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From a Social to a Sustainable Market Economy

A new paradigm for the 21st century
The social market economy played a key role in West Germany’s economic and social recovery after 1945; indeed, the concept has become synonymous with the German “economic miracle”. Evaluations of Germany’s social market economy on the occasion of its 60th anniversary in 2009 are mainly positive. At international level, too, the model has been recognised and even admired as offering a “third way” between capitalism and socialism. And yet the social market economy was the subject of considerable controversy even prior to its inception, and this controversy has continued to the present day, most recently in the ongoing debate about the level of benefits – core services vs. comprehensive provision – that should be provided by Germany’s welfare state.

Since 1987 – the year of the publication of the Brundtland Report – a new paradigm, namely sustainable development, has developed as a guiding vision at international level. Endorsed by the international community at the United Nations Conference on Environment and Development (UNCED) (Earth Summit) in Rio de Janeiro in 1992, the concept of sustainable development is becoming increasingly relevant at the national level as well. At the follow-up conference (Earth Summit+5) in New York in 1997, it was agreed that all countries should adopt a national sustainable development strategy (NSDS) by 2002. Germany submitted its first national sustainability strategy in time to meet this deadline.

Since then, the social market economy and the sustainable development paradigm have co-existed side by side in Germany. However, the relationship between them has rarely been discussed, and little effort has been made to “join up” these two concepts. Numerous experts working in the fields of politics, the economy and research have found it impossible to draw a clear substantive distinction between them. That being the case, this policy paper will start by considering the core elements of the two models and the key differences between them. It will then present arguments in favour of developing the social market economy into a sustainable market economy and consider how this can be achieved in practice, with particular reference to the sustainability strategy adopted by the German federal state (Bundesland) of Rhineland-Palatinate.

I. The social market economy: the background

In order to reach a clear understanding of what constitutes a “social market economy”, it is essential to reflect on its origins. There are three key figures in Germany’s post-war history whose ideas made substantial contributions to the development and realisation of the social market economy: the theoretical economist Walter Eucken (1899-1950), the later Minister of Economics and Federal Chancellor Ludwig Erhard (1897-1977), and Alfred Müller-Armack (1901-1978), a social economist with a strong interest in the cultural aspects of economic activity.

In his book Grundlagen der Nationalökonomie (The Foundations of Economics), Eucken defined the regulating principles for a competitive economy in which the state establishes and sustains the conditions for competition (Wettbewerbsordnung) that ensure optimum social welfare. Eucken argued that the social ethos, i.e. ensuring that all members of society can live their lives in human dignity, is essential if a competitive system is to be successful. However, Eucken rejected the notion of a separate social policy; in his view, “social policy, understood correctly” must be integrated into regulatory policies (Ordnungspolitik) which help individuals to help themselves (dominance of the subsidiarity principle).

Ludwig Erhard – the driving force behind the development of a competitive market economy – viewed competition purely as an economic, not a social phenomenon, and did not attribute any special status to social policy issues in the context of competition. It is thanks to Alfred Müller-Armack – who coined the phrase “social market economy” – that social justice acquired greater relevance in the context of competition. Müller-Armack believed that the market economic system must be integrated into an “overarching system of life” (übergreifende Lebensordnung) – in other words, people must occupy a central place in the inherent logic of the economic order – and that the purely technical process of manufacturing goods must be corrected and supplemented as necessary to that end. Müller-Armack thus developed a flexible concept of a well-performing market economy which was dedicated to the public good and whose success would promote social justice.

Ludwig Erhard took up the concept of the “social market economy” without specifying precisely what it should consist of. This is probably one of the reasons why the concept was met with broad support. The social market economy thus became part of a basic consensus among the various social groups, and this consensus helped to create a strong economy and society in Germany.

The institutional reorganisation of Germany’s economic and social system after the Second World War took place in line with principles which had already evolved during the German Empire and Germany’s first republic. This is...
II. The sustainable development paradigm: the background

As early as 1987, the Report by the Brundtland Commission argued in favour of sustainable development as the new guiding vision for global action. In 1992, the Earth Summit in Rio declared sustainable development to be the blueprint for the 21st century. It also adopted “Agenda 21” as the practical framework for action towards ecologically, economically and socially equitable development in the interests of present and future generations.

At the heart of this consensus is the recognition that the three dimensions – ecological, economic and social – must be considered to an equal extent, and must work together, via local, regional and national sustainable development strategies and in international agreements undertaken within the framework of global governance, in order to achieve sustainable development. In the social/eco-social market economy, however, the economy clearly predominates, with the social and ecological dimensions playing a subordinate role. Equal status for all three dimensions may well be an ideal which can never be fully attained in practice. Nonetheless, this principle must be upheld as the goal to which we must always aspire, in order to do the greatest possible justice to the guiding vision of sustainable development.

The following section will focus on each of the three dimensions in more detail.

1. Ecological sustainability

Without nature, humankind cannot survive. Nowadays, however, human-induced pressure on the natural environment and ecosystems is intensifying, and in some cases has already reached the point of overexploitation. The depletion of natural resources, the diversion of material and energy flows, large-scale modifications of natural structures and the pollution of protected assets such as the Earth’s atmosphere are increasingly altering our natural ecosystems and putting them under stress. Besides these economically relevant aspects, the natural environment also offers opportunities for regeneration and aesthetic enjoyment. The unprecedented rate of resource exploitation and environmental degradation therefore makes a redefinition of humankind’s relationship with its natural life support system imperative.

Ecological sustainability aims to preserve natural ecosystems as the life support system for all human activity. In other words, the economic system cannot be sustainable of its own accord, as its ongoing existence depends on the interplay between human activity and ecological systems.

The question which arises in this context is when, precisely, the optimum level of benefit derived from the natural environment is reached. In environmental economics, there is disagreement between the proponents of weak vs. strong sustainability on this issue. Weak sustainability means that physical capital of equal value can replace natural capital as long as the total capital stock is maintained for future generations. For example, if a roadbuilding scheme results in the clearance of an area of forest, the stock of natural capital is reduced but additional physical capital is created. If as a result of the substitution, the capital stock (physical capital + natural capital)
remains unchanged, a situation of weak sustainability arises. This is distinct from the strong sustainability paradigm. Proponents of strong sustainability also acknowledge the need for consumption of natural capital as part of the economic process. However, they demand compliance with rules to protect these resources and to regulate human activity (see Figure 1). They also call for rigorous protection of those ecosystems which are essential for human survival.

![Diagram](Figure 1: Rules for action in the interests of ecologically sustainable development)

2. Economic sustainability

As with ecological sustainability, the aim of economic sustainability is to maintain the economic capital stock. A starting point for economic sustainability is the traditional theory of growth. This is based on the premise that in the long-term balance, an increase in per capita growth can only be achieved through technological progress. However, since the publication of the first Club of Rome report, entitled *The Limits to Growth*, this notion has aroused intense controversy among economists. The arguments advanced in support of the need for growth relate not only to poverty reduction in developing countries but also to the necessity of growth for the attainment of intragenerational equity in the industrialised world.

The question which arises, then, is how technological progress impacts on the utilisation of production factors, i.e. labour, physical capital and natural capital. If technological progress increases labour or capital while the productivity of natural capital does not increase at all, or not at the same rate, growth will result in increased utilisation of natural resources and/or greater environmental stress. Environmentally-oriented technological progress, however, may result in a decoupling of growth from the utilisation of natural capital. This would mean, for example, that the rate of growth increases while consumption of environmental resources/environmental stress remains unchanged. Alternatively, the rate of growth remains constant while consumption of environmental resources/environmental stress decreases. This decoupling may be reinforced not only by technological but also by social and institutional innovations, such as environmental management systems. Innovations thus acquire an entirely new success criterion; they are no longer regarded as successful if they simply meet criteria of economic success, i.e. if they sell well in the market; rather, they must meet the requirements of all three dimensions of sustainable development and prove successful in the market.

Welfare economics offers a different perspective on economic sustainability. Neo-classical welfare economics is concerned with maximising the individual's material prosperity (per capita income). This is distinct from social welfare, which goes much further, in that besides measuring the material prosperity of individuals or a society in quantitative terms, it also includes subjective aspects (i.e. quality of life). Thus material dimensions such as work, income and consumption are augmented with non-material dimensions such as freedom, social justice and social consensus. This enhanced concept of welfare goes beyond the “national income” indicator. Various alternative indices have been developed for this purpose over the past three decades, their common feature being that they aim to measure more than just material prosperity, i.e. national or per capita income. Examples are the *Index of Sustainable Economic Welfare* (ISEW), the *Human Development Index* (HDI) or the *Pressure-State-Response* model developed by the OECD. The ISEW, for example, looks at spending on private consumption. Consumption by private households is divided by the share of income of the poorest fifth of households compared with the other four-fifths of the population. Using these two key indicators (consumption and its distribution), the ISEW thus measures both economic prosperity and social welfare in a given country. Also the ecological status of a country is reflected in the index by including, for example, the costs resulting from environmental pollution or the consumption of non-renewable resources.

From a sustainable development perspective, then, economic growth does not just mean an increase in the population's income level. In line with the enhanced concept of growth, growth must make a full contribution to improving people's overall welfare, with a focus on quality of life.
3. Social sustainability

In addition to ecological and economic sustainability, social sustainability and thus the preservation of social capital are imperative. Social capital is often understood as the social structure (social networks, social contacts) in a given society. Unlike the other two forms of capital, however, there is no standard definition of the term.

A key feature of social capital is that it is not traded in the market and therefore has no quantifiable price. In common with economic and ecological capital, it is possible to develop a stock of social capital which can be of long-term benefit to the production process. Key elements of social capital are trust, norms and social networks. Four separate dimensions can be identified in this context:

- social integration (e.g. integration of persons from different religious faiths or different socio-cultural backgrounds into society),
- horizontal social links within communities (people should be integrated equally into society regardless of whether they have a disability, for example),
- the relationship between state and civil society,
- the quality of government institutions.

Social capital includes, for example, the existence of a transparent legal or education system which is accessible to everyone and treats everyone equally. However, it is not just about formal equality of opportunity: as Amartya Sen rightly points out, individuals must also be able to access these opportunities in practice (capabilities approach). There must also be a well-functioning economic system with a high level of stability, and the guarantee of basic democratic freedoms.

The existence of social capital can have positive but also negative effects. One of the negative effects, for example, is the growing power of lobbyists, which constrains common welfare-orientated political capacities. Modern information and communication technologies and the Internet are generating positive economic effects from social capital: the Internet in particular has resulted in unprecedented levels of networking and information provision, which has substantially reduced the costs of obtaining information. Social capital can also have positive effects on ecological capital. More intensive social relations and/or a basic consensus within society can result in environmentally harmful behaviour being regarded as anti-social, which in turn may lead to a reduction in environmental pollution.

The question which arises, then, is how the social capital can be maintained and how future generations can benefit from the current stock of social capital. It must be borne in mind, however, that social capital is not owned by individuals, but can only be owned by a social network or, indeed, by society as a whole (unlike human capital, which is person-specific). As the transfer of a society’s social capital to the next generation is only possible to a very limited extent, each generation is, by and large, responsible for developing its own stock of social capital.

4. The interplay between the three dimensions of sustainability

The substantive demarcation between the three dimensions of sustainability and the three types of capital says little about their relationship with each other. It is notable, in this context, that there is already a substantial body of literature dealing with the relationship between ecological and economic capital. Eco-efficiency is a good example: if, for example, a company’s new production plant uses less energy, this will have a positive impact by reducing emissions, which in turn will drive down the com-
pany’s costs. By contrast, the importance of social capital for other types of capital has long been neglected in the economics literature. However, the role of social capital in the maintenance and productivity of other types of capital such as “human-produced capital” (physical capital), human capital (skilled labour) and environmental capital is becoming an increasing focus of interest in the current debate, as the following three examples illustrate:

- Social capital can help to improve the productivity of environmental capital if society’s awareness of ecological problems and its own responsibility increases.
- Social capital can help to increase human capital. For example, empirical studies have revealed a correlation between more confidence within society and a higher level of education.
- Social capital can also increase the productivity of physical capital. For example, one study has found that inter-company contacts, in the form of networks, can have a positive learning effect.

There are many other examples of complementarity between the three forms of capital. For example, clean air and clean water improve human health and therefore the productivity of human capital (by improving workers’ physical capacities and hence their performance). This suggests that the synergies generated through the complementarity of two or more forms of capital increase overall productivity. The complementarity between physical capital, environmental capital and social capital is particularly apparent in the field of education policy. Education can make a positive contribution not only to economic development per se, but also in making economic development more environmentally and socially compatible.

5. A new understanding of justice and equity

A key difference between the social market economy and a sustainable market economy is the understanding of justice and equity. The Brundtland Report, published more than 20 years ago, called for two dimensions of justice and equity:

- Intragenerational equity means achieving a fair balance between the interests of the present generations living in the industrialised and developing countries.
- Intergenerational equity is defined as follows in the Brundtland Report: “Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.”

Naturally, these two dimensions are interrelated. Across the world, income and wealth inequality is increasing. In many countries, equality of opportunity is making little or no progress. Debt and growing environmental problems are ever-increasing burdens which will be passed on by the present to future generations.

**Recommendation**

The German Government and the federal states (Bundesländer), which are responsible for education policy, should mainstream sustainable development as a guiding vision at all levels of education. For example, education for sustainable development should be integrated more fully into the curricula in schools, universities and institutes of further education.

**Recommendation**

The German Government and the EU should work to ensure that both intragenerational equity (between the present generations living in industrialised and developing countries) and intergenerational equity (between present and future generations) are vigorously and consistently promoted. This dual objective is one of the core demands and messages of the sustainable development paradigm. It is not just about demanding greater equality of opportunity; it is about promoting people’s capabilities to access equal opportunities, both inter- and intragenerationally. There are many areas which offer potential here, notably education, health and social security, as well as measures to promote integration and participation.
III. Practical implementation of the sustainable development paradigm

Since 1992, numerous measures have been taken to implement Agenda 21 in politics, society and the economy. In Germany, for example, countless measures have been initiated and implemented in the municipalities under the “Local Agenda 21” banner. The German federal states (Bundesländer) have begun to produce their own sustainable development strategies, and the EU has also unveiled a strategy of its own. Non-state actors such as companies and church-based institutions have also increasingly recognised their responsibility in the context of sustainable development in recent years, and this is reflected in the concept of corporate social responsibility (CSR) in particular.

On the face of it, the national sustainable development strategies (NSDSs) which were agreed at UN level in 1997 appear to show a positive trend worldwide. All the EU countries, including the new members, have produced NSDSs. Implementation of the strategies, which in line with the relevant UN General Assembly resolution had to take place by 2005, has begun in the various countries, albeit with varying levels of intensity. From a global perspective, however, this process has not yet progressed very far (see Figure 2). In Asia in particular, only the implementation process in Japan and South Korea can be said to be progressing well. In the other Asian countries,

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**Figure 2: National sustainable development strategies: the global picture 2003 and 2006**

it is still in the initial stages or has not yet begun. To that extent, the world map showing the state of play as of June 2006 paints a somewhat optimistic picture. There are two main and sometimes related reasons for this:

- In the majority of Asian countries, there are powerful interest groups which oppose equal status for the three dimensions and are lobbying hard to maintain the dominance of the economic pillar. This makes it very difficult to sufficiently introduce and implement environmental and social measures as part of a sustainable development strategy.

- Very often, political actors are not prepared to initiate a participatory process for the development and implementation of a sustainability strategy which includes all social groups. Furthermore, they often lack the methodological and conceptual expertise that is necessary to produce and implement a sustainable development strategy.

In line with the UN resolution, however, the national sustainable development strategies should be characterised by a “soft” approach based on a participatory process of goal identification in which all stakeholder groups are involved as a matter of principle. This is also important because sustainability strategies do not have the binding force of legislation or regulations. Rather, they focus on learning processes and continuous improvements to facilitate progress towards the goals.

The German Government adopted the German Strategy for Sustainable Development in 2002, with updates in 2004 and 2008. The German Council for Sustainable Development is primarily responsible for disseminating and further developing the strategy. Numerous institutions, associations and non-governmental organisations have provided opinions and constructive criticism on the various versions of the strategy. The strategy is structured in accordance with four main guidelines: intergenerational equity, quality of life, social cohesion, and international responsibility. The first version of the strategy identifies 21 action areas with relevant indicators. The action areas range from reducing land use to increasing economic prosperity and the integration of foreign nationals.

Germany’s national Strategy for Sustainable Development identifies various problems which are still unresolved, and in some cases proposes viable solutions. For example, daily land utilisation for housing and transport currently stands at 115 ha per day and is thus well in excess of the target (30 ha per day by 2020), with only a very small decrease being observed to date. It is therefore unlikely that this target value will be achieved. As regards progress in the field of environmental technology and ecological modernisation, the strategy fails to provide satisfactory answers to the question whether a balance can be achieved between economic growth and the environment, and whether the focus on efficiency is adequate. The German Government sidesteps this controversy with the comment that “our proposal is viable as a middle way between two maximum positions” (Progress Report 2004 on the German Government’s Strategy for Sustainable Development, p. 29). Strong sustainability is not discernible or represented as a position here. By contrast, in the action area “Integration of foreign citizens”, the measures outlined can certainly be expected to bring about improvements.

Another positive aspect which should be emphasised is that Germany is aspiring to take a leading role worldwide in the context of sustainable development. Among other things, Germany is keen to engage in research cooperation with the BRIC states (Brazil, Russia, India, China) and South Africa, commencing with a joint research initiative with India in 2008.

**Recommendations**

1. Germany and the EU countries should rigorously pursue the operationalisation of their national sustainability strategies. Germany in particular should endeavour to take a lead role in the context of sustainable development.

2. Cooperation between Germany and the EU with other countries and regions in the field of sustainable development should be expanded. In particular, a development and environmental policy dialogue should be pursued on the basis of equality with BRICs and other newly industrialising and developing countries, with a view to developing the sustainable development paradigm further and supporting its operationalisation worldwide. Initial efforts aimed at research cooperation are already under way.

3. The German Government and the EU should also assist their development partners with the formulation and implementation of their national sustainable development strategies. In particular, they should ensure that civil society in these partner countries is involved in the sustainable development process. This is in line with the original resolution adopted by the heads of state and government, and is also a key element of the Accra Agenda for Action, adopted by the large majority of donor and partner countries in 2008 with a view to improving aid effectiveness.
Although the sustainable development paradigm has been well-established internationally for many years and has been elaborated in numerous national sustainable development strategies, it is often still viewed purely as an abstract vision which is almost impossible to realise in practice. In the following section, this paper aims to refute this position, with specific reference to a regional sustainable development strategy. Rhineland-Palatinate is one of the German federal states which have taken the lead on developing and implementing sustainability strategies. Its sustainability strategy aims to analyse the challenges arising at the nexus between the economic, ecological and socio-cultural dimensions and resolve them in an action-oriented way. It is not about planning for the future in a static or overly precise way; rather, the aim is to establish a framework for a future-oriented Rhineland-Palatine and initiate and drive forward its sustainable development process.

1. The Integrative Sustainability Triangle (IST)

The external framework for Rhineland-Palatinate’s sustainability strategy is provided by the “Integrative Sustainability Triangle” (IST), which brings together the three pillars of sustainable development (ecology, economy and society). The targets defined for Rhineland-Palatinate have been integrated into this triangle and are depicted in the form of sustainability fields (see Figure 3). The previous focus on individual environmental media (air, water, soil etc.) or on ministerial portfolios has thus been abandoned in favour of cross-cutting areas of action. For example, forest management and its related sectors, such as the wood-processing industry, not only fall within the scope of the Environment Ministry’s portfolio but also form part of the portfolio of the Economics Ministry. At the same time, the sustainability fields extend across several action areas in the Integrative Sustainability Triangle and thus form cross-cutting fields of sustainable development.

The sustainability fields are then subdivided into various action areas (see Figure 4), to which quantifiable indicators are assigned. In this context, it is essential to ensure that the number of action areas remains manageable, in order to facilitate the operationalisation of the strategy.
The following criteria apply to the action areas:

- Each action area must have clear relevance to the Agenda 21 programme.
- The stakeholders responsible for implementing each action area must be identified.
- The targets in the individual action areas must be agreed with the relevant stakeholders.
- Finally, indicators must be identified to measure progress towards the attainment of the goals.

“Mobility” as an action area, for example, is measured against indicators such as carbon dioxide emissions from the transport sector and noise pollution, while the “productive base” is evaluated using indicators such as the gross investment rate, and “intact environmental media” is measured against the ecological and chemical composition of watercourses, air pollution and forest stocks.

The individual indicators are assigned a target and are set against comparative values (national sustainable development strategy, other federal states’ strategies, etc.). For example, CO2 emissions are measured in tonnes per capita. This enables the trend in Rhineland-Palatinate over the past 15 years to be plotted on a curve (“tonnes of CO2 per capita”) and compared with the trajectory for the Federal Republic of Germany as a whole.

In order to achieve the targets, appropriate programmes/projects must then be identified.

**Recommendation**

Measures to translate the vision of sustainable development into practical reality can be defined in the sustainability strategies. As the starting point, action areas should be identified and demarcated, e.g. using the Integrative Sustainability Triangle. For each action area, indicators should then be identified which enable a specific objective to be set for the future. Policy-makers should then specify dynamic targets for the indicators, whose attainment can then be evaluated (e.g. using a scale which includes the following grades: “achieved very effectively” – “achieved less effectively” – “inadequate”, with reasons being stated).
2. Practical experience with Rhineland-Palatinate’s sustainability strategy

Rhineland-Palatinate’s sustainability strategy combines the technical requirements of sustainable development with the objectives adopted by Rhineland-Palatinate itself. The methodology applied allows a combination of action areas and indicators to be used. The indicators are an important basis for the sustainability strategy and its operationalisation. For example, they allow a review and comparison to be undertaken with Germany’s national sustainable development strategy – i.e. the level at which the action areas are located – and provide a basis on which to specify target values. For example, one particular target is to increase the share of renewable energies to 30% by 2020. Through this goal, the action areas acquire an unprecedented degree of binding political force.

From the outset, Rhineland-Palatinate’s sustainability strategy was developed and implemented in a participatory process. Not only the responsible ministerial actors but also relevant stakeholder groups were involved in defining the action areas. The stakeholder groups were also invited to identify best-practice sustainable development projects from their locality for inclusion in Rhineland-Palatinate’s progress reports on sustainable development. Numerous projects with clear relevance to sustainability were submitted. This reinforces the awareness that the sustainability strategy is “owned” by the federal state and its citizens and that all stakeholder groups have a responsibility for its further development and operationalisation.

It is not possible to promote all 21 action areas simultaneously and to an equal extent. The route being pursued in Rhineland-Palatinate is therefore to identify five or six key areas (“beacons”) in the strategy, which will then be prioritised for a specific period due to their topical relevance; climate protection is a good example. However, the other action areas will continue to be supported even though they have not been designated as “beacons”.

V. From a social to a sustainable market economy – looking to the future

The concept and realisation of the social market economy played a key role in Germany’s recovery after the Second World War and in the development of the German economic system. The “economic miracle” – i.e. the rapid reconstruction of the economy, with high rates of growth – combined with economic and social stability did much to achieve a high level of prosperity for the German people.

From the outset, however, a key feature of the social market economy was the dominance of the economic dimension, while the ecological and social dimensions played a subordinate role. Efforts to implement intragenerational equity (equal opportunities, as well as fair distribution of income and assets) were therefore half-hearted – there was a persistent lack of coherence between the various policy areas, despite numerous calls for such coherence – and the issue of intergenerational equity was almost completely neglected. Nonetheless, it is important to mention that Germany has made significant achievements in the field of environmental protection, for example, especially as compared with other countries.

However, it is widely accepted among experts, for example, that the minor reduction in CO2 emissions on a global scale is certainly not enough to make an adequate contribution to climate protection. The question, then, is whether the social market economy can help to achieve a lasting solution to the problems outlined at the start of this paper and alleviate the growing pressure resulting from the continued dominance of the economic dimension. This question arises with even more urgency in the context of the Anglo-Saxon economies.

Recommendation

In politics, but also in the economy, there must be a greater recognition that the clear dominance of the economic dimension is not an appropriate response to, and cannot solve, the current national and international problems and crises. Germany should therefore abandon its adherence to the social market economy model and become a worldwide pioneer of the sustainable market economy.

The practical realisation of the three dimensions – economic, ecological and social – on an equal basis can only be achieved via a long-term process, i.e. along the “sustainable development” pathway. Long-term stability and harmony between these three dimensions are only possible if this pathway is pursued consistently. It will ensure more prosperity for the individual, and also a welfare balance at national and international level. This is increasingly being recognised by political and economic actors as well as civil society. For that reason, “all” that is needed now is consistent implementation of the guiding vision of sustainable development for the 21st century.
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