

Kurt Biedenkopf

Lecture spoken for the conference series Market and Morality on April 20th 2009, in the Nieuwe Kerk in The Hague, the Netherlands.

I will reflect on Rhineland Capitalism and what we mean when we use these words. But let me first point out that we should distinguish between capitalism of today and capitalism as it was in the nineteenth century. Capitalism is a phrase that was coined for an economic order in the latter part of that nineteenth century, the outstanding feature of which was that it was not limited by social conscience. The present order, or the order that was developed after the Second World War for both Germany and Europe at the same time, is that of a social market economy. The social market economy phrase describes three qualities: (1) the order is based on open markets; (2) the market is a system of co ordinations of an economy that is based on the division of labour and relates to each other through market processes; and (3) the basis of that is the freedom of competition and enterprise. It is unabated that there is no other system that is as effective as an organized market. It will increase the division of labour and also satisfy consumers' want, and thus increase the standard of living and the wealth of the nation. A beautiful example of this is given in Germany by the comparison of East and West Germany. Since 1949 West Germany and East Germany were separated by two currencies. In West Germany market systems developed under the then proclaimed social market economy. A very substantial social system was built up protecting primarily the working population, the employee population and their families through social systems. The three main social systems still being; the pension system, the health system and the unemployment system. These three systems were all developed in the early fifties and came into law in 1958.

At the same time, an additional law was passed by parliament; the so called law against restraint of competition. Or in the American phrase; the German anti-trust law, although it wasn't an anti-trust law but an anti-cartel law. This law makes it quite clear that you cannot use freedom of contract for the purpose to build up unrestrained market power. This philosophy contrary to the philosophy that prevailed from the nineteenth century right to the beginning of the Second World War. The law says that the right of contract is violated if people use private contracts to build cartels that are strong enough to dominate various markets and thus establish a sort of planned economy based on the private law. Hereby they distort the basic assumptions on which the justice of private contract is based on, namely that both parties have the same position. If both parties are equal and no misinformation was involved and they contract to something, then this contract is just in the sense that it is respected by law. The rights and the duties of the contract are respected by law and if necessary by courts.

This very distinctive vision to vote against private power based on private law institutions is not only a German feature but also a European feature. The same year Germany passed its anti-trust law, the Rome treaty was passed. Article 85 and following contained the very same principle that cartels are forbidden. If there is market power, for instance due to the size of the company, they may not use their market power to discriminate and markets have to be kept open. Also, the four freedoms; movement of people, goods, services and capital, are ensured. The commission is entrusted until today with executing these basic rules.

A market system that is based on these rules and which is complementary to a social system or vice versa, carries the basic risks of an employed population through mostly contributions made by the workers, but also to an increasing extent subsidized by governments. This assures that after

the work period is over, there is an income sufficient to give people a reasonable income for retirement, that there is protection against sickness through the health system, that there is protection against unemployment through unemployment benefits, and if it is a long term unemployment that a basic income is secured on which people can live and then return to the labour market. These two systems, the market economy and the social systems, are part of one and the same thing, namely the social market economy.

Because this is so, the social market economy is not only based on freedom of contract and the right to property, but also based on the qualities resulting from the social system; namely solidarity, which is the basis for the system, and to a certain extent equality of opportunity, which reaches to the area of education. An educational system that qualifies young people to an extent wherein they can make use of opportunities that are available in the economic and social system is a prerequisite for the functioning of the social market economy. In other words, it is not just a capitalist system. In a capitalist system neither education, nor the social security, nor the protection from private economic power, form part of the system, quite to the contrary.

In the United States in the late nineteenth century, when the problem of monopolies controlled by private corporations became ever more pressing, a law was passed which was known as the Sherman act which prohibited monopolies. In Europe, the courts accepted the development and the concentration of power based on contract as a normal condition. In other words, in the US Sherman told the Senate when he introduced his bill, that if Americans don't accept a dictator in the political area, they shouldn't accept a dictator in the economic area. In other words, it's an equation between the control of political power and the control of economic power. This is a very important equation because it shows that the prevention of power resting on private law institutions, property and contract, are incompatible with a free society. This incompatibility is not an organizational question but a value question. It accepts that if you have an open democratic system, but also a syndicalized economic system, in the end the democratic system will not work. This is so because it creates too much dependence of people who would otherwise be free and thrive on non-governmental sources of power, so much that it not only relativates but also endangers the democratic system.

In the debates in the nineteen fifties, in which by the way I participated as a young scholar, the notion was quite clear that the social market economy was a system for the economic order of the country that was closely related to the constitutional system. In other words, it was looked upon as two sides of the coin. One side was the constitutional liberties and their protection, and the other side was the protection of these constitutional liberties in the economic system. From default, from distortion through economic power. The EU accepted the very same principle what actually developed as the Rhineland model of capitalism. The difference between Europe and our national systems is that Europe does not have a social system at present. The European Union rests its case and leaves it to the national entities to see to it that the social requirements of the market economy are fulfilled.

In light of the present crisis, it is important to remember that we have within Europe a competitive situation among the nation states concerning how the social obligation resulting from the social market economy, should be resolved. The Swedish model, the Danish model, the Dutch model, the German model, the Italian model; all found different ways of organizing these things. Some have more government tax supported systems, others have more contributions supported systems, others have basic public systems complementary to private individual insurances, but they

all have the same basic underlying idea. Namely that a market economy must have as a complementary order a system of social protection, at least for the basic needs of the population.

If you separate the one from the other, then you get capitalism. That is exactly what happened in the nineteenth century. The result of this separation was that you had private property and freedom of contract, but no social obligations. This led to the so called 'great social question' of the nineteenth century. We all know the attempts at resolving this question. The communists said that the reason for the unacceptable results of the economic order in nineteenth century was property. They thought that if the state would take over property from society and then the problem would be solved. The social-democrats decided, as they developed, that they wanted an evolutionary way by domesticating property and the property right, in the sense of a social obligation. In the first democratic constitution of Germany, the Weimar constitution of 1919, there is an article on the protection of property. Property is protected by law and is an expression of freedom. But, the law says that property carries with it obligations, it is limited by obligations and its use should also serve the public good. These are very important expression of value with regard to property. They are symptomatic for all limitations of freedoms, guaranteed by the constitution to the extent that these can be used to harm others. We shouldn't leave these things, like the idea that you have labour laws protecting people from random hire and fire, out of sight when we discuss our economic situation. It all belongs together. It is actually a system of freedom and responsibility.

Capitalism is an economic system where freedom is guaranteed without social responsibility, which is the basic difference. *Does this responsibility work?* One of the problems of globalization is that you cannot rely on the willingness of the participants to act responsible without any sanction if they won't. In other words, if you tell people you find them to be morally just and you trust them, and you let the system work and one or the other begins to act non-moral; misusing the freedoms he was guaranteed. For instance hiding risk in products that are sold. Suddenly he finds out that he is doing better than the others. The others begin to worry what will happen when they will stick to their moral views. Sooner or later, this lack of protection of the moral code leads to an increasingly relativation of the moral code until finally it looks to be a-moral when you are moral. You will be punished if you follow the moral code because all those who don't, succeed. That is pretty much what happened in the financial markets in a nutshell.

The financial market expanded vastly because on a global level there were no regulations that were sufficiently operational to restrain the power that is connected with the aggregate of finances in banks, in investment companies, etcetera. If we domesticate the desire to be successful, which is the selfishness that is a prerequisite for healthy competition, or eliminate it fully through socialization, then you will not have a very developing economy. This is why I mentioned East – West earlier. In East Germany by expropriation the whole system was based on state planning. For a while the state planning system and the West German system, if you disregard the reparations that East Germany had to pay, developed parallel to one another until about the end of the sixties. Then the development complexity increased; markets are the most wonderful instruments to organize complexities. The complexities increased in both systems and suddenly at the end of the sixties the East German government found out that its central planning system could not manage a higher level of complexity. So it got stuck while the West German system continued and developed capabilities managing a system of an increasingly complex system. Whoever thinks of nationalisation of important parts of the general economy must be aware of the fact that administrations cannot organize and manage the same levels of complexities of markets. That's a fact, not a matter of moral or ideology, but simply a matter of reality.

So we have an advantage in the market system, but we may not let it get out of control. And the real problem we are faced with is; *what is the optimal balance between the freedom of the system and the regulation of the system?* It is quite obvious that when a system goes haywire and gets out of control, like the financial system did on a global level, the desire is to place on it much more control. So you have sort of a pendulum swinging. It swung out all the way in the wrong direction, namely no regulation. Now the desire is to really go to work and regulate as much as is possible. And even if there were only a few incidents that needed to be regulated, they will be regulated with the consequence that the regulations will apply across the board to everything. This can lead to a sub optimizing of the system. Right now we are involved in the search for the optimum. But we have very little experience with global markets in general and with global financial markets in particular.

Where does that leave us? It leaves us first with a statement of central importance, that we do not have a capitalist system in Europe. We can call a market economy a capitalist economy, but that has a very substantial political relevance because the capitalist system is a system without responsibility. So if we call it a capitalist system, we say we need much more regulation and an expansion of the social part of the social market economy. We can expand that system to a much larger social part of the social market economy. But, the more risk the government takes upon itself and seemingly gives the individual more room to develop its own freedom, the greater is the danger that this assumption of individual responsibility for one's life through the socialization of responsibility, can lead to different political behaviour of the people involved. In Germany we have been discussing for some time now, whether an extended social system increases the dependence of the population on government, and thus reduces the willingness of the population to take risk. Whether a population is in principle willing to take risk or not, has a lot to do with its standard of living. Taking risk is a very important prerequisite for a competitive process; you cannot compete without taking risk. We have to be willing to take risk; that is the price for a better life as we see it. This is not restricted to the economy, but also applies to sports, arts, science, et cetera. If you do not take risk you are just a copyist. As an artist you will only copy other artists' work, as a scientist you will only state what has been stated before, and so on. To think that you can reduce risk to zero or next to zero in a society that wants to enjoy a high standard of living and that wants to be competitive in the world, is an illusion. With other words, we have to weigh the capability of people to take risk against the need of people to be protected from certain risks. Usually we say that the government's purpose is to assume risk that individuals or groups of individuals by their own cannot carry.

What risk can and cannot be carried is a political question. *What does this mean that it is a political question?* One of the problems of the social market economy is rooted in the fact that the institutions that have the task of assuming basic risks for the population are very powerful. When we look at the election campaigns in Germany since the late sixties and early seventies, we find that all parties prior to election promised the population better retirement payments, higher support in case of need, et cetera. In other words, they promised an expansion of social services. *Where are the limitations to an expansion of social services?* That's also a political question. We can have very expanded social services and assume a lot of risk, which is less dangerous in smaller countries than in bigger countries because in bigger countries the systems are more anonymous. If they are more anonymous they are controlled easier, not for the population that participates in them, but for the functioneers that run them. In one debate that I held in the late seventies, we suggested a basic reform of the old age security system in view of the upcoming demographic problems. We were met

with contempt, not by the general public or the population, but by those who ran the system because they don't want to be confronted with the need of proving that the system would work under different demographic conditions. The consequence was that we postponed the adaptation of the social system to the demographic change, with thirty years. Now the time to have an evolutionary transfer from the old system to the new system has passed. Or, as a generalization, the cost to solve the postponed problem increases exponentially with time; the longer you postpone it the more it costs and the increase is exponential. This can be backed empirically with many cases.

This confronts us with a very difficult problem. On the background of this problem it is very important for us to find the right equilibrium between a market economy and the social responsibilities on the one side, and the state and its role in regulation and setting limits, on the other side. This optimal relationship between the two is undisputed, although it was disputed in capitalism. The state in capitalist Germany was called the *nachtwächter staat*; a state that has no other obligation than to warn the people for dangers and fight wars. Internally, this state was not given any responsibility, not even the right to get involved in economic processes. Those days have passed. Our question today is; *what is the right optimum between regulation and freedom?* Part of the regulation of course is the establishment of sanctions in case of the violation of individual responsibility. For instance, there's a banker and he has an income of five, six, or even seven million euro's per year and he runs his bank into the ground. We have seen that such bankers don't have to worry about any obligations that result from this behaviour, like acceptance of responsibility by payment or being personally held responsible for the damages. But if there was a personal responsibility for such a banker for the damage he does, in such a way that all he is being left with is the same amount as someone who goes into bankruptcy is being left with, bankers would act completely different. It is quite obvious that if you disconnect the right to make decisions and the liability for what happens as a result of your decisions, you free the way for greed and people will get as much as they can get. Again, the moral aspect doesn't work if there's no sanction. But if there is a sanction, you don't have to resort to moral because you can simply enforce the sanctions for misbehaviour. Although that has a moral basis, it is concrete because people know what the consequence of non-moral behaviour will be. That is important. If they don't know it, they'll test it. The international financial markets delivered a wonderful example of the results of such a test.

The real question is how do we, in the European Union, react to the following challenges that are imminent and will dramatically influence the lives of my children and even my grand children? The first challenge is that the world population is exploding, although we still live as if this was merely a theoretical notion without any real relevance to us. That is very dangerous. When I was born, the world population was less than two billion; we are now increasingly approaching the number of seven billion. This means that the world population has more than tripled while land for cultivation, the forests and the water supplies have all stayed the same or decreased in size or amount. It is impossible to account for this growth without accepting any change for us personally. Our way of life here in Europe cannot become the way of life for all of these seven billion people, which is one of the challenges. The second challenge is more accepted and it is the limitations that the ecology places on our demands. We consume oil and gas in increasing quantities as if they were available for ever. The predictions for Europe's gas supply for the next sixty years are that we are already over the peak. When my grandchildren are fifty or sixty years old, they will be faced with a totally different world. We'll have to be able to develop methods of coping with a world wherein we retrieve our energy from other sources than from gas. Gas is the most important global resource and we need to leave some of it for the chemical industry and for the power plants to produce

electricity. My great-grandchildren will shake their heads looking back and say 'we don't understand why they did it the way they did.' The limitations on resources and the ecology is the second challenge. The third challenge is; are we capable of building a world order that will be able to guarantee peace in a world that is populated extremely denser than we ever conceived it would be. The more dense the population becomes, and the more transparent the various ways of living become through new methods of communication that have accomplished a tremendous change in the awareness in the world as to how we live and how others live; all this has to be combined, and the denser the world becomes, the more stressful it may get.

One of the reasons that I point this out is that it is my conviction that European democracy, is entering a stress test. This also goes for the rest of the world for that matter. We are entering this for one major reason; all throughout Europe we have been pampered by a continuous growth rate. We have declared a sustainable growth of GDP to be the basis of the functioning of a democracy. You can read about that in the 2000 Lisbon agenda, where the leading heads of state decided that the objective for Europe for the year 2010 would have to be to become the strongest economic region in the world. When we ask twenty to thirty year olds today if they get excited by this objective, they think it is rather ridiculous. Why should Europe be the most powerful economic region in the world? It would be much better if it were the place where life were nicer, better protected, homier, more family oriented, less stressful, more just concerning input and reward; than other places in the world. They have a totally different vision of the future.

We have to decide how to make this compatible; this vision for the future that is not economically defined, to put it mildly. On a scale of importance, economic criteria are scaled at about fifty percent, whereas family life is scaled on 91 percent and the reestablishment of smaller scale forms of communication that are not so anonymous are found to be important. That is what a majority of European youths are looking for as shown by the various polls.

How do we make these visions and the necessities compatible? I don't know. I don't think anybody has the answer. The most dangerous thing that can happen, is that governments decide 'this is the way', having not more knowledge than we do. The desire to act is very common in our thinking; there is a mentality of when we identify a problem, let's fix it. But this isn't a problem that we can simply fix. Rather, it is a cultural challenge, in the very basic sense of the word. Our strength in Europe, throughout history, is our cultural cohesion. We have to revitalize this. When Prod was president of the Commission, he instituted a group and asked them to find out; what holds Europe together? I was the German member of that group. We travelled all over Europe and found that it's the culture; the culture holds Europe together. This culture goes through the economy, the educational system, and politics. There are a set of assumptions for this culture and if we accept these assumptions as the basis for everything else that we do, we will be able, with all kinds of quarrels and conflicts, to stand together and actually stand the stress test in Europe. The same is true for the national area.

I hope the crisis won't be forgotten soon, but rather that it will result in a renewed thinking of the future.