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ARTICLE

**Soziale Marktwirtschaft - Key to Economic Success or
*Contradictio In Adiecto***

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Point of Departure

No words can describe the state of destruction or rather annihilation of Germany as a consequence of allied bombing raids until the very last day of WWII. The present author was a boy of three years when the war ended and he clearly remembers the ruins of the city of Hamburg. The fortune his grandfather had earned and invested in USA was gone, as was the case of all other foreign holdings of German citizens. When your author left school (1962) non-communist West-Germany had been rebuilt by about 90%. West-Germany had become the biggest economy of the world after USA. Huge balance of payment surpluses had put us in the same position China is in today. 1990 communist German Democratic Republic (GDR) joined the Federal Republic (Wiedervereinigung/ reunification). GDR was a completely run down territory. Twenty years later its infrastructure is one of the best in the world. Through all these 20 years the Federal Republic of Germany remained what it had been from the first to the present day: the major financial net-contributor to European Economic Community. Germany always paid more into the common pot than France, Italy and England together. Obviously there was and still is quite a difference in the economic development of Germany and other countries.

What is the reason? The answer mostly given is: German concept of Soziale Marktwirtschaft (social market economy, hereinafter SMW). A “system” would never explain everything. SMW therefore does not explain it all. But it is widely believed that SMW was the biggest single factor for the recovery of Germany after WW II and her performance ever since. It may be worthwhile to have a closer look at what SMW is about.

Scope of Economy

There are as many forms to live your life as there are men. The extreme on one side may be the nomad and on the other side the monk who is spending his life in a monastery following the unchangeable rules of St. Benedict (6th century). Equally, the scope of economic systems reaches from unregulated exchange of rude commodities to strictly regulated systems as we had them under soviet style communism. In the same way as law comes into being, so does economy, and vice versa. Theoretically, it may be possible to dream of an economic order outside of state and law. In practice this has never happened. So far as we know history, economy has always operated within a national and legal order, be this a state capitalism, as we find in old China or under Diokletian in ancient Rome, cooperative structures were found in medieval Europe or early capitalism in Northern Italy from the 13th century onwards. In the same way as nations began to exist and to build their legal order, they also organised their economy. There was no time in recorded history without economic policy (Wirtschaftspolitik). The idea that the state should not intervene at all in economy is as wrong as the opposite, namely, that the state should do it all without paying heed to the freedom of the market and its forces. Abstinence in economic policy is paramount to abstinence of politics at large. World wide consensus today is that the state must further the well being of the nation by overseeing, among other things, development

as well as the economy.

This poses the question as to what aims and objectives economy has and how to achieve these. The answer given in Germany is SMW. SMW is understood not only as an economic system but as a program or leitbild (model, concept) for the society as a whole, comprising all aspects of life including law and social questions in general, in which economy plays the role of supplying means for what the desired quality of life creates the demand.

Invention of SMW

Laissez faire v. State intervention

A. Müller-Armack envisaged the idea of “Soziale Marktwirtschaft” under the impression of the hopeless state of Germany after WW II. There was no realistic chance that Germany would ever recover; and if there was one, this could not be hoped from market forces alone, without *laissez faire*. Nothing was, on the other hand, to be expected from Soviet style socialism. There was no question that a liberal market system had to be reinstalled after the devastation in Germany, a sense of economic freedom and entrepreneurship had to be rekindled.

After WWI there had been appalling examples of *Kriegsgewinnler* (profiteers from the war) becoming very rich, while the majority of the population was almost starving. This was not to be repeated. That part of Germany which was under the administration of the western powers (later West- Germany) had to integrate some 11 million Germans who had been thrown out of their homes in Silesia, Pommerania etc. The present author was 10 years old and remembers well: We West -Germans had little, but these people had nothing. Market economy can work only if seller has at least something to sell and the buyer has something to pay. But, given the existing situation this was found that economy should be deliberately guided as a social (in the meaning of caring and responsible) market economy. A label was found which would later be attached to the stunning economic success of Germany (*Wirtschaftswunder*). What exactly was meant by this, however, was by no means clear, not even to the author himself.

SMW as political label

The label SMW was from the outset of a highly political nature, being at the same time both unclear and inspiring. It was successfully used to win elections for the Christian Democratic Party (CDU) of Adenauer and later of Erhard. The word “sozial” (Engl/French: social), which was unknown to economists and politicians until about 1850, today has become one of the most frequently used and indeed misused words in the world. It has been said, that for its vagueness the word social has no meaning at all. Friedrich Hayek wrote back in 1957 that this adjective takes away the clear sense of everything to which it is attached. *Marktwirtschaft* (market economy; hereinafter: MW) which understands itself to be social, therefore seems to cease being MW. The term *soziale MW* has therefore been labelled as a *contradictio in adiecto*, a contradiction in itself, like cold fire. L. Erhardt, who is generally regarded as the father of SMW, called this a pleonasm, because MW already by itself is “social.”

Historic Background

It may be helpful to give a short overview on changing concepts of state interference with economy in order to show that SMW stands in a row of similar concepts. Greek and Roman writers left some books on agriculture, but nothing on the economic process as such. Economy just happened. We vaguely feel that up to the time of Diocletian (284 – 305) there was what could be called a “liberal” system with little direct interference of the state. For reasons not to be discussed here, things deteriorated thereafter. Costs of the military went up, the huge build up of the imperial bureaucracy added “unproductive” persons to the emperor’s payroll. Productivity both in agriculture and industry declined, inflation went up. The state gradually gained control over every level of the economic process. The liberal system transformed into what has been called, state capitalism or, depending on the point of view, state socialism.

In the European Middle Ages there was little theorizing about economics. Some type of mercantilism can be seen in Sicily, the first modern state (Jacob Burckhardt), under the German emperor Friedrich II (13th century). Exports were encouraged, imports discouraged. Economy was monopolized by the state. Commodities were sold at prices fixed by the state. Market forces, supply and demand, were not yet seen as decisive for price building. By and large this was the state of things during the following centuries. Economic thinking was influenced by upcoming ideas of political or philosophical liberalism. French economist Turgot 1759 coined the famous phrase: *laissez faire, laissez passer* (let them do, let it go), which became the motto against mercantilist control of the state. Economic liberalism followed. Theories began to define economy without reference to the state and devised theoretical models (Max Weber: *Idealtyp*) with no or little reference to the actual environment in which economy operates. Economic theories lost touch with the real world. The *soziale Frage* (social issue) came up. Progress in medicine and health care had reduced infant mortality and increased life expectancy. This led to a virtual explosion of populations in all advanced European countries as of 1800. Masses tried to enter the already crowded labour market. Pauperisation of the working class ensued. Karl Marx’ great work *Das Kapital* does really catch every reader with its heartbreaking examples of the working class in mid 19th century England as opposed to the life style of plant owners.

Apparently the lamentable situation of working classes could not be solved simply by *laissez faire*. Socialists called not only for state control of the economy but for the expropriation of capitalists. It may be noteworthy that it took only hundred years from the liberalism of Adam Smith (*Wealth of Nations* 1776) to the opposite side of communism (*Das Kapital* 1867; postum completed 1883). Since then attempts have been made under various names to blend economic liberalism with some sort of socialism. Bismarck’s invention of a social security system may be the most prominent example. Controversies between social democrats, radical socialists and communists dominated the political scene after WW I not only in Germany. England saw its first Labour Government, Italy went fascist and France almost succumbed to this ideology. Each of these had its own ideas on how the state should take control of economy to improve the condition of the working classes. The big depression of 1930 brought fascism to Germany. Without even knowing the name of Keynes, Hitler by building autobahns and cars (Volkswagen) put into practice what Keynes was about to publish some years later: causing the state to create demand for jobs by deficit spending. It seemed to work. But what followed was a state capitalism or, depending on the point of view, state socialism, in which the government became the major and by and by almost the sole player.

Three steps to SMW

Maslow's Hierarchy of Needs tells us that human needs develop from bottom to top, from basic needs to preserve our physical life, to social needs such as friendship, family, and further to sublime needs such as morality and search for philosophical truth. The same principle seems to apply to the aims and objectives of economic needs and development of human attitudes corresponding to the formation of attitudes and underlying economic motivations.

The first step on this hierarchical ladder of objectives of economy is obviously the supply of food and shelter. These needs are imperative and cannot be delayed. What is needed are instructions on how to grow certain crops, to raise cattle and how to build a house. This is exactly what has come down to us from the Roman writers. Theories on the economic process as such are of no avail at this stage. The same holds true for the mercantilism in the middle ages. It was not based on any economic concept or theory but simple and factual, albeit with some sophistication on the way.

The next step on the ladder comes with new socio-cultural developments and the advancements. The scope of economic activities became wider. Economy which for centuries had been dealing only with a handful of commodities became more complex. Scholars started to ask: where does the wealth come from (French physiocrats, A. Smith, v. Thünen) and, as of 1850 they developed theories about how wealth could be created by good planning and government involvement. Economy was somehow seen as a machine turning out wealth at will of its master, if he only had the right instructions manual. Since then economic theory basically was about writing such a manual. The culmination of this was Keynes. Based on the magic of creating and discreating money through central bank's new methods, invariably with the name of Keynes, are engaged to achieve this. Creating wealth by wealth creating is the word in today's ruling economic theories.

Now the Third and last step on the imagined ladder. Keynes did not have the magic pill. The creation of artificial money was as recent as the central banks which made their appearances by the end of the 19th century. Creating growth by artificially stimulating demand and thereby artificially stimulating supply can well lead to growth, which is as artificial. The financial crisis of 2008/9 has shown this. The vast majority of Nobel Prizes in Economy has been won by Americans. The ultimate worth of their accomplishments remains however doubtful. It is hard to believe in the rich-making magic of indebting yourself, e.g. to communist China!

Shortage of resources, spoilage of the environment, destruction of the social texture etc lead to again wider views. What is economy fundamentally, really about? Is there something beyond feeding and housing and enjoying luxury? Taking resources from somewhere to serve ever increasing needs and exotic wishes elsewhere – can this go in forever? Does it bring life, liberty and happiness? The pursuit of these, or in modern words, quality of life, is the objective of economy under the concept of soziale Marktwirtschaft. Two World Wars have brought the peoples of the world together. From the outbreak of WWI in 1914 we all share at least one historical date. Rich countries cannot turn away from the unfortunate and the wretched of the earth submerged in their calamities. Economy today, for good or bad, is World Economy. It is part of the concept of SMW. An economy which cannot properly feed and house its citizens is neither social nor anything else. A world in which the majority is not properly fed or housed is, to say the least, imperfect and

flawed. SMW wants to change this world by vision Adam Smith prescribed for his time: Enrich yourself and an invisible hand will give your neighbour his share.

Stabilitätsgesetz and the Magic Square

Parliament cannot decree price stability, growth etc. What, however, cannot be legislated is to make it mandatory for government and bureaucracy at all levels to have certain objectives constantly before them. German Law to promote stability and growth of the economy (*Stabilitätsgesetz*) of 8th June 1967 specifies as national objective economic equilibrium (Art. 109 para 2 GG, German Constitution). This law embodies the so called Magic Square of aims to be achieved in SMW(see below). The term magic implies that not all goals can be achieved simultaneously. The real message of this law is therefore the following: Price stability, growth etc are no absolute economic aims, but are only considered to be supportive of the ultimate objective of economy: Harmony without stagnation! This ultimate objective in fact coincides with the well understood national objective of any state. The four objectives of Magic Square are important in all countries, they are by no means special to Germany. But based on its history in the 20th century Germany feels that it has more than other countries experienced their impact not only on economy but on the whole society. These four objectives are the following:

Price stability

Twice in a generation Germany suffered the effects of inflation. After WW I the big inflation of 1923 wiped out all money holdings thus causing social havoc of unheard dimensions. After WW II again German money claims were devalued by 10 to Ever since Germans are particularly sensitive about tampering with the currency and inflating money.

High level of employment

Mass unemployment in the 1930's met with a German population already impoverished by inflation of 1923. Some 6 million unemployed have been the major argument for Hitler and his party in 1933. No wonder that Germany remains very sensitive about this issue of employment.

Balance of payment equilibrium

Export is the core and bone of German economy. It has, except for coal, which is losing importance, almost no natural resources, and must import (e.g. energy and raw material) in order to export refined machinery etc. When the Stability Law was passed, the Bretton Woods system of fixed exchange rates was still in force. Germany, more than other countries, was dependent on an equilibrium of im – and exports, as too high a surpluses would kindle inflation (imported inflation). Floating exchange rates have diminished this danger, but high surpluses can, irrespective of official position, be politically incorrect and may cause the frowning of mighty USA.

Adequate growth

Economic success is almost synonymous with economic growth. But it may be allowed to give a universal meaning to Gossen's law of diminishing marginal utility. The costs of whatever growth are increasing in disproportion to the incremental utility of such growth. Damages to environment and societies can already be seen and felt world wide.

On the other hand it is also true: Stillstand ist Rückschritt – standstill means going back! Stabilitätsgesetz is therefore not against growth, but advocates “adequate” growth in conformity with environmental and other issues. In this context the green mass movement must be mentioned, which has spread out to the world. Probably this also originated in Germany and goes back to romantic and environmental movements at the turn of the 19th to 20th century.

The term *sozial* in SMW

Meaning of Equality

If were to compare men with animals, the greatest differences between men disappear. There are none between e.g. a composer of sublime music like Mozart and a heinous criminal. Both, when compared even to an almost human orang-utan, are human beings and the orang-utan is not. On this basis the principle of equal right is very simple – all men are indeed equal, so why not should they not have equal rights! It is sometimes, that socialists when discussing “social” issues are stuck with this orang-utan- comparison.

But the law of jungle is not the yardstick we need to resort to; it is the environment in which human beings live, i.e human society is the context which defines human situation. And then it is quite evident that all people are not equal.

There is an undisputable difference not only between Mozart and the criminal, but also between a Nobel prize winner and dumb pub patron, between a bus driver and a doctor, a blind man and a man with sound eyes etc. Fundamental differences begin to show forth. If the coveted profession is the job of a conductor in an opera house, we would prefer Mozart (or his contemporary colleague) without even looking at his competitor, who is an amateur musician, even if he desperately needs a job and Mozart is rich enough to live an affluent life. If, however, the coveted commodity is a piece of bread we would probably not make a difference based on education but on who is more in need of food. Obviously there are innumerable criteria in favour of or against treating two or more person equally. Sozial/social in SMW therefore cannot mean equality in a formal, technical sense.

***Sozial* = Equal chances**

Objective differences : Laws and constitutions cannot make men equal. But they can try to level out inequalities by giving everybody an equal chance to live his life. After WW II chances for an average German for a good standard of living were not good. In comparison to the 11 million refugees from former East Germany, who had lost everything, the prospects of West Germans, however, were somewhat brighter. The German authorities could have left it that way. The war and its consequences could not be undone. Everybody has to live his destiny! If there is anything in the post-war Germany to be proud of, it is the way, how inequalities caused by the war were dealt with. Equal chances for those, who apparently had none, were created by taking from those who had some chances left. SMW in Germany started with a series of laws in which “sozial” was understood in a very typical sense: Not taking from rich and giving to the poor, but creating equal chances for everyone, The Lastenausgleichsgesetze (laws on the distribution of losses suffered from the war) basically took privileges from West Germans and gave them to the refugees, but in a quite sophisticated way. Example may be the Hypothekensicherungsgesetz of 2. 9. 1948 (Restatement of mortgages Act), which is an almost genial law. This (and ensuing laws) put a new type of first ranking mortgages on immovable property in favour of defined banks as mortgagees, who then lent or guaranteed loans to refugees – provided that these were not consumed but invested in capital goods, mainly construction of new

houses.

Subjective differences

The same understanding of sozial as Chancengleichheit (equal chances) occurs with individual, maybe inborn differences between men.

In the Mozart- amateur example, it is not the aim of SMW to confer the conductorship on the amateur. The public is not well served with a conductor who enjoys his salary but does not live up to his job. The law cannot make Mozart nor can it make him conductor, but it can try to give equal chances to everybody- to develop their individual potential. This is done through the German educational system, which is open to all and has been designed to level out social differences risen from rich/poor heritage. Germany is well known for its long standing educational system. Vocational education is compulsory; incentives are provided for continuous training and further studies etc. Universities provide to all with no or little costs. In the 1970's Fachhochschulen (Universities of Applied Sciences) have been established in dozens of cities. These are a type of tertiary education institution, sometimes specialized in certain typical areas (e.g. technology or business). Fachhochschulen were invented in Germany and later adopted by other countries. Fachhochschulen do not award doctoral degrees they are designed with a focus on teaching professional skills. The same concept is followed in other areas, e.g. medical care and other basic needs.

Freedom

Caring and *Bevormundung*

Sozial is often understood as caring for the poor and disabled. This sounds good policy. But it is not always as good as it sounds. Even more than equality it is a human right, to be and to remain free. This means that men should not be hindered by the state but rather encouraged to develop their own personality and potential and to live according to their own designs. Caring is often another word for Bevormundung (= selfimposed guardianship over lesser breeds, to cite R. Kipling). Slavery in USA in the early 1800 was less and less justified by economic reasons, but by the “poor negroes being unable to care for themselves”. Latter day colonialism in India and Indonesia was justified by moral vocation of the British and Dutch to teach the coloured people “half – devil and half child” (as R. Kipling was wont to say) .

This type of caring is a disincentive to find your own way , a denial of freedom in the fist place. In an economic sense it is even counterproductive. Literally - it diminishes productivity.

***Subsidiarität* - subsidiarity**

It is an ontological fact that every holder of power or influence (state, authority, individual) wants to have more of this. If sozial is understood as preserving n equal chances to find his own way , sozial also implicates the meaning: protecting your individual potential and freedom against Bevormundung. One countermeasure against Bevormundung is the principle of Subsidiarität (subsidiarity). Although not expressly in the German constitution, Subsidiaritätsgrundsatz is an unwritten and in many cases also written principle of German law. Against the resistance of her partners Germany brought this principle into the European law (Art. 5 Contract on the EU). But there it is slumbering like Dornröschen of the Grimm brothers, a sleeping beauty to be raised to full life and love something, she

really deserves. The meaning of the unwieldy word Subsidiaritätsgrundsatz -principle of subsidiarity is twofold.

Within his sphere of competence a person/authority enjoys freedom and autonomy vis-a-vis its superiors.

The higher ranking person/ authority is (by law!) not permitted to interfere with the sphere of competence of the lower ranks, as long they stay within the limitations of their competence and the law

This Subsidiaritätsgrundsatz –principle of subsidiarity may be explained by a true anecdote. Present writer discussed with a French military officer how it had been possible, that so few German troops could so forcefully resist so many allied forces. The reason, I said, can be made clear by an imagined situation:

French/English/American captain to lieutenant, Hill Nr. 123 must be captured. You take 250 men, 300 machine guns in case some fail, 5 heavy, 2 light cannons. Here is the map: 120 men go up right, 100 go up left; 30 you post there. Beware of this, beware of that etc. Oui, oui mon capitain! German captain to lieutenant: Capture Hill Nr 123. When you have it or run into difficulties you report to me. Jawohl, Herr Hauptmann! The former French captain agreed, as do allied military writers. What is nowadays taught in Business schools as management by objectives is in fact a very old practice in the German/ Prussian army. Today it might go as one explanation for the success of German companies. Still, this principle of echeloned hierarchical Selbstverantwortung (personal responsibility for the outcome of one's actions) is not easily understood in other countries, let alone copied. Example: If the CEO of an American, English, French etc concern gives the order: No more Business Class flights - it is done, although the affected companies are legally independent. It is difficult for an American, English, French etc to understand, that this is not so in Germany. The German CEO could give an order, how to fly, but he would be very reluctant to do so. Do I know, he would ask himself, how the customers of my subsidiary in e.g. Thailand, Ruanda etc would look at this? Let the director of the local company decide and then justify the extra expense.

Socialists and their concept of *sozial/ social*

Meanings of social

The word social is derived from Latin socius = person having the same interest; partner, friend, comrade, assistant. For this common origin there seems to be no or little difference in the meaning of “social” in European languages. Basically there are three different meanings of this word in all languages:

Socialist

In economy the term sozial /social (Sozialismus/socialism) is understood as describing a system or activity which is fully or somehow under the control of the state and its bureaucracy. This usually goes with redistribution of commodities and resources by state interference and corresponding suppression of private enterprise and freedom. Depending on how much we cherish freedom we scale down “social” from beneficial to detrimental.

Quasi - Religious

Second meaning attached to this word is caring, having regard for others, being socially responsible. The combination of sozial and MW changes the meaning of MW itself as well as it changes the meaning of sozial. The primary objective of economy to earn my bread, is complemented by the responsibility for my fellow men. SMW is combining two apparently contradictory positions which in fact, complementary, namely profit seeking and giving assistance to the needy. St. Paul says in Ephesian 4, 28: Work with your hands, so that you may give to the poor.

Socio - Political

As a political term social describes aspects which arise when people live together in the same state, community, factory etc. In this sense sozial/social is neutral and would stand for “justice, equitable, equal treatment” etc. From this arise social services, which are not contrivances of leftists but useful things like garbage collection.

Mixture of meanings

Politicians and law makers usually don't pay much attention to semantic problems. Much of the confusion and even political bitterness which goes with the word family of “social” is a consequence of the different meanings, being mixed or even messed up. Leftists emphasize meaning a. when speaking with religious people, who understand meaning b, and politicians, thinking of meaning c, babelisation is the normal consequence, without people even noticing, that they don't understand each other. All use the same good word “social”, but mean different things.

Those who understand “social” as meaning a, which would be the majority, would fiercely proclaim, and they already do: Germany is not social any more! Pensions should be higher, the rich are not taxed as they should, bankers draw huge bonuses while the unemployed receive only a pittance etc. etc.

Politicians would always insist on Germany still cherishing the concept of SMW. But they have long lost the real meaning of sozial, as set out here. Whenever they dream up a new goody for the electorate (which in many cases is a “bady” for the so called rich) they are wont to spice they verbious pronouncements with the ornament of “sozial”, meaning thereby something along meaning b.

The present writer disagrees with both: Germany has become a welfare state. This may be good or (as he feels) bad. In any case sozial today this is not what sozial meant, when Germany rose from ashes. Far from this! Social goodies of all kinds, socialist ideas (e.g. Mitbestimmung – company codetermination etc) have brought today's Germany far off the right path. Germany does not any more follow the concept of SMW – as described here. At the latest when Germany reunited with former communist East Germany, the Federal Republic has embarked on the shiny fields of socialism. Many seem to like this. The present writer does not. He feels himself being in line with Ludwig Erhardt, who as early as 1974 al ready said, Germany is “socially overloaded”.

Conclusion

Soziale Marktwirtschaft (SMW) has been described as market economy with

state intervention to make more sozial. *Sozial* in that context was described as meaning equal chances for all. It has been shown that SMW has certain elements special to Germany in her post war situation, which however, if adapted, could also be used in other countries, e.g. Pakistan.

Author expresses concerns over Germany having left the authentic path of SMW for a soft socialism. This has the potential of becoming real socialism, which endangers economy and freedom.

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The first management conference we know of was called in 1882 by the German post Office. The topic and only chief executive officers were invited- was how not be afraid of the telephone. Nobody showed up. The invitees were insulted. The idea that they should use telephones was unthinkable. The telephone was for underlings.

Peter F. Drucker, *Managing in the Next Society*