Just Trade and the Social Market Economy

A Christian and economic assessment
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Zusammenfassung

Viele Bürger haben einen ethischen Vorbehalt gegenüber dem Handel. Wohlstandsfördernde Arbeitsteilung erfordert jedoch Handel, der „gerecht“ ablaufen muss. Die Bibel bejaht Handel – aber erwartet dabei den Schutz der Armen. Gerechter Handel benötigt Freiheit und soziale Absicherung. Die deutsche Konzeption der Sozialen Marktwirtschaft integriert beide Aspekte. Jedoch ist der marktliche Wettbewerb kein Spontangewächs sondern eine Kulturpflanze, die vom Staat geschützt werden muss. Die Philosophie der Sozialen Marktwirtschaft, die Aufgaben des Staates und die wirtschaftspolitischen Prinzipien von Eucken werden erklärt. Deutschland verfolgte nur die ersten 20 Jahre eine Politik im Sinne der Sozialen Marktwirtschaft. Einige Aspekte konnten bei den römischen Verträgen in den gemeinsamen Markt aufgenommen werden. Beim Außenhandel und in der Entwicklungspolitik werden wichtige Prinzipien der Sozialen Marktwirtschaft missachtet.

Abstract

Many citizens have ethical reservations about trade since trade relations are often unfair. Specialization (division of labour) is welfare enhancing but needs trade. The Bible does not criticize trade but expects a fair exchange without neglecting the poor. Just trade relations in a market economy require the protection of freedom and a social protection of the poor. The German concept of a Social Market Economy tries to integrate both aspects. The market mechanism (competition), however, is not a weed but a cultural plant, it needs state actions. The government should follow certain principles to safeguard welfare enhancing market relations. In this context the principles of economic policy, as designed by Walter Eucken, are discussed. Only in the beginning of the Common Market some principles of the Social Market Economy had been followed. In foreign trade relations and in development aid these principles are neglected.

1. Introduction

Many Christians are concerned about trade relationships. The working conditions of textile workers in Bangladesh producing branded products for European customers could be considered as criminal. Even in Italy, Chinese workers have been exploited (nearly kept as modern slaves) in the Italian textile industry. Working conditions of rural labourers in Latin America, producing coffee, bananas or flowers for the customers of rich countries, are also brutal. By trade, the rich get richer and the poor get poorer, the critics say. European customers want to pay little for goods demanded, the international companies want to make high profits and need high prices, and the losers are the indigenous workers – because they are not organized. Third World import stores started to sell those imported products at a fair price, in order to overcome this injustice. The Micah-Challenge[1] speaks up for more aid for the Third World. Is there a possibility for improving the lot of the poor and to enforce just trade?

I like to mention that trade, domestic and international, for more than two thousand years has been considered as a "blameable" activity (Aristotle). Engaging in trade was associated with fraud and cheating. The Christian fathers took a hostile attitude towards trade.[2] St. Augustine advises: Let Christians not trade! He criticizes traders for wishing to buy cheaply and selling dearly. "The trader could not escape the temptation to sin merely by turning to a craft such as shoemaking, where he would be tempted to lie as to when the shoes would be finished and to cheat by poor workmanship."[3] However, in order to meet their daily needs people have to trade. Should we all live like Robinson on his island, we would have a low standard of living.

2. Division of labour and the necessity of trade

Already Xenophon (431-350 BC) pointed out that specialization (division of labour) is welfare-enhancing – but this requires exchange. How should this trade which is necessary for society's wellbeing be organized? More than two thousand years after Xenophon the Scotsman Adam Smith (1723-1790) explained that free trade is generally the best way to organize economic exchange. However, the individual gains of trading depend on the power of the participants. The distribution of those gains could be unjust. There is a need of an arbiter to guarantee a fair exchange. The powerful may, otherwise, exploit the

[1] See Lachmann (2013b).

[2] See Lachmann (2013a, p. 8).

[3] Viner (1991, p. 40).

poor. The living conditions of the poor have been brutish for thousands of years. Is there a way out of this economic injustice? German Christians tackled after WWII this problem by designing an economic order which tried to achieve justice and efficiency. This order called Social Market Economy (Soziale Marktwirtschaft) proved to be very successful.

According to the principles of the German Social Market Economy the state should guarantee a fair exchange by controlling and reducing economic power. The government should lay down the rules of trade but should not interfere into the exchange process itself. The government should be the impartial arbiter like the referee in a soccer game. There is, however, no neutral arbiter in international exchange relations. Free trade is always to the advantage of the mighty and the higher developed partner. In addition, business does not always like free trade – hence we observe cartels and collusion. Lobbyists try to influence authorities to change the rules of trade to their favour. Much of trade – particularly in international trade – is unfair. Hence many Christian groups criticize the outcome of international trade relations. Therefore, the pros and cons of trade have to be discussed and the term "just trade" must be scrutinized. What is the Christian view of trade? What does the Bible tell us concerning economic behaviour, economic exchange and the organization of trade, even world trade?

The forerunner of the EU had been the European Economic Community (EEC). Its goal was a Common Market to increase the competitiveness of Europe vis-à-vis the US. A larger trade area increases business efficiency (increasing returns of scale) and economic efficiency by allowing fiercer competition among member state companies. Many efforts have been undertaken to guarantee a common market in Europe. There is thus a need for both an inner trade policy (harmonization, competition policy etc.) and an outside trade policy (protection and discrimination etc.). We give a short outline concerning the problems of creating a competitive market – taking the German Social Market Economy as an example. First we discuss if there is a Biblical view on trade.

3. Trade in the Old Testament

"It is not good that the man should be alone; I will make him a help (fit) for him" (Gen 2, 18). This seems to indicate that man should not be able or to be forced to do everything himself. God – so it appears – supports the idea of a division of labour. Hence, trade was already common during OT times – even trade with foreigners. Abraham bought from Ephron, a Hittite, the field and the cave of Machpelah (Mamre) for 400 shekels.[4] King Salomon traded with Hiram, the King of Tyre, timber of cedars in return for wheat and oil. Actually, the Sido-

[4] The trade negotiation between Abraham and Ephron, the Hittite, can be found in Gen. 23.

nites even gave development aid to Israel, since they were better trained than the Israelites. The result of it: "There was peace between Hiram and Salomon" (1 Kings 5,12). Foreign trade – as long as it is not a zero-sum game – was and always is peace creating.[5]

Libanius – among his students where the Church fathers St. Basil and St. John Chrysostom – a pagan professor stated already in the forth century[6]:

"God did not accord all things to all parts of the earth, but he has divided his gifts among different countries, so that peoples should have need one of the other, in order that from their mutual dependence they should be held to maintain society (community) together. Thus he has brought commerce into existence as a means available to all the world of enjoying in common all things wherever they were produced."

This view would lead logically to an economic order with free trade based on an international division of labour which could increase individual wellbeing.

Palestine constitutes a bridge between Africa, Asia and Europe. Local trade was, therefore, supplemented by international trade. According to Ezekiel (27, 17) Juda and Israel exported wheat from Minneth, millet, honey, oil, and balm. Also wool and wool products have been exported. Trade leads generally to an uneven wealth distribution. The OT has many social regulations to protect the unlucky and disadvantaged. There are thus many ethical comments on trade already in the OT.

The OT mentions especially the human problems created by trade. Amos criticized that merchants reduce the grain measure (ephah) and enlarge the ingot payment (shekel). They were also eager for the Sabbath to end in order to return to trading (Amos 8, 4-6). Trade caused – also in Israel – injustice in the wealth distribution. The oppression of workers has also been criticized by Isaiah (58, 3-8) and some minor prophets. The NT view is not different. Jesus and the Apostles did not criticize trade or economic activities as such. Jesus did not even speak up against interest payments. However, justice and mercy has to be shown – especially to the poor neighbour. Trade helps mankind to be more productive – however, after the Fall of Man, everything good may also have negative effects. That holds for trade, too. Trade creates richness; the rich very often oppress the poor. As the OT shows the Israelites often even forgot their creator. Moses already warned the Israelites:

"When you have eaten and are full, and have built beautiful houses and dwell in them, and when your herds and your flocks multiply, and your silver and gold are multiplied, and all that you have is multiplied, when your heart is lifted up, do not forget the Lord your God." (Deuteronomy 8, 11-14)

To sum up the biblical view on trade: Trade as such has not been criticized. However, the ethical behaviour of the participants gave room for criticism.

[5] The early Church fathers criticized trade because they considered it as a zero-sum game, i.e. what one person gains the other must loose – which holds also for nations.

[6] Viner (1991, p. 42).

The Bible warns – like the Church Fathers – against avarice. To be a Christian means to have a personal relationship with Jesus, hence his behaviour should follow ethical lines.[7] It is necessary to distinguish between personal behaviour (not cheating, being generous, showing solidarity and charity) and rules of trade. Could there be an economic order in line with Christian ethics? Before we deal herewith we have to examine the meaning of "just trade".

4. Just trade

The term "just", however, is not an economic one. During the Middle Ages the Scholastics discussed intensively the meaning of a "just price". Who determines the fair price of a good? The buyer considers a low price as fair; the seller, in contrast, speaks up for higher prices. Whose value judgement should prevail and why? Some commentators looked for a bureaucratic solution. But the bureaucrats don't know the just price either. Often they refer to the cost of production for determining the just price. Their proposal may set up the following rule: The average cost, calculated with a mark-up, should be taken as a proxy for a just price. However, we know from economic analysis that in such case there is no incentive to reduce costs. Actually, a trader can then increase his profit by increasing the cost. The higher the average cost, the higher is the profit (if he obtains a fixed margin on the average cost as his profit). A competitive environment, on the other hand, increases the incentives to reduce costs in order to increase the profit rate. In a competitive market, economic theory tells us, the price is given. Firms can influence their costs of production only. This is the reason for decentralizing and liberalizing economies (especially in Great Britain during the Thatcher government). A more liberal setting leads to efficient production (lower costs) but may also increase social injustice and poverty. The policymaker faces a dilemma situation: Efficiency or justice? What kind of compromise can be found? From the Christian point of view we need an economic framework which guarantees freedom (which increases wealth for some but might lead to injustice to others by an uneven wealth distribution) and justice as well.

Just trade should imply just prices – also for the small producer in the Third World. Economists consider the market price as the just price. The market price is the highest price at which a seller can sell his goods and the lowest price at which the buyer can buy them. But this message holds only if seller and buyer meet at the same eye-level. Without a level playing field the outcome would not be voluntary accepted by both partners.

Interestingly, in Germany – after WWII – some Christian economists, theologians and jurists developed the idea of the "Soziale Marktwirtschaft" (Social Market Economy), a system that tries to avoid political and economic power.

[7] See Sleeman (1976, pp. 9-24).

They designed a system that protects freedom and justice at the same time. We should delineate the philosophical background of this concept of the German Social Market Economy – since many of their aspects have been taken into the European Common Market set-up.

5. Philosophical background of the Social Market Economy

Most principles of the new concept of a Social Market Economy go back to the ideas of classical liberalism, namely the assumption that a market system is best suited to regulate economic relationships. However, in contrast to the old liberal ideas, the government has also to play an important part in this new economic system which is very much in line with the ideas of Adam Smith and John Stuart Mill who already underlined the importance of a functioning government and its important role for the working of a market economy. The government was seen to be responsible for the economic framework to function well. Let me start with some historical remarks based on the German experience.

The growing influence of liberalism during the 19th century in Europe led to industrial growth, but also to the so-called „social question" (Soziale Frage). In Germany, a group of economists, often called „socialists of the chair" (Kathedersozialisten) demanded social corrections of those negative side effects of liberalism. The German Economic Association, founded in 1872, was hence called „Verein für Socialpolitik" (Society for Social Policy)[8]; their members strived for an improvement of the social situation of the poor in the country. The best known economists and administrators of those days in the German speaking area understood themselves as liberals and supported the free market. In contrast to the English classical economists, however, they considered the social question as a challenge for the government. Already Gustav von Schmoller (the leader of the younger German historical economic school) in 1874 addressed this question in his famous paper „Die soziale Frage und der preußische Staat" (The social question and the Prussian state).

The Social Market Economy is not yet identical with the „Free Market Economy", a concept of underlining only the traditional regulatory functions of the state, i.e. such legal regulations that are necessary to provide external security, to guarantee the rule of law, and to provide an infrastructural framework (known as "minimal state" or Nachtwächterstaat, night watchman state). This kind of economic order is more in line with American liberal economists who plead for minimum state interventions and who are convinced that it is the best for the people to leave the economy largely to its own devices.

[8] The Association of German Economists is still called Verein für Socialpolitik.

The founders of the Social Market Economy could take into account some historical experiences: The failure of economic policy after the First World War and the following dictatorship. The erratic interventions of the German government during the Weimar republic (the government of Germany from 1919 - 1933) increased the then existing economic problems. Also the woebegone experiences of fascism and war-time planning helped to understand the importance of individual freedom and showed the danger of government interventions for the freedom of the population. Thus the „ORDO-liberals" started considering anew the role of government in the market system. Market models were developed which put a new emphasis on the relationship between business and government. It was the aim of those theorists to restrain political power as well as economic power. They considered only a government which is self-restrained as a strong one. A government which interferes too much into the economy will become dependent on the support of pressure groups with the result of losing the political ability to follow economic policies which are for the best of all people!

The originators of this new concept did not consider it to be a theory, but only to be a concept of general rules concerning the economic framework of the society. They spoke of a „Stilgedanke" (styling thought), where the implementation always has to be adjusted to the economic problems of the time. The concept of a Social Market Economy provides for its continual further development. This leads to a greater flexibility and adjustment capacity in facing new economic problems.

The fundamental idea of this concept consists of connecting the principle of freedom of the market with that of social responsibility and economic redistribution for the purpose of economic justice. The economic goal consists in: efficiency and social justice!

Many ideas of this concept are deeply rooted in Christian ethics. Actually, the fathers of the German Social Market Economy have been confessing Christians[9]. After WWII four opposition groups were trying to impose their ideas on the economy to be reconstructed. None of them was able to impose its ideas on the other ones. The German Social Market Economy can thus also be understood as a compromise in that intellectual struggle going on between the exponents of socialistic ideas (labour movement), the ORDO-liberal group which partly reflected catholic social teaching, and those which were influenced by ideas of brotherly assistance advocated by the theory of social ethics of the Lutheran church. The fourth group consisted of some liberals who spoke out for a more pure liberal reconstruction of Germany (neo-liberals). None of these four groups could assert itself in West Germany after the war. The concept of a Social Market Economy met the demands of all those groups – however, not completely. The liberals got market freedom; the socialists obtained some ideas of social

[9] The confessing Christians (Bekennende Kirche) were persecuted by the Nazis. Dietrich Bonhoeffer, a leading protestant theologian of the Bekennende Kirche, was even killed shortly before the end of WWII.

responsibility of the state. The whole model was backed by the social teaching of the Catholic Church and protestant ethics.

The founders of the Social Market Economy realized the irenic principle of a functioning market. They understood man as able to look for his own fate and to decide himself concerning his own destiny. Ordoliberals like Wilhelm Röpke and Alexander Rüstow were, in addition, influenced by philosophical reflections, above all those of Max Scheler.[10] The originators of the Social Market Economy were already exponents of a European integration. Alfred Müller-Armack and Ludwig Erhard (first minister of economic affairs in Germany) supported the idea of a united Europe. In conflict with the first German chancellor Konrad Adenauer they were also concerned with strong economic ties with the United States of America (against the French concentration on Europe which had been supported by Adenauer). Alfred Müller-Armack und Ludwig Erhard were able to get many of their ideas embodied into the Treaty of Rome.

As already mentioned the state has some important tasks to undertake. Free competition is not enough to guarantee the working of a market. Economic theory points to some market failures which the competitive system is not able to solve by its own. Hence the government has to interfere to overcome those deficiencies of the market to make the market work.

6. Correction of market failures

Market failure implies that not all economic transactions can be regulated by the market efficiently by its own. It needs, however, an outside help to carry out its job of efficient production and using the scarce resources to the best of the society. The following problem areas have to be dealt with:

externalities
public goods
natural monopoly
abnormal supply function
asymmetrical information of the participants

Externalities: The market works well whenever economic decisions of individuals do not interact with each other. However, often, production and consumption of some people interfere with the well-being of others. There can

[10] Max Scheler (1874-1928) as a phenomenologist sought to discover the essence of mental attitudes and their relations to their objects and severely criticized the formalistic ethics propounded by the German philosopher Immanuel Kant. He pleads for a utilitarian ethics based on human purpose and intention. He stresses man's religious consciousness and was a critic of Marxism. Scheler built largely on the "order" or "logic of the heart" discussed by the French religious philosopher Blaise Pascal.

be negative and positive side effects of economic decisions on third parties. Those side effects are called externalities. We have to distinguish between real and monetary externalities. Monetary externalities work through the market mechanism and should not concern us. If for some reason many people demand a certain good, let us say apples – the price of apples will go up and everybody who wants to buy or supply apples must react. Another example would be the interest rate. If many people want a credit, interest rates go up; this has effects on suppliers and demanders. Coordination problems arise only through real externalities, i.e. non-monetary ones! An example of positive externalities would be a vaccination. If I protect myself against being attacked by a dangerous disease, I cannot infect others. I bear the cost of this vaccination; however, others gain by this, too. Third parties obtain a benefit and do not pay for it. They acquire a welfare gain "free of charge". My personal calculation, however does not take into account the effects of others which results in an under-demand of those health services. This is the reason why governments should supply some kind of medical protection. Negative effects can be seen concerning the problems of the environment. Industrial production creates smoke and other negative effects, like noise etc. The social costs of production are much higher than the private ones which the companies only take into account. Hence we have an over-production as seen from the social point of view. The government has to interfere in order to correct for externalities, in other words: The government has to invent rules to internalize externalities.

Public goods: Another problem concerns the common use of goods supplied. Not everybody can be excluded from consuming certain goods if they are produced. Radio broadcastings everybody can listen to. The broadcasting station is supplying a public good, in a similar way defence or police services are public goods. People, who do not pay for those services, can still reap the benefits of their supply. The light-house is considered to be a pure public good: Once there, every boat passing by uses its services without interfering with the use of other ships seeing the light, too. A public good is thus defined as a good where the exclusion principle and the principle of rivalry don't hold. Typical for a private good is rivalry. The steak I am eating somebody else can not eat as well. In addition I can exclude others who want to eat my steak. Since I do not allow somebody else to eat that steak I will be punished for this self-centred act by the price I have to pay for that steak, i.e. all social costs are completely borne by me! Whereas private goods are consumed by one person, public goods are consumed by many. To exclude others might be expensive or not possible at all. It would be possible to charge people using roads (which is often done with turnpikes), but in this case it is better having the government pay for or supply those services. If there is no rivalry in use and if the exclusion principle does not hold, we are confronted with the problems of public or collective goods. A road or bridge might be used by many without disturbing each other (however: the problem of traffic jams has to be taken into account!). The question arises: Who pays how much for the use of those public goods? – The theoretical answer of economists is easy: everyone should be paying according to his marginal utility, which, however, is practically impossible to calculate and find out. Thus although there is a high demand for public goods, nobody will supply them since it is not clear how they will be paid for. If the people are asked how much it is worth to have this motorway or that bridge, they will reduce their personal importance in order to pay less. They all like to be free-riders. If everybody wants to ride freely there will be no train supplied. Thus it is the task of the government to pay for the production of those services – it is not necessary that the government also produces them!

Natural monopoly: The third problem arises with the production of goods, where the average costs are declining for a longer period. Declining average costs means that no company can make a profit following the optimizing rule of a competitive market: Marginal cost equals the given market price. The cheapest way to produce the goods would be in a monopolistic set up. In this case the government has to interfere. For example: water supply, local telephone services, waste disposal, and sewerage are mostly in the world supplied by public authorities or handed over to private companies which obtain regional monopolies and are controlled by government agencies. Since average costs are declining it is economically the cheapest way to ask just one company to produce all the goods necessary. This leads to business efficiency but violates market efficiency. If only one company supplies the public good, it can behave as a monopolist and charge a higher price and offer lower quality in comparison to products which are supplied within a competitive process. Therefore, those private monopolies have to be regulated. However, what would be the proper price? One answer would be to follow average cost pricing with some mark up. Even government supervision by controlling prices is easier said than done. Usually the government agency allows prices in accordance with average costs plus mark-up. The higher the average cost, the higher the price. If for example the government allows an 8 % mark-up, a company can make a higher profit by increasing its costs. This is a typical problem for public utilities. The companies are inefficient. Their workers earn a higher wage compared to the other sectors; they very often try to get extra training, and the water management needs information concerning the working of the water supply system in Hawaii etc. Hence the managers will visit Hawaii and produce some extra costs. Every increase in cost increases also the profit. In a competitive system, in contrast, the profit is increased by reducing costs. This is the incentive problem for public utilities which are the results of a natural monopoly.

Abnormal supply reaction: Problems arise also in labour markets and with agriculture. Whenever economic decision units have a certain fixed target as their goal, they might react in a different economic way than microeconomics suggest. A labourer might need a certain sum of income in order to survive with his family. If there is a reduction in his wage rate, he will not reduce his supply of labour; on the contrary, he has to increase his supply of labour in order to achieve his target income. This increases labour supply and reduces the wage rate again. Although wages (prices) decline, there is an increase in supply which leads to a further reduction in the level of wages. This behaviour leads to an abnormal supply reaction.

During the industrial revolution in Europe this phenomenon has been observed and it led to increasing poverty of the labour force and finally to the social question with the result of socialist movements (Marxism). In most countries of this world there is hence a Ministry of Labour. Also farmers try to increase the amount of their production if they experience a decline in their prices. Whenever there is an abnormal reaction of one market side, the government has to interfere in order to stop results which are not in line with the ethical values of a society and to keep the market process working in a fair way. A minimum wage for example or some minimum prices for agriculture would help to overcome the problem. Then prices cannot be reduced further and the circulus vitiosus (vicious circle) of declining prices or wages will be stopped. The deregulation of labour markets might lead again to an increasing poverty of the working poor. Hence trade unions demand again the introduction of minimum wages. The Common Agricultural Policy (CAP) was from the very beginning introduced in the Common Market to help farmers and still requires a big part of the budget of the EU. The tremendous increase in productivity in agriculture led to the necessity of regulating the bulk supply of some important agricultural products.

Asymmetric information: Another problem arises in a market process if suppliers and demanders have asymmetric information. For example it is very difficult for second hand goods to find the correct price. Only the owner knows how well his car was taken car of and if he had an accident; the buyer has no information about those things. Or consider a health insurance. The insurer does not know the hazards of his possible client, who will not reveal his sickness in order to refrain paying a higher premium. Hence we will not obtain an optimal (fair) exchange. In such cases the government has to interfere in order to reduce the degree of asymmetric information. Either the supplier and demanders have to be forced to supply all necessary information, or there must be a kind of liability to prevent cheating. Most economists agree that there is market failure and that the government has to do something in order to correct them. The best way would be to introduce property rights in order that the market works. Hence also the EU has to take over certain responsibilities to guarantee a fair trade via a functioning market process in the member states. However, the Social Market Economy implies more government activities than overcoming market failures.

7. What else should governments do? Safeguarding competition and justice!

Whereas liberal economists, like Frederick von Hayek, underlined that the state cannot foresee the course of market developments (in terms of structure, behaviour and efficiency), the ORDO-liberals insisted that freedom needs to be supplemented by carefully considered rules and institutions. Hayek, the liberal thinker, tried to design institutional rules that reduced to a minimum the need for collective action. ORDO-liberals and with them the advocates of a Social Market Economy, however, declared it to be a task of the government to lay down the framework for all parties involved in the economic progress. The maxim was: Policy to shape the economic system - yes! - Steering of the market process - no! Nothing that could be coordinated via markets and prices should be undertaken by the government. The bureaucracy does not know the economic situation better than the market. How should the government interfere? For this Walter Eucken formulated some principles, mainly his formative and regulatory principles, which we have to pick up later.

In addition to correcting market failures there is a need of correcting also the market outcome. The need for social policy and for measures to stabilise the economy must also be considered. According to the German ordo-liberal tradition, the government has to guarantee the working of the market process via an effective competition policy.

However, there are further tasks for the government which are underlined by the supporters of a Social Market Economy: The consumption of a few goods might be neglected by the population. The people are just not aware of the importance of the goods and will thus demand to little. We have information problems, especially over time. Therefore the government supplies education and health services because the population might not demand the optimal amount. Those goods are called merit goods. In addition, the capital market does not work perfectly. Hence, it is very difficult to obtain a credit for educational purposes – the creditor does not know if he gets his money back. Hence, the government has to overcome this deficiency! However, one has to mention that merits goods violate the doctrine of consumer sovereignty. In a dictatorial way the government is convinced to know better what is good for the consumer. Also pressure groups might use the political process to force the population to demand certain goods they offer.

Ordo-liberals underline the need for safeguarding competition. American liberals would not support this idea because they think that the market system only needs free access of the market partners and do not believe in long run possibilities of companies keeping market power. Last but not least there is a need for stabilization policy and social policy.

Often it is thought that competition will be the result of the free play of all individuals. However, competition is not a "weed" which grows by itself, competition is a "cultivated plant" (Kulturpflanze) which must be taken care of by the government. Free competition might result in anarchy or in monopolies. By whatever reasons, some companies seem to be more efficient than others; business in general does not like competition. Competition means that the economic position is always endangered. Companies thus try to form cartels in order to protect themselves against competition. J. St. Mill once claimed: „Competition kills competition." Already Adam Smith pointed to the danger of collusion. He once remarked[11]

"People of the same trade seldom meet together, even for merriment and diversion, but the conservation ends in a conspiracy against the publick, or in some contrivance to raise prices. It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice. But though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies; much less to render them necessary.

A regulation which obliges all those of the same trade in a particular town to enter their names and places of abode in a publick register facilitates such assemblies. It connects individuals who might never otherwise be known to each other, and gives every man of the trade a direction where to find every other man of it."

Competition is mostly good for the consumer. A functioning competition results in supplying the society with all the goods it needs at the lowest costs. The optimal use of scarce factors of production is guaranteed by a functioning competitive market system.

Reality tells us that this kind of neoclassical competition will never arise. In economic theory, which is mostly static in its neoclassical design, competition policy would require many small competitors (perfect competition). However, this is not in line with reality. Competition arises if there are competitive partners which can influence the market price. A big group of small producers (agriculture) is not able to influence market prices. We are speaking of a „Schlafmützenkonkurrenz" (day-dreamer competition).

It is the task of the government to regulate the economy such that competition will prevail. This would mean that cartels and certain company mergers are not allowed and that the government has to observe the market to check if there are enough companies supplying a good and if there is rivalry.

Hence in modern competition theory we like to achieve a "workable competition".[12] This results in preventing companies from growing too big in order to obtain market power. On the other hand, the government should try to help small and medium sized enterprises in order to obtain such a size that they can compete with market rivals. For example small shops are united together in a cooperative in order to obtain better prices from industry by combining their demand! However, one never knows if equal prices are the result of competition or collusion (Gentlemen's agreement).

In the Treaty of Rome which established the Common Market in 1957, Germany was able to lay down the principle of competition into the European integration process. The Treaty of Rome was a compromise between France and Germany. Following German demands the Treaty of Rome incorporated a strong competition policy. The French got a state controlled agricultural policy

[11] Smith (1976, p. 145).

[12] For the history of competition policy models, see Neumann (2000).

(CAP) and an interventionist development aid policy. There has always been a struggle concerning the economic approach to follow. Germany supported the federal and competitive principle whereas France spoke up for a more bureaucratic system with more state interference. This struggle is still going on. In the beginning of the European integration German ideas prevailed. In the last decades the French position grew stronger. Even the introduction of the Euro has been done according to the French position.

Problems arise nowadays by provisions of the treaty of the European Economic Community. Newly created European institutions are becoming a source of new regulations, albeit in the name of integration. This often leads to a reduction in competition. I also like to add that for some heavily protected branches in Germany, the European Commission was able to open the market up for European-wide competition as, for example, in the banking and service sectors.

Nevertheless, the merger control has no „bite" and is de facto being increasingly undermined, because there are various ways of bypassing it (in Germany, there are exceptions possible by waivers of the Federal Minister of Economic Affairs (Ministererlaubnis)). The minister can, because of general macroeconomic considerations (claimed public interest), override a decision of the Federal Cartels Office.

History demonstrates that law cannot protect law, and that the source of harmony between law and regulations issued at the highest level is never to be found in the constitution, but rather in the harmony of the social elements. Nor can any economic system survive, if the social forces reject it. Politicians in Europe, so it seems, merely pay lip-service to the aims of the principles of the Social Market Economy.

Walter Eucken, the leader of the Freiburg[13] school, also underlined some principles for a successful economic policy which I would like to mention, since they influenced the German economic thinking after WWII. By those principles he wanted to aid economic policy making – since he did not trust economic policy making[14]. He doubted that politicians have the knowledge and the willingness to pursue a competitive economic policy. The fundamental principle is the all-embracing drive for competitive prices. He underlines the principle of the priority of price stability and of open markets. He emphasizes also that liability should not be restricted and he puts importance on the unity of „Gestaltungsmacht (power)" and liability. Whoever has the right and power to decide, the right to influence or create a legal relationship, he should also bear the resulting economic consequences. Eucken also saw the importance of limiting the power of interest groups and put priority to "Ordnungspolitik" over

[13] The ordo-liberals were often called „Freiburger Schule" (School of Freiburg) since most of them taught at the University of Freiburg in South Germany.

[14] See Grossekettler (1997).

"Prozesspolitik"[15]. Walter Eucken hoped that the law students would learn those principles and the judiciary system would watch over the competitive economic order.

Unfortunately, the German politicians did not abide in following the principles of a Social Market Economy. Especially the social democratic Federal Minister of Economic Affairs Karl Schiller spoke up for an "enlightened Social Market Economy". He wanted to combine the ordo-liberal ideas with the Keynesian ones. This led to more and more government intervention.

8. Excursus: Principles for a successful economic policy

After WW II, the ordo-liberals hoped to introduce a third chamber of political decision making in the new founded German Federal Republic that should examine the decisions of the government, if they were in line with the principles of the Social Market Economy.[16] Politicians rejected this proposal. Walter Eucken hoped that churches and jurists would support the concept of a Social Market Economy with its main principles, i.e. in particular the competitive part of this new concept. Especially all jurists should know the basic principles of the Social Market Economy. However, those ideas could not be realized. As a way out of the economic dangers he was afraid of Walter Eucken formulated some principles of economic policy that the government should take into account in its decision making.[17]

He formulated four different groups of principles:

- constitutive principles
- regulative principles
- potential additional principles
- institutional principles

[15] Ordnungspolitik could be understood as institutional policy – setting the proper rules; whereas Prozesspolitik describes the interventions of the government on the economy in order to steer it.

[16] This suggestion resembles the third chamber which von Hayek proposed. See also Grossekettler (1997).

[17] See Lachmann (2004, pp. 41-43) for an explanation of the importance of those principles. See also Eucken (1952/2007, pp. 254-291). Those constitutive principles are relevant for safe-guarding a competitive environment!

The constitutive principles[18] were:
• the principle of competitive prices
• the principle of priority of price stability and monetary stability
• the principle of open markets
• the institution of private property for the distribution and allocation of economic resources
• the principle of freedom of contract
• the principle of liability of the owner and the decision maker
• the principle of a constant and transparent economic policy.

The following regulative principles[19] had been mentioned:
• the principle of reducing and correcting market power (control of monopolies)
• incomes policy to correct for undue inequalities without hindering investments
• correction of externalities
• correction of abnormal supply reactions (backward bending supply function).

As potential additional principles[20] for competition policy have been mentioned:
• the principle to avoid punctualism, i.e. the legislative authority, court decisions and the economic administration should be aligned towards the principles of the competitive order (conformability principle = Denken in Ordnungen)
• the principle of reluctance to use business cycle policy (or macroeconomic stabilization policy)
• the principle of aid for self-help, i.e. social policy should be conducted in a way which is conform with the market.

Lastly, the institutional principles concerning national policies (staatspolitische Grundsätze) are:
• the principle of reducing the power of interest groups
• the principle of compliance with the principle of subsidiarity concerning the tasks and possible interferences of the government

[18] See Lachmann (2004, pp. 44-45); also: Eucken (1952/2007, pp. 291-304).

[19] See Lachmann (2004, pp. 45-48); also: Eucken (1952/2007, pp. 304-324).

[20] Under “Ordnungspolitik” the Ordo-liberals understood a rule-orientated policy. The government should institute a framework such that the free decision-making of the companies will lead to the desired result. In contrast, “Prozesspolitik” means interference into the market process in order to control the economic outcome. Ordo-liberals accept some government interventions; however, they should promote and impede the working of the market forces!

• the principle of the priority of "Ordnungspolitik" over "Ablaufpolitik" or "Prozesspolitik"

The constitutive principles are important to guarantee a functioning competition. However, even if the constitutive principles are observed, the results are socially not always acceptable, therefore corrections are necessary. Consequently, regulative principles are needed to protect the working of the Social Market Economy. Especially Alfred Müller-Armack emphasized market conformity which should be observed by formulating economic policies. However, it is not sufficient to formulate economic concepts; one has also to look at legal possibilities of implementation and compliance.

9. European trade policy and the Social Market Economy

In order to be able to compete with American companies Europe had to constitute a common market.[21] France and Germany, however, had divergent conceptions of the European Economic Community. France with favourable condition for agriculture was interested in a common agricultural market (CAP). Germany had lost after WWII her agricultural heartland and depended on industrial growth for further economic development. Hence Germany was interested in a common trade policy. Germany had to agree to a common agricultural policy in order to obtain a dismantling of trade barriers. The price France had to pay for the establishment of a common agricultural market was to accept the common trade policy. The creation of the Common Market was the result of a package deal between France and Germany, the two leading economies in Europe. With the Treaty of Rome (1957) the Common Market has eventually been created. The goal was the free movement of goods and services and of the factors of production (labour, capital).

Trade relations should be "just". What should be understood as a "just trade"? In the view of the European Commission "just" is understood as equal prerequisites for all traders, a level field. Especially governments should not interfere at the border and also not after a good has been imported (crossed the border). These rules are actually in line with WTO requirements. Harmonizing standards means that governments have to give up sovereignty in some areas. National standards to determine the desired production of salami, proper beer,

[21] Already Frederic List analyzed the importance of a greater market for international competitiveness. He, therefore, spoke up for a unification of the German states during the middle of the 19th century – in order to be able to compete with the British economy. An infant industry tariff should – in the beginning – be imposed until international competitiveness is achieved.

the ingredients of sausages etc. had to be given up. Those national standards often had been misused as a device for protectionism, keeping out foreign products. National industries like to be protected against unfair foreign competition. Governments could not subsidize their industries any more. A subsidy hinders fair competition – hence the European Commission controls national governments as far as their industrial policies are concerned.

Besides keeping peace on a continent which experienced in the past heavy conflicts and wars, and preventing national conflicts to aggravate, the EU was able to crack down on some strongly protected industries and open them up for competition. The national service sectors (insurance) had been heavily protected against foreign suppliers. The EU was able to open up those markets to enforce the four freedoms: Free move of capital, of goods, services, and of labour. Increasing the degree of competition lowered prices which were to the advantage of the consumers. For industrial goods a common market has been achieved early. The free movement of capital had been achieved in 1993. Problems still exist concerning the free movement of labour – especially with the new Eastern members. The European Commission was able to open some sectors for competition which the German Government was not able to do so. This would be in line with the German concept of a Social Market Economy.

Real economic integration has been successful. Trade between the EU members increased. Complete abolition of bilateral customs duties was achieved in 1968. Foreign trade with non-members did not improve that much. Economic integration theory distinguishes between trade creation and trade diversion effects. Trade creation is welfare enhancing. Inefficient production is overcome by importing cheaper from member countries. Hence trade is increased by giving up own production leading, however, to economic problems for the non-competitive industry. This results in political resistance of the losers of trade. Trade diversion means buying from member countries instead of buying from cheaper non-member countries. This is not welfare enhancing – trade diversion leads to a less efficient world production. EU trade had both effects: trade creation and trade diversion. Economists criticize the "Fortress Europe"-approach of trade. From the point of view of world welfare European trade policy was not just – hindering the economic development of trade partners.

Monetary integration has not been that successful. Since the Euro-zone did not make up an optimum currency area[22], fixing the exchange rate created trade tensions. This failure of monetary integration had heavy consequences.

[22] An optimum currency area is an area where no exchange rate adjustments are necessary to keep a trade balance. The following criteria have been discussed: Extent of factor mobility (Mundell), degree of openness (McKinnon), degree of differentiation of the economy (Kenen), degree of financial integration (Ingram), level of national inflation rates (Fleming); degree of the integration of national economic policies (Haberler), and degree of real exchange variability (Vaubel). See (Lachmann 2004, pp 470).

Monetary integration had been done under a setting which led to moral hazard, and which had damaging effects on the real economy.

10. Just Trade and the Third World

The first common economic policy, as already mentioned, was achieved in the agricultural market. Yet the market mechanism had been abandoned. Prices were stabilized above the equilibrium market price. The common agricultural policy (CAP) led to protectionism. Especially the Third World suffered because their agricultural exports to the EU decreased. The subsidised European agricultural production led to inefficiencies and a reduction of their welfare. CAP was designed as an aid for the European producer. Prices above the market price led to overproduction. CAP could be considered as a weak tool for helping French and German farmers and turned out to be very expensive for the European Community. Consumers paid twice: they have to pay higher prices than necessary for food and they have to support this price increasing policy via higher taxes. This outcome was neither just nor in line with the concept of a market economy.

In addition, the CAP had negative effects on the world economy. Europe subsidized agricultural production heavily and hindered the economic development of the Third World. Especially African countries criticized the "European fortress-approach". European agricultural imports suffered under very high tariffs.[23] Europe even dumped their agricultural production on the world market – reducing agricultural prices even further with the well known negative incentive effects for the Third World. European trade policy could be considered as a cause for an increased suffering of the people in the Third World. Food and cloth are the goods nations can produce early in their economic development process. Exactly those goods could not enter the EU freely. This was clearly a violation of principles of a Social Market Economy, and in addition this was not a "just trade" policy. Europe did not "export" the philosophy of a Social Market Economy to the rest of the world, but neglected those principles in her foreign trade policy, thus denying just trade to foreigners.

Development aid even increased the suffering of the developing countries (DC) further. Monetary transfers led to an increase of the exchange rate (revaluation) which reduced the competitiveness of DC exporters. Food aid reduces the prices of agricultural goods in DCs. Hence farmers in DCs experience a negative incentive effect and could not compete against subsidizes European agrarian imports. Famines were the consequence.[24] Via development aid the EU helped

[23] Japan and the US followed a similar agricultural policy.

[24] Sometimes I asked my students how long they would study if they receive 3.000 € each month until they finish their studies. Most of them answered: for a long time. Development aid – given to corrupt elites in developing countries

some DCs to produce meat. After they were able to produce meat, their market had been destroyed by meat exports dumped from the EU to reduce her storage cost of meat because of European overproduction.

This is not in line with "fair trade". Disturbing the market mechanism by subsidies hurts the economic partner. Another problem arises if value and social judgements are imposed on foreign countries. Germany does not allow imports of good which contain child's labour. By this the German government wanted to help children in developing countries (DCs). Germans demand "fair trade" – i.e. no dumping wages, protection of the environment and the climate and the introduction of some social policy. These goals are right – but how could they been achieved? Poor children have only a few choices: to starve and die, stealing and other criminal acts, prostitution or to work. Work would be the most ethical solution. If Europe wants to help children in DC's they should help building schools, pay for teachers and follow a policy of education cum work. Even Europeans solved their social question some 150 years ago by increasing efficiency first and then tackling the social question. Child labour was very common in Europe during the industrial revolution. Successful economic development reduces child labour. It would be better to pay a higher price to children at work instead of sanctions which hurt those whom we – so it is said – want to help. Critics assume that this regulation is an unfair way to protect EU industries, a kind of protectionism. Trade is unfair if it neglects the need of the poor!

Like aid policies of the USA and other developed nations, this policy has not been successful. Mostly overproduction was dumped (as food aid) to DCs hindering an own agricultural development. Financial aid – given from governments to governments – led to corruption. Even native Africans started to criticize development aid by weakening own African initiatives to develop themselves.[25] European aid policy is neither in line with a Social market Economy nor could it be considered as a just trade policy.

11. Conclusion

The concept of the German Social Market Economy proved successful for nearly 20 years. Many aspects were once followed even on the EU level. But the German government gave up following those policy principles. It would be good to revive some of those principles Walter Eucken laid down. If policy makers would have followed the constitutive principle of the liability of the decision maker, the Euro crises would not have emerged. The economic ideas of the

– will support corruption. Trade would be better than aid. We should buy their agricultural products instead of corrupting them by development aid.

[25] See Moyo (2009). Especially Easterly (2006) strongly criticizes Western development aid.

Ordo-liberal School seem to have been forgotten – even in Germany. If Europe wants to experience an "economic miracle" as Germany experienced in the 1960s politicians should consider some of those concepts which were successful. Negative economic consequences of wrong decision take time to discover, but going back to sound economics might turn out to be too costly – if done too late. Protecting freedom and justice still leads to fair trade for all participants.

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