thought, economic ideology and policy-making in transition countries.

When the former Soviet Union collapsed, this meant not only the breakdown of an economic and political system, but also of an ideology that had been, in spite of the disapproval of many intellectuals, shared by the vast majority of citizens of the country [see Gadzhiyev, 1996, 30]. Political and economic ideologies can be seen as a part of what Arthur Denzau and Douglass C. North call “shared mental models” [1994]. According to their definition, mental models are “internal representations that individual cognitive systems create to interpret the environment” [Denzau and North, 1994, 4]. Ideologies, then, may be seen as “the shared framework of mental models *that groups of individuals* possess that provide both an interpretation of the environment and a *prescription as to how the environment should be structured*” [Denzau and North, 1994, 4; my italics]. The decisive characteristic of shared mental models is their path-dependency. The images people produce and communicate about are based on religious and cultural traditions that reach far into and are deeply intertwined with history [Denzau and North, 1994, 22].

It is the starting point of my analysis that the patterns of thought prevailing in a given society must be considered when elaborating the problem of rapid institutional change. A politically implemented economic structure which is incompatible with the

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cultural and intellectual traditions prevailing in that society will, in the long run, either be modified according to the prevailing shared mental models or will be completely replaced by a different type of organizational structure [see North, 1997, 17; Oleynik, 1997/1998, 21; Pejovich, 2003, 349]. In this sense Alfred Mueller-Armack, the originator of the concept of Social Market Economy, noticed “that every political and economic change may deepen its roots only if it was preceded by a change of the central *weltanschauung* of a time” [Mueller-Armack, (1941) 1944, 72].¹ From this point of view, the art of transforming a post-socialist society mainly consists in linking new ideas and institutional structures to a people’s mental propensities.² But there is another dimension to this problem. The countries undergoing transition strongly depend on Western aid. To gain financial support the governments need to convince the Western financial institutions of their reform strategy. Thus, in addition to the interaction between political rulers and electorate, the interaction between national political rulers and international economic institutions comes into play.

The political decision-maker is likely to find her- or himself in a dilemma: On the one hand, she or he has to deal with the shared mental models of his people, which in a country that has passed through catch-up development are likely to be anti-capitalist, as I will show in the following. On the other hand, she or he must take into consideration the economic ideology prevailing in the Western world, which tends to be clearly pro-capitalist.

In history, there is one frequently-quoted example of the successful implementation of a market economy in a society which had gone through (1) *catch-up development* and (2) *totalitarianism*, in which (3) the *shared mental models* of the population seemed *not to favor capitalism*, and (4) where the political will and the economic ideology of *foreign powers* had to be considered: The Federal Republic of Germany (in the following: Germany) after World War II.³ The question of whether the German “Social Market Economy” could be a model for Russia has indeed already been widely discussed in both the Russian and the German literature on transition since the 1990s.⁴ Unfortunately, in the discussion about the applicability of the German model to Russia the cultural-ideological dimension has so far been neglected almost entirely.⁵ Yet the originator of “Social Market Economy”, Alfred Mueller-Armack, was not accidentally a representative of the neo-historical school of economics and devoted his theoretical work almost entirely to the so-called theory of economic styles [see Kaufhold, 1996; more detailed Schefold, 1994]. This theory deals, in the interdisciplinary tradition of German *Sozialwissenschaft* (social science), with the interaction between economy and culture, especially religion. The starting point of this research program was the assumption that the economy is “part and expression of a general lifestyle” [Mueller-Armack, (1941) 1944, 29]. From this perspective, Mueller-Armack’s main concern – and in my opinion this is highly relevant in regard to Russia – was how the acceptance of capitalism might be improved in a country, where the population traditionally had distinct socialist and romantic propensities. At the same time the rhetoric of Social Market Economy as an outspoken liberal reform program met the political demand of the Western Allies, especially the Americans, who at the beginning of the cold war wished to establish a liberal and capitalist society in the Western part of Germany in order to demonstrate the superiority of the Western model.⁶ My central

purpose is to shed light on this neglected aspect of transition by elaborating the German case in some detail, and to ask whether and how this experience can be applied to today's Russia.⁷

The paper is divided into six sections. In section two I will demonstrate, with reference to the ideas of Karl Polanyi and Niklas Luhmann, that in terms of the institutional structure of society the task of transition mainly consists in establishing the prerequisites for the differentiation of a subsystem "economy" from society. If it is true that the task of transition is not just to substitute the planned economy with the market economy but also to cope with a cultural heritage that both in Germany and in Russia seems to have favored totalitarianism, one must also raise the question of structural parallels between the German and Russian "roads to serfdom". So, in section three I will give a short outline of an interpretation of totalitarianism that understands both Hitlerism and Stalinism as the result of a failed attempt of economic modernization. Section four deals with the emergence of the concept of Social Market Economy in the writings of Walter Eucken and Alfred Mueller-Armack. Section five analyzes the implementation of the concept in post-war Germany. In the conclusion I will give a preliminary answer to the question of what may be learned from the German post-war experience for today's Russia.

TRANSITION AND SOCIAL DIFFERENTIATION

In Western economic literature the standard definition of transition goes as follows:

Generally interpreted as the replacement of one economic system by another economic system; in the 1990s, the replacement of the planned socialist economic system of the former Soviet Union and the countries of Eastern Europe with market economies [Gregory and Stuart, 1998, 18].⁸

In my opinion, the idea that the task of transition consists of substituting one economic system with another is misleading at least. From a system's theoretical point of view, the decisive difference between the plan and the market is that only in a market economy one can really speak of the existence of an economic system, because only in capitalist societies there exists a clear boundary between economics and politics, which nevertheless, and this is central to my argumentation, do interact. This was very clearly understood by Karl Polanyi, who wrote in 1944, in his masterpiece "The Great Transformation":

A self-regulating market demands nothing less than the institutional separation into an economic and political sphere. Such a dichotomy is, in effect, merely the restatement, from the point of view of society as a whole, of the existence of a self-regulating market. It might be argued that the separateness of the two spheres obtains in every type of society at all times. Such an inference, however, would be based on a fallacy. ... Neither under tribal, nor feudal, nor mercantile conditions

was there ... a separate economic system in society [Polanyi, (1944) 1975, 71].

Let us now take a brief look at how the uncoupling of the economy from society evolves [in more detail see: Zweynert, 2002b]. This process of social differentiation requires the establishment of private property, which removes the economy from the realm of direct state influence. But this is only a prerequisite for the process of separation. The actual conversion of the economy into a clearly distinguishable subsystem of society takes place when communication within the system is specialized for economically relevant aspects by excluding the social and political dimensions of economic interaction. The 'language' of capitalist economic systems, i.e. the prices, says something about economic shortages but it does not contain any information about the social or political status of the interacting persons [see Luhmann, 1989, 13-42]. Accordingly, in capitalism we can clearly distinguish a political and an economic system of society. A planned economy, by contrast, is an integral part of a primarily undifferentiated social system. Since there is no systematic boundary separating its political and economic components, there is no specialized communication with regard to economic aims. Whereas – in an economic sense – the individual is essentially deprived of power, the decisions made by the planning authorities are more strongly oriented towards ideological and political criteria than towards economic shortages.

In regard to economics, the main characteristic of totalitarianism is that the boundary between politics and economics is eliminated. In totalitarian societies, the economic subsystem is completely subordinate to the political system. Hence, all economic questions turn into questions of power. Peter F. Drucker in his book *The End of Economic Man. The Origins of Totalitarianism* [1939] saw this very clearly. The question of whether the economic system in fascist societies – and he regarded both Mussolini's Italy and Hitler's Germany as "fascist" – is to be characterized as capitalist or socialist he answered as follows: "It is, of course, neither. Having found both invalid, fascism seeks a society beyond socialism and capitalism *that is not based upon economic considerations*. Its only economic interest is to keep the machinery of industrial production in good working order" [Drucker, 1939, 132; my italics].

CATCH-UP DEVELOPMENT, ECONOMIC IDEOLOGY AND TOTALITARIANISM

In the previous section, I described the emergence of capitalism as an uncoupling of the economic subsystem from society. It is the lasting achievement of Karl Marx that he was the first observer of this process to understand that in a differentiating society there can arise severe tensions between the emerging subsystems. Marx' analysis of the interaction between the political and the economic system was based on two assumptions: first, that the being determines the conscience and, second, that the tension in capitalist societies which, in his opinion, existed between the economic base and the political and juridical superstructure, inevitably had to increase in the course of development until the system would finally break down. His idealistic opponents focused their critique on the first assumption. In their opinion it was not the economic base but, as Werner Sombart put it, "the spirit of the time ... which also characterizes the economic performance of the period" [Sombart, (1916) 1969, vol. III/1, XII, my translation].

The vivid discussion about materialism versus idealism has led to some negligence of Marx' second assumption. This is somehow surprising because the general idea that the tension between the differentiating subsystems increases in the course of development is not necessarily bound to the question of whether the "spirit" or the "economic base" is regarded as the dominant engine of change. The decisive point of Marx' argument is that the tension between the economic and the political subsystems *must* rise and that this *must* lead to social revolution. With admirable analytical ability, the Russian revisionist Pyotr Struve showed as early as in 1899 that this assumption is absolutely arbitrary. It was much more likely, he argued, that the contradictions and tensions between the subsystems would gradually tone down each other in the long run [Struve, 1899, 664-72].

The main failure of the idealist assumption of the "primacy of the spirit" is that it is unable to explain why capitalism, from the 19th century on, started to spread nearly everywhere in the world, a process that has not yet come to an end. Even if it is true that its original emergence in Italy, the Netherlands and Great Britain was due to certain intellectual and/or religious patterns [see North, 1995, 26-34], this does not explain how it could make its way into other countries. In order to understand the expansion of capitalism, we must bring into our analysis the political competition between the national states. The capitalist uncoupling of the economy from society, the establishment of a well-defined border between state and economy, proves to be a superior institutional arrangement. It is a truism that there is a tight connection between the economic prosperity of national states and their political power. Once capitalism has developed in at least one country, less developed countries come under *political* pressure to imitate this institutional arrangement.

Such a politically induced economic catch-up development initiated from 'above' is the all-decisive historical experience Russia and Germany have in common. In my opinion, the Russian and the German "roads to serfdom" must be considered within the context of the conflict between economic catch-up development and the patterns of thought prevailing in these societies. As I have elaborated elsewhere in more detail [see Zweynert, 2002b], I am of the opinion that the mutual connections between "spirit" and "substance" are too complex to be understood by the human mind. Consequently, we are forced to make simplified assumptions about these connections. In order to understand the link between catch-up development and the prevailing patterns of thought in a society, it seems to be a suitable starting point to assume that in societies there is usually at least a rough conformity between economic structure and prevailing patterns of thought. According to Karl Polanyi's description of the "Great Transformation" from feudalism to capitalism, the main difference between a capitalist and a non-capitalist society is that the former is to a higher degree differentiated whereas the latter is more homogenous. With regard to the economic structure the main difference is that in capitalist societies we can clearly distinguish a political and an economic system of society, whereas in non-capitalist societies this is impossible, because these spheres are inseparably intertwined. So, according to the assumption of conformity between economic structure and patterns of thought, we can assume that in non-capitalist societies holistic patterns of thought are likely to prevail, whereas in capitalist societies the patterns of thought will reflect the differentiation of that society and vice versa.⁹

In the case of a 'natural' emergence of capitalism, the evolution of the economic structure and the development of the prevailing patterns of thought go hand in hand, although certainly not without tensions. And the question of whether it is the change in the economic structure that leads to a shift in the patterns of thought or the other way round is not of interest to us here. Rather, what I want to argue is that the original equilibrium between economic structure and patterns of thought is disturbed in the case of catch-up development. This disturbance is politically induced, but it has a direct impact on the economic structure of the society concerned. The resulting disequilibrium would not be problematic if the patterns of thought adapted to the new economic structure of society quickly. Yet as Russian and German history prove, this is not always the case.

However, there are examples of countries in which this adaptation seems not to have caused significant problems. Hence, there must be additional factors that determine the ability of societies to adapt to changes in the 'economic base'. One important factor, in my opinion, lies in the *specific* religious or intellectual traditions of countries or cultural regions. By saying that usually there is a harmony between economic structure and "spirit", I did not *specify* the patterns of thought prevailing in non-capitalist societies. In fact, which specific patterns of thought prevail in a country is not determined by the economic structure. Rather, it is very much due to historical accident.¹⁰ Historical specificity makes it impossible to construct highly abstract models.¹¹ It forces us to confine our analysis to specific countries. Yet I think that the following general statement is still possible: If it is true that the "Great Transformation" is a transition to a more complex, differentiated order, then the tension between economic modernization and the prevailing patterns of thought will be stronger (1) the more rapid the spurt of economic development is and (2) the more the specific religious and/or intellectual patterns prevailing in a society are shaped by holistic traditions.¹²

If we combine the above-mentioned point with Alexander Gerschenkron's [1962] famous thesis that the spurt of economic development will be the greater the more backward a country is, we may conclude that the path of economic modernization is the more risky the more backward the starting position of a country is. While this is not really a surprising finding, we may also conclude that especially a quick development of capitalism, and that is, successful developmental policy, is likely to generate strong protest movements against the differentiation of society¹³ – and this is exactly what happened in Germany in the "golden twenties", as we shall see later.

The tensions between traditional values and the modernization of social reality in developing countries regularly make themselves felt in an ideological division within the educated elite: One group speaks out in favour of the modernization of the country to overcome political and economic backwardness. As this usually means aiming at imitating the development of Western Europe or the USA, in the Russian literature this camp is strikingly referred to as "westernizers." A second group strictly opposes the idea that the society should enter the Western path of social differentiation and speaks out for a 'national' path of development that aims at maintaining the traditional structure of society which is characterized by a lower degree of social differen-

tiation. What is typical for this group is its orientation towards the pre-modern past of society, and therefore in the following I will refer to this camp as the “romanticists”.

Such an ideological division within the intellectual elite is problematic in at least two regards. For one thing, every more or less modern society is characterized by a certain degree of cultural fragmentation. Yet widespread dissent about fundamental ideological questions simply means that the different members of society have fundamentally different interpretations about their environment. This destabilizes the expectations about the behavior of the other members of society and hence raises the transaction costs of all kinds of social interaction [see Denzau and North, 1994, 19; Pejovich, 2003, 351-2]. The second point is tightly connected with the first: If the country is ideologically divided, this can easily lead to political and economic destabilization, because a change of power will be likely to bring about a radical political change of course. If society as a whole is unsettled between the alternatives, ideological division may even lead to a political zig-zag. In the worst case the clash between westernizers and romanticists may even result in a counter-revolution against democracy and capitalism.

In the short run, it is even likely that a rapid spurt of economic development enforces anti-capitalist sentiments because it deepens the gap between dominant patterns of thought and economic reality. In the long run, however, following Struve we would expect that the prevailing patterns of thought will more and more adapt to the new economic structure of society.¹⁴ The conflict between westernizers and romanticists, reflecting this tension, runs like a thread through the Russian and German social philosophy of the 19th and early 20th century. But after decades of bitter argument between the two camps, on the eve of the October Revolution and the National Socialists' seizure of power respectively, it looked very much like the westernizers would finally gain the upper hand.¹⁵ Why then did the attempt at modernization fail and why did both countries enter the “road to serfdom”?

This can only be understood if the impact of external political shocks is included into our model¹⁶. In his famous article on “Self-Reinforcing Mechanisms in Economics” W. Brian Arthur asked, “if an economic system is locked-in to an inferior local equilibrium, is ‘exit’ or escape into a superior one possible? There is rarely in economics any mechanism corresponding to ‘annealing’ (injections of outside energy that ‘shake’ the system into new configurations so that it finds its way randomly into a lower cost one)” [Arthur, 1988, 16]. In my opinion, under certain circumstances external shocks can indeed provide the outside energy necessary to push society to a new path of development. Because of cultural continuity, this new path will, however, not entail a complete departure from the historical past of the society in question. The ‘switch’ from one path to another is possible, because in modern, highly differentiated societies a variety of institutional possibilities can be found. In this sense, it is social differentiation that enables modern societies to adapt quickly to a changing environment whenever external shocks occur.¹⁷

In the following, I will confine my analysis to Germany. As in a living organism, when a society encounters an external shock, for example a war or a natural disaster, it temporarily tends to reduce its level of differentiation. This is necessary to mobilize

the principle of solidarity which, in highly differentiated societies, tends to decrease. Where the economic system has uncoupled from society, an economic crisis is nothing else but an external shock and one might expect society to react to this shock by temporarily weakening the boundary between the political and the economic systems. Exactly this is what happened everywhere in the Western world during the Great Depression. In the USA, for example, the New Deal Policy under President Roosevelt led to strong political interventions into the economic system, and one might question whether an economy with administrated prices can still be regarded as autonomous. And not surprisingly, also in the USA, the economic crisis led to a blossoming of socialist ideas. But on the whole, very few American (or British) intellectuals generally questioned the path of social differentiation. And the few who did, could not find mass support for their ideas in a broader stratum of the population.

In Germany, however, the economic crisis led to a vigorous revival of the holistic patterns of thought among both intellectuals and the broad stratum of the population [in detail see Hock, 1960]. As Friedrich August von Hayek put it in his highly controversial book *The Road to Serfdom*, the attitude of German intellectuals as well as that of the majority of German economists in the time of the Great Depression may be described as “economophobia” [Hayek, (1944) 1994, 222]. But it is crucial not to forget that German anti-capitalism, which can be traced back at least to the early 19th century, did not start with the Great Depression. Already in the “golden twenties” – and clearly as a reaction to rapid economic development – German economic thinkers like Werner Sombart, Othmar Spann, Friedrich von Gottl-Ottlilienfeld and Oswald Spengler repeatedly condemned the disintegration of society and called for a return to the absolute supremacy of state power [Janssen, 2000, chapter 2]. Then their views did not remain unchallenged [see below, section 5], but when the Great Depression broke out in Germany these social scientists had prepared the ground for the radical anti-capitalism that was one of the decisive forces which brought the Nazis to power. The link between the German economophobia and the emergence of totalitarianism was suitably described by Peter F. Drucker:

It is not that the standard of knowledge of the economists has deteriorated. It is the belief in the desirability and in the necessity of the sovereignty and autonomy of the economic sphere that is disappearing; and with the belief, the reality [Drucker, 1939, 49].

SOCIAL MARKET ECONOMY AS AN ATTEMPT TO OVERCOME THE TOTALITARIAN HERITAGE

The totalitarian experience clearly shows that politically induced catch-up development is a risky path in countries where the potentially holistic patterns of thought, reflecting economic backwardness, are enforced by specific religious and intellectual traditions. In such countries there can appear a wide gap between the fact of social differentiation and the holistic ideal of a homogenous society according to which there shall be no borderline between the political and the economic sphere: Capitalism may blossom, while at the same time in broader strata of the population there is deep

discomfort caused by the 'atomization' of society. The divergence between the economic structure and the prevailing patterns of thought, both in Russia and in Germany, may be seen as one of the causes of totalitarianism. The success of Social Market Economy in Germany can, to a certain extent, be explained by the very fact that it paid attention to the question of how the acceptance of capitalism within the German population might be improved. As we shall see, it contained both "Western" and romantic elements and therefore helped to reconcile the traditional arguments between these ideological camps. This was no accident: The concept of Social Market Economy had two 'fathers', one of whom was a thorough westernizer, whereas the other originally belonged to the romanticist wing of the German intellectuals.

Walter Eucken [1890-1950, on his biography see Lenel, 1989; Johnson, 1989] was educated in the tradition of the German historical school, but split with historicism in the 1920s to become a spokesman both for theoretical economics modeled along classical lines and for economic liberalism.¹⁸ Again and again he questioned the conviction of the members of the historical school that in the late stage of capitalism the concentration process and the amalgamation of the political and the economic spheres were inevitable. One year before the Nazis returned Germany to barbarism, in an article on "Structural Changes of the State and the Crisis of Capitalism", he bluntly confronted his historicist colleagues with the viewpoint that "it was the liberal state of the 19th century", which, by strictly separating the state and the economy, was "the soil in which capitalism could thrive" [Eucken, 1932, 302]. In urgent words Eucken warned against "modern anti-capitalism" which wanted to substitute the institutional separation between the economic and the political spheres of society by "a total state, which shall embrace the economy" [Eucken, 1932, 305].

The call for a strict division of labor between the political and the economic system was also clearly expressed in Eucken's major theoretical work *The Foundations of Economics* (1940, English translation 1950), in which he outlined his theory of economic order. Its main thesis is that there are two general possibilities to organize a society economically: planned and market economy. Mixed forms, in his opinion, cannot be durable because in the long run society will inevitably turn into one of the two forms. The task of the government, then, is to choose between the market and the central plan as economic co-ordination mechanism and to provide a coherent economic policy. Much as this may sound like a technocrat's analysis of alternative models of economic order, one must bear in mind that *The Foundations* were published in 1940. And between the lines Eucken left little doubt that he preferred market economy, because socialism could never provide "an effective and lasting system, which does justice to the dignity of man, for this new industrialized economy with its far-reaching division of labor" [Eucken, 1950, 314]. Such an order Eucken called *Ordo*.¹⁹ This term goes back to scholastic thought and means a natural social order which "is the meaningful bringing together of diversity to a whole" [Eucken, 1959, 239]. By referring to human dignity Eucken explicitly introduced a normative element into his theory of economic order.²⁰

For the purpose of this paper it is important to understand that Eucken's dictate that in a market economy there should be a strict boundary between state and economy and that the former shall only intervene into the economic process in exceptional

cases, can be regarded as a “westernizer’s” position. At the same time, the desire to transform the fragmented modern world into an organic whole, as it is expressed in the term *Ordo*, shows traces of the holistic tradition of German social philosophy. Although this tradition played a certain role in Eucken’s thought, it was much more central an element in the socio-economic reasoning of Alfred Mueller-Armack, to whom we shall now turn.

Alfred Mueller-Armack [1901-1978, on his biography see Watrin, 2000; Willgerodt, 2002] entered the academic scene in 1932 with a work on the *Developmental Laws of Capitalism*. In this book he presented himself as a very typical German economist of his time. Not only was he historicist in method and demanded a fusion of politics and economics under the guidance of a strong state. One year later, in a small work on *State-idea and Economic Order in the New Reich* he even explicitly welcomed the Nazi-dictatorship, because it put an end to the artificial limitation of state power to jurisdiction and administration and finally made it “borderless” [Mueller-Armack, 1933, 11]. His excitement about the new regime, however, was soon to turn into disappointment²¹ and he entered into what he later called inner emigration.

After the end of World War II, under the influence of Walter Eucken, he, too, became a proponent of “a constitutional division of power between state and economy”, demanding that they had to be “strictly separated” [Mueller-Armack, (1948) 1974, 100]. But in line with the historical school he always remained an adherent of a methodological approach that paid attention to the sociological and cultural embeddedness of economic performance.²² However, although the methodological as well as the political views of Walter Eucken and Alfred Mueller-Armack were contrary in the early 1930s, there was one important unifying element in their thought even then. The historical economists were adherents of a political relativism according to which economic policy could not be based on general economic laws but had to react not only to the economic conditions of time and space but also to the general “spirit of the times” (*Zeitgeist*). This relativism somehow deprived economists of their authority as political consultants because *every* development seemed to be justified if only it could be explained by specific intellectual or real circumstances. One of the central aims of the founders of the Freiburg school was to re-establish the consulting function of academic economics towards politics.

Exactly this was also the main concern of Alfred Mueller-Armack’s historicist economics.²³ In his *Developmental Laws of Capitalism* he regretted that in Germany a situation had emerged in which the intellectuals were not able to provide “orientation”, because they had either turned away from politics or did “not find the courage to act diplomatically and so deprived themselves of political influence” [Mueller-Armack, 1933, 194]. Thus, in contrast to the adherents of the historical school and similar to Eucken, Mueller-Armack focused on how the economist could help to establish and to defend the economic and political order. Yet “diplomacy”, which here means the art of convincing others of one’s ideas, can only be integrated into economic thought if sociological and cultural factors are taken into account. Thus, there is no space for diplomacy in Eucken’s theory of economic order. In this sense it was the methodological legacy of the German historical school which made Mueller-Armack aware of the fact that the politician who wished to establish a new political and economic order first had

to analyze the prevailing cultural and intellectual patterns in the country concerned. Only by acting diplomatically, that is – at least seemingly – in accordance with the political mood and the intellectual propensities of people will the politician gain the opportunity to exercise lasting influence on the course of events.

WHAT HAPPENED IN GERMANY?

The German “economic miracle” can only be properly understood if one considers the question of how the intellectual fathers of Social Market Economy managed to “sell” their vision of a liberal economic system to a population that was feeling highly ambivalent about capitalism to say the least, and to the Western Allies, who were irresolute about how quickly the German elite should be allowed to regain political sovereignty. Although both these processes of communication – the national and the international one – are intertwined, I shall here deal with them separately.

The national dimension

Speaking about national economic ideologies is quite an ambiguous thing. It is often overlooked that modern societies are too differentiated for the identification of homogenous cultural patterns to be possible [for this critique see Wimmer, 1996]. Nevertheless, the idea that the traditions of thought prevailing in a country are path-dependent and that therefore at least some continuous traditions can be figured out, finds an impressive confirmation in the history of German economic thought. The decisive constant of German economics, from the Cameralists to the Historical Schools, can be seen in the holistic conviction that society forms a homogenous whole [see Pribram, 1983, 209-24]. This holistic methodological approach went hand in hand with the demand for a fusion of state and economy or, to put it another way, with a hostile attitude towards the emergence of an autonomous economic sphere of society. Insofar as the economic quintessence of totalitarianism is the complete subordination of the economy under political power, national socialism can be seen as a perversion of a tradition that was already prevalent in the German romanticist and historicist strands of social and economic thought [Janssen, 2000, 119-20].

The breakdown after the end of the Nazi-regime had ambiguous effects on German economic ideology. On the one hand, “trust in the benevolence of the government and the wisdom of the authorities was lastingly shattered” so that “it was the fondest wish of the population to be freed from any tutelage” [Haeuser, 1964, 234]. On the other hand, there were two factors that operated in the opposite direction. First, the German habit of relying on the authorities in periods of crisis was still very much alive, despite the totalitarian experience. Second, it was the common view at the time that it was capitalism that had brought the Nazis to power [see Blum, 1969, 10-11]. This conviction was by no means restricted to the left; indeed, all the major parties were in search for collectivist solutions for the task of reconstruction [Nicholls, 1994, 131].²⁴ As Reinhard Blum has thoroughly documented, directly after the end of the war, the question for the overwhelming majority of the population as well as for the

intellectual elite was not capitalism *or* socialism, but *how* socialism should be organized [Blum, 1969, 26-37].

The story of the rise of Social Market Economy can in a way be seen as an example of the successful division of labor [Klump, 1997, 130-2]: If Walter Eucken had laid the theoretical foundation with his theory of economic order, it was up to Adam Mueller-Armack to supplement this order-theoretical basis with sociological and political aspects. Only by doing so he was able to offer a reform program which was then transformed into policy by Ludwig Erhard. Although, as Andreas Pickel [1997] has convincingly shown, it is typical for transition processes that these three aspects – the theoretical, the ideological and the political one – are closely connected, Alfred Mueller-Armack is certainly the key figure of the German reform strategy as far as economic ideology is concerned. Therefore in the following I will concentrate on him.

Mueller-Armack saw the main failure of classical liberalism in the idea that the task of establishing a market economy in post-war Germany could be regarded as a purely economic problem, whereas he held that

Although there appears in Germany occasionally the thought that what is needed is only a conscious unfolding of the competitive order and that this by itself will make it possible to bring social problems under control, it should have become evident by now that such a reliance on direct interaction will not provide for a solution on the task before us. The job does not merely consist in shaping an economic order, but also enquires its incorporation into a total life style [Mueller-Armack, 1978, quoted by Haselbach, 1991, 155].

More than that, absolutely in line with the holistic traditions of German social philosophy Mueller-Armack was of the opinion that free capitalism would lead to an “atomization” of society [Mueller-Armack, (1950) 1974b, 108].²⁵ Therefore for him the task of social policy was “to give our society a formula of *integration*, which ... binds tensions and provides a realistic foundation of *community*” [Mueller-Armack, (1962) 1974c, 153; my italics]. In order to overcome modern “over differentiation”, Mueller-Armack demanded a new “unity of style which can only be derived from the uniformity of belief” [Mueller-Armack, (1948) 1959a, 456].

For him, therefore, the question arose how the prevailing religious and secular ideologies could be reconciled and transformed into unity. In order to achieve this aim, he developed his *Soziale Irenik* [Mueller-Armack, (1950) 1959b]: As he noticed, in post-war Germany there were four significant “intellectual powers”: Catholicism, Protestantism, Marxist socialism and liberalism. Every ideological group was confronted with the task of “overcoming its intellectual isolation and paying attention to the demands of the other groups” [Mueller-Armack, (1950) 1959b, 578]. Note: To pay attention to the ideas of other ideological camps does not necessarily mean to include their wishes into one’s own concept. In a diplomatic sense it can also mean to take into account other ideologies in order to “sell” a reform program to these groups. Exactly this is what the ideological dimension of Social Market Economy is all about. Mueller-Armack’s economic and sociological studies and the totalitarian experience

had taught him that in Germany there was a widespread demand for *Gebundenheit* (the feeling of being part of a social collective, a community). The “third way” Mueller-Armack offered was not so much a compromise between capitalism and socialism as between differentiation and integration of society. This is already demonstrated by the term “Social Market Economy” itself: “Social” stands for the integration of society. According to the famous distinction of Ferdinand Toennies, groups of people organized according to social principles are communities (*Gemeinschaften*) rather than societies (*Gesellschaften*). So, in accordance with the holistic patterns of thought prevailing in German culture, the adjective “social” raised positive emotions in the German population. But what is more, for decades it had been the very battle cry of several protest movements against capitalism – and it surely is no accident that even the Nazis made use of it. “Social” was, one may say, a killer word against capitalism in German political discourse. Mueller-Armack’s stroke of genius was to link it with a euphemism for its potential victim. This meant to transform the word “social” into a “weasel word” in the Hayekian sense²⁶ that, from now on, served a very alien master: capitalism. By promising a “third way” between capitalism and socialism and by rhetorically linking an adjective that represented “community” with a noun that stood for “society” the “irenical formula” (*irenische Formel*) Social Market Economy played an important part in overcoming the intellectual dissent between “westernizers” and “easternizers” in post-war Western Germany and in achieving a wider acceptance of capitalism within the population. Of course it shall not be overlooked that the widespread acceptance of capitalism in post-war Germany was not only due to political rhetoric. The effect of the monetary reform of 1948 shall in no way be questioned here. Yet the rhetorical formula “Social Market Economy” has been very much alive in Germany up to the present day. Whenever an economic crisis arises, there is a consensus from the left to the right that the concept of Social Market Economy shall not be abandoned but renewed and adapted to the new circumstances.²⁷

The international dimension

So far, I have only dealt with the national dimension, the dialogue between policy-makers and population. We shall now turn to the interaction between the German intellectual and political elite and the Western Allies. For if one thing was clear in post-war Germany it was that political and economic concepts which contradicted the political aims of the Western Allies had no chance of being realized [Blum, 1969, 3; Ambrosius, 1977, 218]. The question of how the German elite and the Allies interacted, and to what extent the concept of Social Market Economy may be regarded as the foundation of the German economic miracle, has been one of the favourite subjects of investigation of German economic historians for decades [for a short overview see Brackmann, 1993, 7-16]. As I am primarily concerned with questions of ideology here, I shall leave this discussion aside and concentrate on the question of how Social Market Economy tied in with the interests of the Western Allies. Directly after the war they had rather different ideas about how Germany should be reconstructed: In England, socialist thought was predominant at the time, France wanted above all to prevent Germany from becoming a strong political power again, and the Americans

were irresolute between turning Germany into an agricultural country or forcefully promoting its reconstruction [see Nicholls, 1994, 123-5]. Only when the political tension between East and West culminated did the position of the Allies become more defined: First, it helped the Americans to gain dominance over France and Great Britain. Second, the conflict between the political systems made the implementation of a mixed system less likely and increased the chances for a decision in favour of a "pure form" [Blum, 1969, 183; Ambrosius, 1977, 224-5]. It is true that the Americans wished to establish a liberal order, and it is also true that Social Market Economy was a liberal reform program. But does this allow us to conclude that Social Market Economy fully coincided with the ideas of the Americans?

In a brilliant paper Terence Hutchison [1979] has shown that this was certainly not the case. In the 1940s and '50s, he argues, Keynesian ideas were clearly dominant in both British and American economics. Therefore, "in Britain and, to a lesser extent, in the United States, the most widely propagated doctrines on economic policy contrasted sharply with those, inspired the infant Social Market Economy" in Germany [Hutchison, 1979, 435]. As he shows, even American mainstream economists, who surely could not be suspected of having socialist sympathies, feared that a reform program "running against the tide of opinion and history, would fail both in terms of production and distribution, in particular with regard to social welfare and the standard of living of the lower paid". Some experts were indeed so skeptical about the program that "it was even asserted that the East German planned economy might forge ahead" [Hutchison, 1979, 440].

This shows that two aspects must be clearly distinguished: The prevailing political climate and the dominant economic ideas. Unquestionably, against the background of the cold war German economic policy could not possibly have ignored the political demand to demonstrate the superiority of capitalism and democracy. At the same time, political liberalism is compatible with a fairly wide range of economic concepts. The idea of Social Market Economy suited the political demands of the Americans but ran against the tide of Anglo-Saxon mainstream economics of that time. The key figures of Social Market Economy, Walter Eucken, Alfred Mueller-Armack, and Ludwig Erhard, gained space for action and eventually grasped the political initiative, because they could draw on a reform program that had been worked on since the late 1930s. The program of Social Market Economy can be seen as characteristically German in that it was in line with the German tradition of finding a "third way" between capitalism and socialism, and in that it tried to reconcile the romanticists with the "western" wing of German ideological traditions. The fact that Social Market Economy accorded with the specific national habits of thought was the foundation that it worked to combine a liberal order with the path-dependent shared mental models prevailing in Germany.

The German experience shows that although countries undergoing transition certainly depend on the attitudes prevailing in the richer countries, there is still room for action by the national elite. The degree of dependence on the 'sponsors' will indeed depend mainly on whether there are persons able to provide coherent reform strategies that take account of the specific circumstances of the country in question. More than a hundred years ago, in 1884, the Russian minister of finance Sergei Witte (1892-

1903) expressed the thought that without such a “national idea”, which must not be confused with a *Sonderweg*, the political rulers are bound to waver between the contradictory recommendations of their Western advisers [Vitte, (1884) 1910, 154]. The Russian experience of the 1990s indeed confirms the doubts whether it is possible to reform a country without taking into account its historical past.

CONCLUSION

If we compare the German reforms after World War II and the Russian transition of the 1990s we find two differences: First, the German reformers built on a reform concept German liberal economists had worked on since the 1930s and which reflected the intellectual traditions of the country, whereas in Russia the neo-liberal reform program of the 1990s was chosen “for reasons of fashion alone and because of the recommendations of Western economists and political scientists” [Nikolayev and Makhotaeva, 2003, 65], so that it lacked a solid understanding and backing even within the scientific and political elite. Moreover, the implementation of a radical neo-liberal reform program did nothing to ease the conflict between the ideological camps. As a result, the Russian intellectual elite remains divided into slavophiles and westernizers even today.

Second, mainly due to the legacy of historicism, the German liberals were extremely conscious of the fact that, as Ludwig Erhard wrote as early as 1943/44, the government is “always only able to realize an economic order in accordance with the mental images of the people in an economic and social respect” [Erhard, (1943/44) 1977, 2]. The ‘young reformers’ in 1990s Russia, on the other hand, showed little if any interest at all in the political mood and the prevailing patterns of thought in the population. As Anders Aslund, one of the leading experts on Russian transition, wrote in 1995:

A major problem in Russian society is that popular understanding of the state of the economy and government policy is scant at best. Its origin is the extraordinary distance between the rulers and the ruled in communist society. Unfortunately, Yegor Gaidar’s decision not to present a reform program at the beginning of the radical reform excluded people when they were most curious and supportive. A popular complaint today is: ‘Nobody tells us anything’ (...). In order to bridge this gap, it is crucial for government and reformers to reach out to the population explaining the dilemmas of society and telling people what can and what should be done [Aslund, 1995, 13].

This holds true, in my opinion, up to the present day. There is a tradition in Russian liberalism, deeply embedded in Russian history since the times of Peter the Great and Catherine II, which maintains that a modernization of society is possible only if the population is bypassed by authoritative political action ‘from above’ [Murrell, 1993, 135]. However, it was presumably also due to the influence of the neo-liberal economic consultants that the political decision makers paid no attention to the mental premises of a capitalist order.

As a result of the failed attempt to quickly implement a Western economic and political order in the early 1990s, both capitalism and democracy have been somewhat discredited in Russia since about the middle of the '90s. A detailed analysis of the change of political attitudes among the Russian population between 1992 and 2002 can be found in the Centre for the Study of Political Policy's study "A Decade of New Russia Barometer Surveys" [Rose, 2002]. The authors of the study sum up the Russian population's attitude towards the economic system as follows:

When Russians are asked to evaluate economic systems, the economic system before perestroika is consistently rated highest – and as Russians have acquired more experience of their market economy, those approving the old system have risen to 80 percent. The current economic system is consistently given a negative rating by most Russians. More than four-fifths were negative in 1992. The proportion negative has fallen since. In 2001 for the first time the median Russian was neutral about the present economic system. Those positive about the new system have risen from a small minority to 41 percent. However, the mean rating on the scale remains negative, minus 12 [Rose, 2002, 40].

How contradictory the attitudes towards the market system still are is clearly shown by the fact that from 1992 to 2001 approval of a socialist economic system has risen from 62 to 82 percent, while at the same time approval of the current economic system has risen from 9 to 29 percent [Rose, 2002, 51].

The example of the German Social Market Economy suggests that in order to improve this situation, it would be necessary to develop a liberal reform strategy which on the one hand pays attention to general economic principles, but which on the other hand also takes into consideration the country's specific cultural and historical traditions. In my opinion this is the only possible way to (1) overcome the dissent between slavophiles and westernizers within the intellectual elite in Russia and (2) to improve the acceptance of the market order within broader strata of the population. The historical experience and scientific recommendations of the West are certainly important for this discussion, but in the end it is up to the Russian elites to prepare the ground for the acceptance of an open society in Russia.

The Russian experience with the reforms of the 1990s clearly confirms Alexander Gerschenkron's statement, "that the politics toward the backward countries are unlikely to be successful if they ignore the basic peculiarities of economic backwardness" [Gerschenkron, 1962, 30]. A key to the German success after World War II was that not least due to the intellectual influence of the historical school the German liberal reformers were aware that such peculiarities are not to be found in the economic sphere of society alone, but that cultural and intellectual patterns are equally important as 'hard' economic factors. In a way it is Russia's misfortune that economists are only now – and certainly to a significant degree due to the Russian experience of the 1990s – becoming increasingly aware again of an insight that was vital for the German

reforms: namely, “that the process of transition ... is a cultural issue rather than a mere technical one” [Pejovich 2003, 348].

NOTES

The present paper is the first outcome of a research project on the historical and cultural path-dependency of the transition processes in Central and Eastern Europe, which is carried out jointly by the *Hamburg Institute of International Economics* (HWWA) (Department European Integration) and the University of Hamburg (Institute of Economic Systems, Economic History and the History of Economic Thought). The project is funded by the *VolkswagenStiftung*. I would like to thank Peter Rutland (Wesleyan University) for stimulating discussions which helped me to clarify my ideas, Heinz Rieter (Hamburg University) and an anonymous referee for their helpful comments on earlier versions of the paper, as well as Lena Nievers for proof-reading and editing the text. All translations from the Russian and German were done by me with the assistance of Lena Nievers.

1. The assumption that institutional change presupposes a shift of the dominant shared mental models does not mean, however, that I share the view of some German historicists of the 19th century that the “national spirit” (*Volksgeist*) completely determines the political and economic structure of that country [for a critique see Hodgson, 2001, chapters 4 and 9]. This view would, in my opinion, lead to a fatalism that would make the discussion about cultural factors in transition pointless. The main difficulty in grasping the links between culture and economic order is the reciprocity of both. As Douglass C. North puts it: “It is the interplay between belief structure and the external environment that shapes the belief structure” [North, 1995, 22].
2. Very much in line with this, Peter Murrell argues that since in the medium and long run politicians cannot put through reforms against the will of the population, “although the lessons from the experiences of other countries will be helpful, even the broad agenda of reform has to be carefully calibrated to the existing features of society” [Murrell, 1995, 80].
3. To avoid a misunderstanding: I do not argue that the historical situations of Germany after 1945 and of Russia in the 1990s are identical, nor that the German reform strategy can or should be imitated in today’s Russia. The point I want to make is that in German and in Russian history some structural parallels, some common features can be detected, and that therefore in regard to the future of Russian economic reforms it might be instructive to compare the two cases. For a careful elaboration of the historical dimension of transition see Wagener, 1997.
4. In German literature see Cassel [1994], Radke [1995], Kartte [1996], Hoehmann [1997], in Russian literature see Mityaev [1992], Gutnik [1997], Chepurensko [2001], Kondraseva [2001]. There is even evidence that the German model exercises some influence over the Putin administration: At a symposium that took place in Germany in November 2000, Putin’s then chief economic adviser German Gref answered the question of whether “social market economy in the time of globalization [can] be a model for Russia” as follows: “Our goal is market economy with a social countenance, whereby liberalization is the main foundation” [Graef, 2000, 46].
5. There has been a lively discussion on the question of whether the German Social Market Economy is a “real” concept of economic policy or if it is to be seen mainly as a rhetoric formula. If I concentrate on the second aspect in this paper, I do so only because it has been almost completely neglected in the discussion on the significance of the concept to Russia, not because I want to deny that there are indeed significant differences between the German and, for example, the US-American contemporary versions of capitalism.
6. The strong sympathy for socialism across broad sections of society is certainly one feature Germany and Russia had in common. Of course there were socialist and romantic movements in other countries, too, but nowhere did they gather such strength as in Germany and Russia in the second half of the 19th and the first decades of the 20th century.
7. Of course it would be desirable to compare the historical development of Russia and Germany in more detail. Unfortunately such a comparison, which would have to begin at least with the latest in the early 19th century, is beyond the scope of a journal article.
8. In view of this definition rather surprisingly, the authors at least seem to suspect how problematic their strict focus on economic problems is. So on page 78 they write: “Throughout this book, we

focus on the economic rather than the political arrangements of the Soviet Union. This separation is artificial, however, because the Communist Party was a powerful mechanism, influencing all activities, especially economic activities, in the Soviet Union."

9. In the introduction to his major work "Economic Backwardness in Historical Perspective" [1962] Alexander Gerschenkron pointed out that "the intellectual climate within which industrialisation proceeded, its 'spirit' or 'ideology,' differed considerably among advanced and backward countries" (p. 7). Unfortunately, he did not pursue this important thought systematically in his study.
10. The role Prussian Calvinism played in German history has been widely discussed in historiography. It is well known that the expansion of Calvinism to Prussia can be traced back to a concrete political incident, the expulsion of the Huguenots from France. Similarly, the fact that Russia received Christianity via Byzantium, not via Rome, certainly had to do with her geographical position – but this was in no way historically predetermined.
11. This is not only true regarding theories about economic development but also regarding modernity in general. Because of the unquestionable influence that specific patterns of thought have on the institutional structure of societies, there is not just one type of modernity but rather a multitude of modernities, each one reflecting specific religious or cultural patterns [see e.g. Gusfield, 1967; Eisenstadt, 2000]. On the other hand, I do not think that the cultural embeddedness of developmental processes must necessarily contradict Talcott Parson's famous thesis of the existence of "evolutionary universals" in society [Parsons 1964]. Rather, it is the interdependence between general and specific patterns that makes the evolution of society so complicated.
12. I cannot deal with the parallels between the German and Russian history of ideas in any detail here. However, there is sufficient evidence to suggest that in both Germany and Russia there existed holistic traditions of thought whose strength can certainly not be explained by the economic 'backwardness' of these countries alone. The holistic traditions of German thought are known also from the history of 19th- and early 20th-century economics in Germany. And the author of the standard work on the history of Russian philosophy writes about Russian thought: "Russian Philosophers, with rare exceptions, have sought wholeness, a synthetic unity of all aspects of reality and all impulses of the human spirit" (Zen'kovsky, 2003 (1948), vol. 1, 7).
13. The then 'heretical' thesis that the rapid economic growth the American developmental policy of the '50s and '60s was aiming to achieve had to be seen as a dangerous destabilizing force was formulated in an interesting paper by Mancur Olson [1963]. Yet Olson, very much in line with the methodological fashion of this time, completely ignored the cultural dimension of this destabilization. According to him it is the "contradiction between the structure of economic power and the distribution of social and political power" [ibid., 543] that causes political problems in rapidly developing countries. Although I agree with his general assessment of the effects of rapid growth, I do not find his line of argumentation particularly persuasive. In my opinion, the conflict between prevailing patterns of thought and changes in reality offers a far more significant explanation of destabilization in quickly developing countries than Olson's somewhat materialistic argumentation.
14. By saying that in the course of capitalist development traditional values will be substituted by modern ones I do not want to deny the persistency of traditional values. On the basis of the World Value Surveys the American sociologists Ronald Inglehart and Wayne E. Baker have recently come to the conclusion that on the one hand "economic development is associated with pervasive, and to some extent predictable, cultural changes", but on the other hand "the influence of traditional value systems is unlikely to disappear ... as belief systems exhibit remarkable durability and resilience" [Inglehart and Baker, 2000, 49].
15. Thus, in the 1920s the organicistic approaches in German economics were gradually replaced by concepts modeled more on 'western', i.e. Anglo-Saxon ideas [see Janssen, 2000, chap. 2]. The shock of the 'Great Depression' then led to a revival of holistic concepts in the 1930s (see below). In Russia, the October Revolution was preceded by the so-called 'Silver Age' of Russian culture, during which the country seemed to change course both culturally and economically, moving quite clearly towards a 'western' path of development.
16. On external shocks as a source of institutional change see Raiser, 2001, 223.
17. As Geoffrey Hodgson puts it, "complexity and variety within the system are necessary so that the system can survive and deal with complexity, variety and *unforeseeable shocks in the real world*" [Hodgson, 2001, 334, my italics].

18. The most comprehensive work on the evolution of Eucken's economic thought is Goldschmidt, 2002.
19. This term was included only into the sixth edition of 1950. Therefore it is missing in the English translation, which is based on the fifth edition from 1947.
20. All in all, Christian ethics was such an integral part of ordo-liberal thought that it seems fully justified to say that "ordo-liberals treat economics as a moral science" [Peacock and Willgerodt, 1989, 5; see also Rieter and Schmolz, 1993; Goldschmidt, 2002].
21. As his pupil Christian Watrin notes, it is now impossible to reconstruct how long Mueller-Armack remained convinced that National Socialism would solve the crisis of the modern age. We can see, however, that the ideas he expressed in his cultural and religio-sociological writings of the following years, which picked up the thread from Werner Sombart and especially Max Weber, were "directly contradictory to the biological racism of National Socialism" (Watrin, 1988, 51).
22. In an article on "The scientific origins of Social Market Economy" (*Die wissenschaftlichen Urspruenge der Sozialen Marktwirtschaft*) Mueller-Armack explicitly pointed out the historicist roots of Social Market Economy [see Mueller-Armack, 1973, 248].
23. Therefore, his policy-oriented style-theoretical approach had little in common with "the more diffuse concepts" of *verstehende Nationaloekonomie* [see Klump, 1997, 148].
24. Even the party of Ludwig Erhard, the conservative Christian Democrats, still proposed the nationalization of the coal, iron and steel industries in their Ahlen program of 1947.
25. "Today, the state of society in the world is characterized by social disintegration, by a division of the individual as well as of society" [Mueller-Armack, 1950a, 108].
26. "As a weasel is alleged to be able to empty an egg without leaving a visible sign, so can these words deprive of content any term to which they are prefixed while seemingly leaving them untouched" [Hayek, 1988, 116].
27. Indeed, it is to be observed that in German economic policy the irenic formula "Social Market Economy" provides a high degree of continuity. This continuity has its dark side, however. For it can prevent the implementation of more radical reforms, which are all too easily suspected of putting an end to Social Market Economy. This mechanism can be clearly observed in the current debate about structural change in Germany.

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