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# About the Author

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Professor Stegmann was born in Germany. In 1958 he obtained the Licentiate in Theology at the University of Munich and was ordained as a priest in the same year. He attained the Doctorate in theology in 1962 from Munich University and in 1972 a post-Doctoral teaching qualification for Christian Social Teaching from Bonn University. From 1978-1996 he was Professor of Christian Social Teaching at the University of Bochum. After his retirement in 1996 he came to South Africa where he helped to develop the Catholic Social Academy in Bethlehem, South Africa.

Originally the project was meant to serve the Diocese of Bethlehem. It caught the interest of the Southern African Catholic Bishops' Conference. The Conference now supports the idea. In the framework of the academy, Professor Stegmann worked for the great cause of reconciliation. By doing so he gave of his best as a facilitator and as a mediator.

On 09 April 2002 Professor Stegmann received the Cross of the Order of Merit of the Federal Republic of Germany for promoting social co-operation, social co-existence and racial understanding.

Editorial Note: Volume 13 Number 1 2012 and this volume of *St Augustine Papers* present a collection of the work of Franz Josef Stegmann. We have chosen, in this instance, not to eliminate repetition of content between articles where this occurs.

# **Social Market Economy: a Good Chance or a Wrong Track?**

Since 2008 economies in industrialised and developing countries as well as the entire world economy have been in a deep crisis of the global financial system and, in the wake of this financial crisis, in a serious economic crisis. The world has not experienced such a crisis since the years around 1930. Economic activities were diminishing; thousands of workers lost their jobs, and people all over the world suffered painfully from this crisis. In Germany, in the year 2009, experts reckoned the downturn to be about 5% of the gross-national-product GNP, which is the annual value of goods and services,. In the wake of the financial crisis many countries got into a huge debt crisis. Now the crisis has passed its peak and an economic upturn seems about to start again. But all over the world economic experts and politicians of different backgrounds agree that one main cause of the crisis is a kind of unrestricted, unlimited capitalism, which might be called 'elbow-capitalism' or 'catch-as-catch-can capitalism'. Therefore it makes good sense to look into the essentials of Social Market Economy, which could have prevented the crisis, and the assessment of Social Market Economy from the perspective of Christian Social Teaching.

## **SOCIAL MARKET ECONOMY – WHAT IS IT?**

### **Historical background**

After World War Two the concept of an economic order gained acceptance in Central Europe in one way or another, and became known as Social Market Economy. Politicians and in particular economists, who had opposed the German National Socialists, among them Alfred Müller-Armack, Alexander Rüstow, Ludwig Erhard – to mention just these few, because I refer to them later on - worked out the essentials of the concept already during the war. They had experienced the consequences of a pure market economy in the great world economic crisis around the 1930's and the shortcomings of a centrally planned and controlled economy, which the German National Socialists had introduced before and during World War

Two (1939-1945). The concept takes up elements of both economic systems, but tries to prevent their mistakes and failure.

World War Two saw the defeat of Germany, its industry destroyed, its economic structure ruined. About 80% of the residential buildings and almost 90% of the industrial plants lay in ruins. Millions of workers had fallen during six years of war and millions were prisoners of war. The Russian dictator Stalin released the last 10 000 prisoners only in 1955, ten years after the end of the war.

I was a young boy and remember those years quite well. Even in the early 1950s, when I started attending university, the situation was still pretty bad. For example, we could not enter Munich University through the main entrance because there was a huge bomb crater. In wintertime, each student had to bring a bundle of wood every week to heat the stoves of the lecture halls. The heating system, destroyed by bombs, was still out of order and we would have been freezing at ten and more degrees below zero. All in all the economy was truly shattered and Germany's economic future seemed hopeless. I have many memories of those dark days and could continue telling of them for some time. All in all the economy was truly shattered and Germany's economic future seemed hopeless. But within a period of 15 to 20 years the economic reconstruction was successful. To a great extent, Social Market Economy managed this unexpected reconstruction.

In 1989 the 'really existing socialism' in Eastern Europe and Russia started to break down with profound implications for the whole world - including South Africa, where the end of Apartheid became obvious. In these political and social upheavals the concept of Social Market Economy has again played a central role. The majority of people in the former Communist countries considered Social Market Economy as the 'way of hope' into a better future. The slogan going around in the Communist German Democratic Republic during and after the 'peaceful revolution' of 1989 was "If the DM (deutschmark) does not come to us, we shall move to the DM!" The DM was the symbol of Social Market Economy.

Today Germany enjoys strong economic power. The recent world economic crisis and the debt crisis in many countries show this. As the most powerful economy in Europe Germany stands surety for some hundred billion Euros to strengthen the Euro currency weakened by the debt crisis in countries like Greece, Ireland and Portugal. In Germany “most companies and enterprises are getting strengthened by the economic crisis” and “doing better in terms of sales, quality of their products, efficiency and the number of employees than before the crisis”<sup>1</sup>. Economic experts call the surprising strength of the German economy “a locomotive for the recovery in Europe and beyond”<sup>2</sup>. At the same time – what is as astonishing is Germany’s social level which is unusually high. Even compared with many industrialised countries, its social structure is surprisingly stable. The number of strike days, for example, is one of the lowest in industrialised countries – quite apart from developing countries.

It is true; Germany also has to face serious economic problems. Take, for example the problems caused by the re-unification! Since 1990 a sum of about 90 billion Euros has been and is transferred each year to the former communist German Democratic Republic to reconstruct its ruined economy. Take the problems caused by the reversal of the population pyramid! The same number of people in work must bear the costs for an increasing elderly population. And take problems caused by the much-discussed economic globalisation. Due to the high wage level, many companies transfer factories from Germany to the eastern part of Europe and to South East Asia, where wages are much lower and the work force is not less qualified. Nevertheless, economic and social standards are remarkably high.

Many factors contributed to Germany’s economic and social development. But the most important one was the general policy of Social Market Economy. On the other hand many do not know what this economic order means or what it ought to be. As a result, they associated it with the cruel capitalism that arose in the 19<sup>th</sup> and 20<sup>th</sup> centuries – a capitalism, which did not know and even excluded social responsibility, ethics, social justice;

those words were not even in its vocabulary. This connotation is still valid and seems to be confirmed by the recent financial and economic crisis – a painful experience for people all over the world. Social Market Economy – what is it?

### **Competition of performance and efficiency – safeguarded by a clear framework**

Its founders understood by Social Market Economy, an economic system, which combines “the principle of freedom in the market with the principle of social justice”. Ludwig Erhard, Minister of Economic Affairs for many years, translated it into practical policy and became known as 'Father of the German Economic Miracle'. The concept is based on the conviction that competition, competing activities of economic participants are “an indispensable tool for organizing modern mass-societies”<sup>3</sup>. Therefore, the central core of Social Market Economy is “competition based on performance, on achievements of efficiency”<sup>4</sup> (*“Leistungswettbewerb”*). This requires a private and competitive economy instead of a centrally planned and controlled economy. Competition between economic participants prevents self-interest, the driving force for economic activities, from being excluded. This exclusion is a main problem of centrally planned and controlled economies, which fix prices of goods and salaries of workers in advance, without taking into account their efforts and achievements.

Competition between economic participants, however, does not automatically result from the 'free play of market forces' - as history and modern economics teach. Competition "only works if a clear framework and legal regulations safeguard it"<sup>5</sup>, emphasised Alfred Müller-Armack, a highly respected economist and for many years aide to Ludwig Erhard, Minister of Economic Affairs. Competition only works within a proper order. Because of that, state policy has the responsibility to create "the legal framework for every economic activity, business, trade and industry"<sup>6</sup> in order to enable, establish, and safeguard competition. According to the concept of Social Market Economy, the state is not a simple night-watchman; on the contrary, "the state has to establish

competition between the economic participants", possibly forcing them to compete - demanded Norbert Walter, chief economist of Deutsche Bank, Germany's largest bank. "Competition does not happen by itself; the state has to establish it"<sup>7</sup>. State authority has to safeguard it, "to prevent restrictions of competition and control monopolies and cartels". Rid of competition, monopolists are tempted to increase prices to the consumers' disadvantage, thereby gaining a monopoly profit. Wherever, for example, only one oil company runs petrol stations in a region, it must not compete with other companies and can fix prices as high as it wants. This misuse of the legitimate principle of profitability can be prevented if each economic subject must permanently compete with fellow competitors in the market place. Competition forces enterprises to set their prices as low as possible in order not to be eliminated by fellow competitors, who set lower prices. Anti-monopoly laws have to ensure that monopolies are not being created and, if they are unavoidable, that they are controlled by the state "in order to make competition work most effectively for the consumers' interest, advantage and benefit". Ludwig Erhard and his co-fighters for Social Market Economy managed that as early as 1957 when the national parliament passed a Monopoly Law and established a Monopoly Commission against heavy opposition from industry and commerce. In the meantime the European Union took on parts of its responsibilities.

Competing economic participants, however, do not automatically realise the best possible supply to all people, the common good. Competition realises good supply only within "a clear framework and legal regulations". Already more than 50 years ago Alfred Müller-Armack spoke of "a fatal error to expect a perfect social order from market automatics"<sup>8</sup>. State policy has to establish "a clear framework and legal regulations"<sup>9</sup> that make individual economic participants act in their own interest as is demanded by the well being of all. We must distinguish between the 'framework for activities' and 'activities within the framework'. We must distinguish - to use the example of a soccer match – between 'rules of the game', which each soccer player has to observe, and 'moves in the game', which depend on the efforts and skills of each player. For example, whenever a soccer player violates the rules of the soccer match – maybe by

committing a foul – he will be punished and get a 'yellow' card, or will even be disqualified and must leave the soccer field. Whenever in the 'economic match' players such as the butcher, the baker, small enterprises or big companies or somebody else, violates the 'rules of the economic match' – maybe by cheating customers, by damaging the environment or by fixing prices and undermining competition –, the players must be punished and in grave cases removed from the game. So in their own interest each player will observe the regulations set by the state for a fair and sound economic life. Each 'economic player' must observe the rules of the framework; and the state authority has to ensure that everybody does observe them.

### **Important legal regulations of the framework**

I give examples of regulations, which in Germany are parts of such a legal framework.

- Laws on the humanisation of working conditions so that employees are not already crushed under the wheels of the production process: These laws include health and safety regulations at work; protection against unlawful dismissal: employers must inform employees about the reasons for retrenchment, keep periods of notice and pay certain amounts of compensation; observe limits of working hours, which have to be agreed by employers and employees, referring to days and weeks - for example, 8 working hours a day, 40 working hours a week.
- Laws referring to the field of insurances: Each person must have a public or private health insurance (or be included in a family health insurance); the same goes for the retirement insurance; employees must have an unemployment insurance, whose contributions are equally paid by employers and employees.
- Measures for providing a satisfactory income distribution by adequate taxation: High income earners pay a bigger percentage of taxes than low income earners. An abundance of wealth alone is not a desirable aim, if this wealth is unjustly distributed. So taxation laws aim at allocating the national product in such a way that the distribution of income is just and fair.



- Laws on worker co-determination in the running of enterprises: In large German companies, these laws provide for an equal representation of the owners and the workforce on the board of directors. In smaller companies one third of the board of directors are representatives of the employees. This board determines the major policy of the company and appoints and controls the board of executive directors, who make the everyday and routine decisions. So the workforce is involved in economic decision-making and running of the business in which they work<sup>10</sup>.
- Laws referring to the integration of ecological targets. These targets become more and more important: Businesses of every size have to recycle their waste themselves or through special recycling enterprises. The expulsion of carbon dioxide CO<sub>2</sub>, which causes the dangerous climate change, is limited. If the expulsion exceeds a certain amount the company must pay fines. Already in 1991 Pope John Paul II demanded in his Encyclical *Centesimus Annus* that “the State must provide for the preservation of the natural and human environments” (No. 40,1).
- Satisfactory laws on the transparency of financial transactions and the liability of banks (which also in Germany are still partly missing): Bank consultants should be obliged to inform their clients in detail of what the shares and all the financial products which they offer them consist of, , and should be obliged to explain the risks, which the clients take, when they buy those products. On the national and global level, clear liability rules must force banks and bank managers to pay for the damage whenever they trade in faulty, doubtful financial products and whenever they give incorrect advice to clients or do not – or not sufficiently – inform them about the risks. Banks must increase their own capital to a higher percentage of the turnover so that they can be liable for financial mismanagement. In the wake of the recent financial crisis these measures are intensively discussed and at least partly improved.

## **Social alignment of the economy and social rules**

Added to the "competition of performance and efficiency" the social alignment of the economy and social rules are equally essential. They are the so-called 'second pillar' of Social Market Economy. The founders of Social Market Economy saw these social elements on four levels:

- The alignment of the economy with the demand and needs of the consumers (by 'the play of supply and demand') and not with a central state authority as was in Germany during the war and is still existing in centrally planned and controlled economies.
- Income distribution tied to individual efforts and performance and in this sense "a just income distribution"<sup>11</sup>. Those who work hard are entitled to earn more than those who are lazy .
- Constant improvement in economic efficiency and productivity due to the permanent pressure of competition.
- Interventions by the state to complement competition by compensating for socially negative results of the market and facilitating necessary changes in economic structure.

During the war, in Germany the economy was planned and controlled by a central state authority. Individual consumers were not allowed to buy what they wanted or as much as they wanted. The government prescribed, for example, how much bread and butter per month could be eaten, how many coats and pairs of shoes per year each person was entitled to buy, how many pigs a farmer had to feed and so on. The same goes in a figurative sense for the entire economy. Every economic participant, small enterprises and big companies, had to fulfil the economic plan set by the state. Against the background of this centrally planned and controlled economy, the alignment of economic activity to the needs and wishes of the consumers appeared in itself to be a social achievement. Sometimes the emphasis on economic efficiency, aligned to consumer wishes, is criticised as materialistic. The highly regarded social philosopher and economist Alexander Rüstow, also one of the 'fathers' of Social Market Economy, responded to those critics that "as long as all human beings do not enjoy at

least the subsistence level, the improvement of economic efficiency is more than an economic demand, it is a social, a moral demand"<sup>12</sup>.

The founders of Social Market Economy realized that economic competition alone is insufficient to form a humane economic order. "Many things, which are inaccessible to the market mechanism, are of the greatest importance for human needs", emphasised Alexander Rüstow. People, who are not able to compete, because they are old, they are young, they are sick etc, "cannot be abandoned to the market... One must do something for those market passives", as Rüstow called them, "if one wants to be responsible and humane". Because of that, the community, the state, has to establish a so-called 'social security net' to take care of these people. Market and competition are "not an end in themselves but rather a means to an end", a tool for supplying people in the best possible way; they must be at the service of human needs.

State intervention is also required to facilitate and make bearable and acceptable those changes in the economic structure, which "are beyond the ability of the individual people affected". For example, half a century ago more than 600 000 miners had worked in the Ruhr Region, the most industrialised region in Germany. Today all coal mines are closed; recycling industries and service industries replaced them to a great extent. Assisting interventions by the state were very important. Without these interventions serious social tensions would have been unavoidable. Such huge changes, Rüstow demands, "cannot be allowed to regulate themselves, at some time or another"<sup>13</sup>, in a pure market economic or capitalistic way. The social alignment of the economy, the 'second pillar' of Social Market Economy, prevents people from being crushed in changes of the 'economic match', which are beyond the ability of those affected. As early as 1947, at the beginning of the reconstruction of Germany's shattered economy, the Prime Minister of Bavaria expressed this understanding of Social Market Economy: We need "an effective and sound market economy" as well as "social safeguards" which ensure that the economy "does not degenerate into a mere profit economy"<sup>14</sup>

Economic efficiency increases the capability of the state to make tolerable necessary changes in economic structures and to correct socially negative results of the market process. Economic efficiency is the condition of social efficiency. 'Economic downswing' results in 'social downswing'. Economic efficiency is not everything, but without economic efficiency everything becomes nothing.

## **CHRISTIAN SOCIAL TEACHING ON A SOUND AND JUST ECONOMIC ORDER: SOCIAL MARKET ECONOMY**

### **Christian Social Teaching on a pure Market Economy**

From the very beginning the attitude of Christian Social Teaching towards a pure market economy or capitalism was a critical one. The first Social Encyclical *Rerum Novarum*, published in 1891 by Pope Leo XIII, criticised "unrestrained competition", which led to "the concentration" of trade and industry "in the hands of a few individuals" (No 2), but did not deal with the issue in detail. Only 40 years later Pope Pius XI in the Encyclical *Quadragesimo Anno* of 1931 discussed the problem of unregulated competition and free market. "Free competition, though justified and quite useful within certain limits, cannot be the guiding principle of economic life". Some translations read: free competition "cannot be the ruling principle of the economic world" or "cannot be an adequate controlling principle in economic affairs". The Latin text says: "*Liberum certamen... rem oeconomiarum dirigere plane nequit* - Free competition cannot direct the economy". By "free competition" the Encyclical understands "unregulated competition" and demands "that economic affairs be once more subjected to a true guiding principle" (No. 88,1). Then Pope Pius strongly condemns an economic system, in which "capital so employs the working or wage-earning classes as to divert business and economic activity entirely to its own arbitrary will and advantage without any regard to the human dignity of the workers, without any regard to the social character of economic life, social justice, and the common good" (No. 101). This is a clear condemnation of a pure Market Economy and any 'Elbow Capitalism'.

Today Christian Social Teaching on a pure Market Economy is just as clear. The *Compendium of the Social Doctrine of the Church*, published by the Roman Pontifical Council for Justice and Peace in 2004, recognizes "the market as an irreplaceable instrument for regulating the inner workings of the economic system" (No. 349). "Market operators must be effectively free to compare, evaluate and choose from among various options" (No. 350). But the *Compendium* firmly declares: "The idea that the market alone can be entrusted with the task of supplying every category of goods cannot be shared" and calls this idea "an 'idolatry' of the market" (No. 349). The market is unable to satisfy important human needs. These needs require goods, says John Paul II in his Encyclical *Centesimus Annus* of 1991, which by their nature are not mere commodities and "cannot be satisfied by market mechanisms... goods which by their very nature cannot and must not be bought or sold" (No. 40,2).

The founders of Social Market Economy shared the same conviction. "Many things, which are important for human needs, are inaccessible to the market", emphasized the already mentioned Alexander Rüstow, one of the 'fathers' of Social Market Economy. Competition and market "are a means to an end, not an end in themselves"<sup>15</sup>. They "must be at the service"<sup>16</sup> of human needs.

### **Christian Social Teaching on Social Market Economy**

The strongly critical assessment of a pure Market Economy points already to the stand of Christian Social Teaching on Social Market Economy, which gained increasing acceptance in Central Europe after World War Two. The Encyclical *Mater et Magistra*, published by Pope John XXIII in 1961, emphasises, "that in economic affairs first place is to be given to the private initiative of individuals", whereas public authorities must intervene in order "to promote social progress for the benefit of all citizens" (No. 51, 52) is nothing but what the founders of Social Market Economy demanded: to establish and safeguard competition of the individual economic participants by a clear framework as the core of Social Market Economy and to complement it by social and economic state interventions,

by creating a 'social net' – or as Alfred Müller-Armack, one of the founders of Social Market Economy, plainly stated – “a clear framework and legal regulations” are essential "to make competition and market economy work most effectively for the advantage and benefit of all"<sup>17</sup>. - In 1985, Joseph Cardinal Höffner of Cologne, a former Professor of Christian Social Teaching and chairman of the German Catholic Bishops' Conference, declared the Church in favour of "a socially tempered, socially oriented market economic order"<sup>18</sup>: market economy – yes, but it must be socially tempered, socially orientated.

The already mentioned Encyclical *Centesimus Annus* of 1991 judges "business economy, market economy or simply free economy certainly in the affirmative" sense, if it is "within a strong juridical framework which places it at the service of human freedom" (No. 42,2). "There is certainly a legitimate sphere of autonomy in economic life which the state should not enter. The state, however, has the task of determining the legal framework within which economic affairs are to be conducted". Pope John Paul II avoided the expression 'Social Market Economy', which is specifically European (or even German). But he used the concepts "freedom" and "social justice" to show the ethical basis of Social Market Economy; and he used "market mechanisms" and "juridical framework" to name its fundamental regulatory elements. And his references to “abundant work opportunities”, to a “solid system of social security” and to the removal of the “commodity character” of labour by means of legislation to safeguard its “dignity” (No. 15,1; 19,2) express the principal objectives of Social Market Economy<sup>19</sup>. Commentators, therefore, correctly call the Encyclical "a declared belief in Social Market Economy"<sup>20</sup>.

The Pastoral Statement *The Common Good*, published in 1996 by the English Bishops' Conference, stresses “that market forces, when properly regulated in the name of the common good can be an efficient mechanism for matching resources to needs”<sup>21</sup>. - The *Compendium of the Social Doctrine of the Church* finally describes the "fundamental task of the state in Economic affairs" almost in the same way. The state has to determine "an appropriate legal framework for regulating economic affairs”.

However, “Economic activity, above all in a free market context, cannot be conducted in an institutional, legal or political vacuum... the State must therefore adopt suitable legislation" (No. 352), in a suitable legal framework.

This understanding corresponds exactly with the way Social Market Economy sees itself. Competition is not the only “guiding principle”, but one “guiding principle of economic life”, to quote the Encyclical *Quadragesimo Anno* (No. 88). “There is a legitimate sphere of autonomy in economic life”; the state, however, has to determine “the juridical framework”, as the Encyclical *Centesimus Annus* says (No. 42,2). Competition must be safeguarded by a clear framework and complemented by equally important social elements. The task of the economy is the best possible provision of goods to all people. Only freedom and creativity of the economic participants can realise this objective. Therefore market and competition are one essential of Social Market Economy. Competition, however, does not automatically result from the 'free play' of the market participants and does not automatically realise social justice. Because of that, a clear framework must regulate competition, and social alignment and complement the equally important 'second pillar' of Social Market Economy.

### **Optimal utilisation of economic resources by competition**

Christian Social Teaching on Social Market Economy points to a main advantage of this economic system: competition of efficiency. In principle, market and competition are to be approved, because they utilise best the limited economic resources. I refer to Jesuit Father Oswald von Nell-Breuning, a highly respected social scientist and theologian. He had worked out the draft of the Encyclical *Quadragesimo Anno* of 1931, was of great influence on Christian Social Teaching and after World War Two, as aide to several governments, on Germany’s social policy. His whole life was committed to the labour movement; he could not be suspected of sympathy with any kind of capitalism.

I have already mentioned the destruction of Germany's industry after World War Two: about 80% of the residential buildings and nearly 90% of its industrial plants lay in ruins. In this disastrous situation, Oswald von Nell-Breuning, then a member of an Advisory Council of the government, demanded as early as in 1948: First eliminate the centrally planned and controlled economic system and "get market economy going as much as possible"<sup>22</sup>! The main reasons for his assertion were: Material resources, when compared with the material needs of mankind, were in short supply. The commandment of solidarity demands, therefore, that sufficient material goods, vital for life, are made available to as many people as possible. Competition and market - more than all the other economic systems we know to date - are able to utilise the scarce and limited economic potential in the best possible way and to stimulate a more effective economy. "Competition challenges the market participants to take into account the interests of other people", emphasised Karl Lehmann, the then Chairman of the German Catholic Bishops' Conference. Whenever market participants refuse to do this, they will not be successful. "The market punishes laziness and refusal to work and rewards motivation and willingness to work"<sup>23</sup>.

The previously mentioned statement by the English Bishops stresses that "no other system has so far shown itself superior in encouraging wealth creation and hence in advancing the prosperity of the community, and enabling poverty and hardship to be more generously relieved. Centrally commanded economies, in contrast, have been seen to be inefficient, wasteful, and unresponsive to human needs"<sup>24</sup>. Economic inefficiency and squandering of resources in the 'really existing socialism' in the former Soviet Union, Eastern Europe and East Germany are an obvious and concrete proof. In this context the Encyclical *Centesimus Annus* of 1991 calls "the free market most efficient for utilising resources". It "helps to utilise resources better", to "promote the exchange of products"; and above all it gives "central place to the person's desires and preferences" (No. 34,1; 40,2).



The more the volume of goods, which are vital for life, can be increased, the more the living conditions of the huge population of the planet earth can be improved. The more the consumption of limited resources, the consumption of scarce energy can be decreased, the less the living-conditions of future generations will be burdened. Uneconomic utilisation of the limited economic resources, squandering of the economic potential in 'centrally commanded economies', violates human solidarity, or - in Christian words - breaks the commandment to love one's neighbour. Because of that, the moral quality of market and competition lies primarily in their capacity to use scarce and limited economic resources to the optimum. Competition and market - more than all the other economic systems we know to date - are able to utilise the scarce and limited economic potential in the best possible way and so, on the whole, to stimulate a more effective economy.

Let me give an example of uneconomic utilisation and squandering of economic resources in "centrally commanded economies". My brother-in-law grew up in the German Democratic Republic. After World War Two, the Communists seized power in this part of Germany, dispossessed the private farmers and amalgamated their property into huge so-called collective farms. The former independent farmers became employees of these collective farms.

One day - it was harvest time - we visited his family. The villagers were just harvesting wheat. Because there was not enough space for the threshed wheat grain in barns, they made huge piles of grain in the central village square. The wheat grain had been lying there in the open air - maybe - for ten days, two weeks or even longer. In the meantime thunderstorms came, as well as lots of rain and the grain started rotting, coming out and growing again. Nobody took care of the wet piles. We asked the villagers "why don't you cover them or bring the grain into barns". "That's not our job. Other teams are responsible for that. Our job is to cut as much wheat as possible each week. For that we get money - and some brandy and a winner flag at the end of the week whenever we are the team that has cut the biggest amount of wheat. But we are not interested in what happens

afterwards. That's not our 'cup of tea', that's not our business". So much for the villagers! What was missing was their self-interest in the outcome of the harvest, their interest in a good harvest as such. The fact that the Socialist system did not take into account the self-interest of those villagers, was a main reason for the breakdown of the centrally planned and controlled economies in Eastern Europe and the former Soviet Union.

To sum up: Uneconomic utilisation of the limited economic resources, squandering of the economic potential violates human solidarity, or - in Christian words - breaks the commandment to love one's neighbour. Competition and market - more than all the other economic systems we know to date - are able to utilise best the limited economic resources and to stimulate a more effective economy. The *Compendium of the Social Doctrine of the Church* of 2004 summarises the advantage: Market and competition have the "capacity to guarantee effective results in the production of goods and services. A truly competitive market is an effective instrument for attaining important objectives: responding to consumers' demands, bringing about more efficient use and conservation of resources, rewarding entrepreneurship and innovation" (Nr. 347).

### **Humane economic process - positive social results**

The core of Social Market Economy is competition of performance, established and safeguarded by a clear framework. This regulated competition is the precondition and guarantee for economic achievement and efficiency and enables the best possible supply to all people. Added to economic competition are, as important, the social alignment of the economy and social rules. This social dimension, the 'second pillar' of Social Market Economy, has to focus on a humane economic process and positive social results.

From the very beginning both pillars, market economy and the social dimension, are essential and equal in weight. It is not good enough to make possible and to safeguard market and competition, and afterwards - perhaps - to correct socially negative results. To put it in a metaphor, it is not good enough to pull the child out of the river, after he has fallen in. It

is just as crucial that from the very beginning the social dimension is recognised as essential and equal in weight to all economic activities. To use the metaphor again, the child must be protected from falling into the water. Social Market Economy does not only enable and safeguard the 'play of the competing market forces' and later on – if necessary – carry out social corrections. Because of that, from the very beginning state and politics have to provide those conditions, which are needed – I refer again to the above mentioned doyen of Christian Social Teaching Oswald von Nell-Breuning - for "a socially satisfying economic process and its socially just results"<sup>25</sup>.

"A socially satisfying economic process" includes the humanisation of working conditions so that employees are not already crushed under the wheels of the production process; and it includes the involvement of the work force in economic decision-making. Such a satisfactory production process also aims at providing the conditions for the creation of new and sustaining jobs, by changing the economic structure before segments of industry and their jobs go into decline. All these goals are examples, which belong to a "socially satisfying economic process". -

"Socially just results" demand, for instance, the integration of ecological targets, which are becoming increasingly important. Destruction of the environment must not be accepted. "It is the task of the State", Pope John Paul II in the Encyclical *Centesimus Annus* of 1991 firmly stated, "to provide for the defence and preservation of common goods such as the natural and human environments, which cannot be safeguarded simply by market forces" (No. 40,1). And "socially just results" include a fair and just income distribution; an abundance of wealth alone is not a desirable aim, if this wealth is unjustly distributed. Therefore, it is the task of Social Market Economy to direct the allocation of the national product to different groups of people in such a way that the distribution of income and fortune is adequate and fair.

## **SUMMARY**

The aim of the concept of Social Market Economy, as understood by its 'fathers' and by Christian Social Teaching, is to combine the free initiative of individuals in the market place with a socially just development. Two economic systems are to be rejected:

- the so-called the Pure Market Economy, which one might call 'Elbow-Capitalism' or 'Manchester Capitalism', in which the weak and poor are exploited by the mighty;
- the socialist system of a centrally planned and controlled economy, which is unable to manage the problem of both efficient production and just distribution.

The concept of Social Market Economy takes up elements of both economic systems, but tries to prevent their shortcomings and failings. According to its founders, the core of Social Market Economy is "competition of performance", established and safeguarded by a clear framework. This regulated competition is the precondition and guarantee for economic achievement and efficiency and enables the best possible supply of all people. Added to economic competition are, as essential, the social alignment of the economy and social rules. This social dimension forms the 'second pillar' of Social Market Economy. From the very beginning both pillars, market economy and the social dimension are essential and equal in weight.

Therefore, the State must safeguard competition by law, must prevent and compensate for socially negative results of the economic process by social policy, and must make necessary changes in the economic structure endurable by economic policy. Because of that, Social Market Economy and Pure Market Economy or 'Manchester Capitalism' are fundamentally different, and Social Market Economy requires a powerful state. According to the concept of Social Market Economy, the State is not a simple 'night watchman'. Wilhelm Röpke, again one of the founders of Social Market Economy, clearly described the essential difference between both economic systems: "According to the capitalistic concept,

competition was a natural plant" growing by itself; according to Social Market Economy, competition "is a cultivated plant"<sup>26</sup>, which must be tended, pruned, and nursed. Thus the 'fathers' of Social Market Economy understood this economic order as the so-called 'third way' between a Pure Market Economy or Capitalism and a centrally planned and controlled economy or Socialism.

Social Market Economy ought to provide not only legal guaranties for a free and well-working competition, correcting socially detrimental results at some later stage. Social Market Economy, in the full sense of the term, recognises the social dimension as essential and equal in weight to all economic activities; and it provides those conditions that are needed from the very beginning for "a socially adequate economic process and its socially just results"<sup>27</sup>. A mere 'regulated competition' is not sufficient.

To express it metaphorically and to put it in my words: the bread we need to eat must first be baked. For that we need a well-working oven; that is to say, we need an economy that operates efficiently. And market and competition are able – more than any economic system we know up to now to utilise the scarce and limited economic resources in the best possible way. The bread, however, must not be baked under inhumane working-conditions; and the bread must be fairly distributed; everyone must get a just share. For that, what is needed is a framework, shaped by the legislator in alignment with the common good and carried through by state policy. Social Market Economy in this comprehensive sense is, as Germany's former President Roman Herzog stated, "an excellent example of the combination of economic efficiency and social justice"<sup>28</sup>.

## NOTES

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- <sup>5</sup> Müller-Armack, Soziale Marktwirtschaft, 390 (see note 3)
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- <sup>7</sup> Norbert Walter (1999), Mehr Macht – weniger Moral? in: Rheinischer Merkur, No. 25, 28 June, 14
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- <sup>15</sup> Rüstow, Palaeoliberalismus, Kommunismus, Neoliberalismus, 5, 6 (see note 13)
- <sup>16</sup> Rüstow, Wirtschaft als Dienerin der Menschlichkeit, 8 (see note 12)
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- <sup>27</sup> von Nell-Breuning, Wie "sozial" ist die "Soziale Marktwirtschaft", 236 (see note 25)
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# **Market Economy and Morality: Contradictory or Complementary?**

I begin with reference to my native country and its recent history! World War Two saw the defeat of Germany, its industry destroyed, its economic structure ruined. About 80% of the residential buildings and almost 90% of the industrial plants were ruins. Millions of workers had fallen during six years of war, started by Germany, and millions were prisoners of war. Soviet Russia released the last 10 000 prisoners only in 1955, ten years after the end of the war.

I was a young boy at that time and remember those years very well. Even in the early 1950s, when I started attending university, the situation was still bad. For example, we could not enter Munich University through the main entrance because it was still blocked by a huge bomb crater. In wintertime, each student had to bring a bundle of wood every week to heat the stoves of the lecture halls. The heating system, destroyed by bombs, was still out of order and we would have been freezing at ten and more degrees below zero. All in all the economy was truly shattered and Germany's economic future seemed hopeless. But within 15 to 20 years the economic reconstruction was successful.

Today Germany enjoys strong economic power. It is just the recent world economic crisis, which clearly shows this. As the most powerful economic power in Europe many regard the country as a locomotive for an economic recovery. At the same time – what is as astonishing – its social level is unusually high; some criticise it as being too high. Even compared with industrialised countries, Germany's social structure is surprisingly stable. The number of strike days, for example, is one of the lowest in industrialised countries – quite apart from developing countries.

It is true; also Germany has to face many economic problems. Take, for example, the problems caused by the re-unification: since 1990 a sum of

about 90 billion Euros has been and is transferred each year to the former communist German Democratic Republic to reconstruct its ruined economy. Take the problems caused by the reversed population pyramid; the same number of people in work must bear the costs for an increasing elderly population. And take problems caused by the much-discussed economic globalisation. Due to the high wage level, many companies transfer factories from Germany to the eastern part of Europe and to South East Asia, where wages are much lower. Nevertheless, economic and social standards are remarkably high, and the so-called 'social net' is tense – some criticise: too tense.

Many factors contributed to this economic and social post-war reconstruction, for example, aid from the United States, the so-called Marshall Plan. But the most important one was the general policy of economic competition as an essential part of Social Market Economy. Now the question arises: are economic competition, market economy on the one hand and morality, social justice on the other, contradictory, as it seems at first glance and is often asserted, or are they complementary? Therefore the relationship between 'economic competition and social justice', between 'market economy and morality' is of utmost importance. It is no accident that the *Institute of German Economy*, a leading research centre, confers a prize for economic ethics every second year.

The first chapter briefly describes the tension-laden relationship, even more: the contradiction between economic competition and morality. Why do freedom in the marketplace and social justice seem to exclude each other? Then I present, briefly, the thesis of modern economic ethics: the framework is the main place - not the only one, but the main place - where morality in a market economy is to be situated. This thesis claims that the framework can resolve or at least reduce the conflict between competition and morality. In six steps I will explain the thesis and its consequences and give reasons. The last chapter asks about individual moral commitment needed within the framework.



## **CONTRADICTION BETWEEN COMPETITIVE OR MARKET ECONOMY AND MORALITY**

Even more in the fields of economic policy and everyday business life, two contrasting positions frequently come into conflict. Some make the autonomy of 'economic forces' of the market, the autonomy of 'economic laws' and the autonomy of the economy as such, absolute. They are convinced that compliance of the economy with and subordination to moral laws create bad economic results. In a market economy each individual economic participant tries to minimise the costs of products and to maximise the sales revenue in order to make as much profit as possible. This principle of profitability is supplemented by the principle of competition. At the same time, fellow competitors try to minimise their costs and to maximise their earnings as well. By doing so, all of them put pressure on costs and prices, because each competitor wants to sell as many products as possible. Therefore, the core of market economy is competition, is the 'free play of market forces'.

A crucial condition of this 'play of market forces' is freedom of decision by the individual economic participants. Compliance with moral laws - even if very well-meant, but coming from outside the economic field and, consequently, 'alien to the economy' – and subordination to such 'alien' moral laws would restrict this freedom, cause additional costs, and disturb the free market process. Submission to moral laws would therefore prevent the economy from operating efficiently and would create negative and bad results. Because of that, this subordination does not and must not have a place in the 'play of market forces'.

The opposite point of view claims the absolute priority of ethics over the economy. Economy and market are not an end in themselves. They must be at the service of human beings and their needs. The aim of the economy is not to enable individual market participants to make as high a profit as possible, but rather to supply all people in the best possible way. The economy has to be subordinated to morality and to give ethics absolute priority. Often people holding these moral convictions only make moralising appeals to economic participants, without taking into account

the particular nature and requirements of the economy; therefore, business people just as often do not listen to those appeals and refuse them.

The basis of both contrasting views is the fact that in a market economy, in an economy that is competitive, additional efforts - for example for social or ecological targets, for humane and moral purposes as such - seem to be well-nigh impossible. As a rule, economic efforts for whatever targets are connected with expenses, with costs. In a market economy additional efforts, which are additional costs, can be used and exploited by fellow competitors who do not have to bear those additional costs. If, for a longer time, the expenses of an enterprise are higher than the expenses of competitors, this enterprise is going to become bankrupt and will be eliminated by the market. Because of that, competition and morality are thought to exclude each other.

From this fact two famous figures - Karl Marx and Friedrich August von Hayek, who received the 1974 Nobel Prize for economics - drew contrasting conclusions. Karl Marx demanded, for the sake of social justice and morality, the elimination of economic competition as completely as possible. By contrast, von Hayek, who lectured on economics in the United States for many years, considered the concept of Social Market Economy to be a contradiction in itself, a 'wooden iron', and rejected its social dimension in favour of market efficiency. He therefore gave the 2<sup>nd</sup> volume of his main work "*Legislation and Liberty*" the title "*The Illusion of Social Justice*"<sup>1</sup>. Thus, morality and competition, market economy and social justice seem to exclude each other.

## **RESOLVING THE CONFLICT BETWEEN COMPETITION AND MORALITY BY THE FRAMEWORK**

Whenever the expenses an enterprise has to bear exceed the expenses of its fellow competitors permanently or even only for some time the enterprise will become bankrupt and be eliminated by its fellow competitors, by the market. At this level, therefore, competition and morality do exclude each other. - Do they do so in any case, or can the dilemma be solved? It is a real dilemma, a real conflict. Modern business ethics claim that this

conflict between competition and morality can be solved - at least to a great extent. An approach, which understands business ethics primarily as the ethics of institutions and structures, attempts to do so. I therefore call it economic ethics.

Let me go a little further afield! When I was studying at Munich University, I enjoyed mountain climbing. When you are away on such a tour and your friends leave their lunch behind, you will surely share your food with them. But when this happens for a third or fourth time, you will probably check their backpacks before starting the next hike. This face-to-face relationship makes it easy to detect and change deviant behaviour. - But when the breakfast jam, which I am used to buying from the store, becomes progressively less tasty, I cannot exercise control in the same way. Instead, I switch brands and buy another kind of jam. If many consumers do the same, the jam producer begins to notice a drop in sales; he will look for the cause and, in his own interest, attempt to remove it.

What does this experience tell us? In modern mass-society, without face-to-face relationships, controls operate in a different way from those in a small and accessible group. This experience and insight leads to the basic thesis: "The framework is the main place - not the only one, but the main place - where morality in the market economy is to be situated"<sup>2</sup>. -

In four steps I will explain why "the main - not the only, but the main - place of morality in modern market economy is the framework"<sup>3</sup> and provide reasons.

### **DISTINCTION BETWEEN 'INDIVIDUAL MOTIVES' AND 'NATIONAL ECONOMIC RESULTS'**

The starting point is the distinction between 'individual motives for economic activities' (*individuelle Handlungsmotive*) and overall or 'national economic results of activities' (*gesamtwirtschaftliche Handlungsergebnisse*). Enterprises and individual economic participants rightfully try to make a profit; even as large a profit as possible is their legitimate aim. As a rule, self-interest is the motive for their activities.

People work and are busy in order to meet their needs, to fulfil their purposes, and to realise their aims. They "want to ensure their livelihood and to improve their lot and place in the society"<sup>4</sup>, says Karl Lehmann, former chairman of the German Catholic Bishops' Conference.

These mainly economic motives do not exclude other motives – for example, to work for the well-being of others, to gain respect and reputation in society, to fulfil oneself. But to a great extent, economic activities are inspired and motivated by individual economic interests; that is to say, in the broader sense by self-interest, which is not selfishness and should not be confused with it; self-interest is the driving force and incentive for individual economic activities. - In addition, whenever market participants are unable to make a profit but, for a longer time, suffer losses and go into the red, the market will eliminate those enterprises; they do not survive, and their jobs are lost.

With regard to what is called the national economy, the situation is totally different. The task of the national economy is to ensure the best possible provision for all people; in other words, "the 'social aim and object' of market and competition is the welfare of everyone, the public weal"<sup>5</sup>, a part of what Christian Social Teaching calls the 'common good'. This distinction between the 'level of individual motives', the 'level of individual economic participants and their targets on the one hand' and the 'level of the national economic system', the 'level of the national economy and its task' on the other is crucial and must not be overlooked or mixed up. The untying and separating of individual economic participants and their motives on the one hand and the national economy and its task on the other already forms the basis of the famous statement of Adam Smith, the founder of classical liberal economics: "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect what we need to eat but from their regard to their own interest. We do not talk to them of our needs, but of their advantages"<sup>6</sup>.

## **DISTINCTION BETWEEN 'FRAMEWORK FOR ACTIVITIES' AND 'ACTIVITIES WITHIN THE FRAMEWORK'**

Self-interest, the profit factor, is not "an end in itself but rather a means to an end. The goal is the realisation of the individual person and the common good of all"<sup>7</sup>. The activities of individual economic participants, however, do not automatically realise this public good, the best possible supply to all people. Historical experience and modern economics teach this. They put it into effect only within an adequate framework, within a proper order. We must therefore draw a distinction between the 'framework for activities' and 'activities within the framework'. The framework for activities includes the constitution, economic laws, the legal order of competition, and whatever are essential features of the political and economic convictions of the community. This framework is the area of responsibility of the national legislator and, in our time, of global institutions. Activities within the framework are, for example, investment policies of enterprises, strategies of buying and selling, price policy, and so on. These activities are the area of the individual market participants.

One must distinguish, to use the metaphor of the football match, between 'rules of the game', which each player has to observe, and 'moves in the game', which depend on the skills of the individual players. Politics, more precisely, the legislator must establish a legal framework that makes individual economic participants in their own interest act and behave in business life as is demanded by the well-being of all. Each 'economic player', all individual market participants, have to observe the rules of this framework set to their activities and to the economy as a whole; and the state authority has to ensure that these rules are observed. In this way, "competition takes place and is carried out within rules which safeguard the public good"<sup>8</sup>. As a result, "the framework is the main place where morality in the market economy is to be situated"<sup>9</sup>. Within the framework, in the fields of moves, there is competition. The 'moves in the economic game' are free – not totally morality-free, but what I call 'paradigmatically or systematically-free', as we will see later.

Within the framework, the ability, the imagination, and above all, the efforts and skills of the individual economic participants are stimulated and challenged. Thus, at the same time, competition and morality - on different levels - come into effect. The co-ordination of individual wishes is carried out according to the market rules; the framework has to ensure that self-interested action does not degenerate into selfish action and contradict social aims. The Pastoral Statement "*The Common Good*", published by the English Catholic Bishops' Conference in 1996, takes up the same thought: "The good functioning of the market requires a regulating and legal framework"<sup>10</sup> corresponding to the principle of solidarity. The key role of the framework is most important and must not be overlooked. It is the main place of morality in modern market economy.

### **SHORTCOMINGS OF A CENTRALLY PLANNED AND CONTROLLED ECONOMY**

Friedrich Engels, a friend of Karl Marx, was the first who used the term 'centrally planned and controlled economy'. Walter Eucken, a high-profile economist and one of the founders of Social Market Economy, introduced it into economics and politics. The expression 'centrally planned and controlled economy' describes an economic system in which a central state authority plans and controls the whole national economic process as well as - to a great extent - the activities of the individual economic participants. This is its crucial characteristic. The central authority draws up the economic plan, directs the economic process and determines economic activities: production and consumption, prices and wages, investments and amount of income, and so on. The single economic units (big and small enterprises) are executors of the plan: their managers are officials of the state. Its central authority plans and controls both the micro-economic and macro-economic processes. The economies of the former Eastern-Block States and of Germany during World War Two are illustrative examples of such centrally planned and controlled economy.

#### **Exclusion of the self-interest of individual economic participants**

A major problem of "centrally commanded economies"<sup>11</sup> – as the English Bishops called them - is the fact that they do not take into account the self-

interest of individual economic participants. In general, individual interests are the motive and driving force for economic activities. Motives of self-interest do not exclude other motives, as I have already mentioned, and self-interest is not the same as selfishness. It "must not be identified with reprehensible and egoistical self-love". History shows that "all attempts to base a sound and viable society only on the principle of altruism have failed and will fail"<sup>12</sup>. Of course, self-interest can degenerate into selfishness. But basically self-interest is a natural human attitude. Remember the words of Jesus: "Love your neighbour as you love yourself" (Mt 19: 19; Mk 12:31)! The commandment to overcome greed and selfishness does not mean that we have to put aside our own desires and ambitions. This would be an inhumane demand. Self-interest is the motivating force behind our activities - economic activities included.

A centrally planned economy is an obstacle to that and excludes this economic and generally human function of personal advantage as a driving force for economic activities. Income and prices, fixed by the state authority, determine the degree to which individuals can fulfil their needs and wishes - at least insofar as this fulfilment depends on the amount of their income. The central economic plan has already fixed these data in advance, without taking into account the individuals' efforts and achievements. This fact excludes the principle of self-interest as the driving force and incentive to economic activities.

Centrally controlled economies, for example in former communist East Germany, tried to replace the 'achievement principle' - so to speak 'through the back door' - by introducing bonus systems and by fixing high performance targets that had to be met. However, according to my own experience, neither high fixed quotas nor cleverly thought-out bonus systems could replace the principle of self-interest as incentive to economic achievement. The history of the past decades has taught that both attempts did not succeed. The fact of not having taken into account the self-interest of the economic participants was one main reason for the breakdown of the centrally controlled economies in Eastern Europe and the former Soviet Union.

## **Lack of a rational economic management**

Another difficulty centrally planned economies have to face is the problem of a 'rational economic management'. The rational economic principle aims at utilising the limited resources as economically as possible. Valuable resources must not be used to produce less valuable goods. In a market economy, price - not fixed by a state authority or by monopoly arrangements or powerful suppliers - indicates the consumers' appreciation for the different goods. In a centrally commanded economy, price cannot do this job and play a role in indicating the appreciation and demand of the consumers for the particular products. The central plan of the state authority determines the volume of output and fixes prices already in advance. This economic system lacks an automatic indicator, which shows the consumers' wishes and directs the factors of production to the most economical use. Uneconomic utilization and squandering of economic resources are the unavoidable results.

Each centrally planned and controlled economy has to face both of these difficulties. According to my experiences in the communist German Democratic Republic, these difficulties were the main grounds for the economic collapse of the former Eastern-block states. By their nature, such economies are unable to meet the demand of the people. "The Common Good" statement by the English Bishops rightly emphasises that "commanded economies... are inefficient, wasteful, and unresponsive to human needs. Nor have they fostered a climate of personal liberty"<sup>13</sup>. The 'really existing socialism' is a concrete proof of the failure of a 'centrally planned and controlled economy'. Not least for this reason, the slogan going around during the 'peaceful revolution' of 1989 in East Germany was: "If the DM (deutschmark) does not come to us, we shall move to the DM". The DM was the symbol of Social Market Economy.

## **ADVANTAGES AND DISADVANTAGES OF MARKET AND COMPETITION**

Market and competition are imperative because they are able to utilise the scarce and limited economic resources in the best possible way - more than any other economic systems that have been experienced in history and are known today. I refer to the late Oswald von Nell-Breuning SJ, a foremost



social scientist, author of the Encyclical *Quadragesimo Anno* and doyen of Christian Social Teaching. Having committed his whole life to the labour movement, he could not be suspected of sympathy with any kind of pure market economy or capitalism. In order to reconstruct the ruined German economy and its destroyed industry, von Nell-Breuning demanded after World War Two: "First get the market economy going as much as possible<sup>14</sup> and eliminate the centrally planned and controlled economic system!" The main reasons for von Nell-Breuning's assertion were - and are in my view - as follows: Material resources, when compared with the material needs of humankind, are in short supply. The commandment of solidarity therefore demands that sufficient material goods necessary for life are made available to as many people as possible.

Market and competition - more than all the other economic systems we know to date - are able to utilise the scarce and limited economic resources in the best possible way. "No other system has so far shown itself superior"<sup>15</sup>. Economic inefficiency and squandering of resources in the 'really existing socialism' in the former Soviet Union, Eastern Europe and elsewhere are an obvious and concrete proof. "Certainly the mechanisms of the market secure advantages: they help to utilise resources better", the Encyclical *Centesimus Annus* states. "They promote the exchange of products; above all they give central place to the person's desires and preferences"<sup>16</sup>.

The more the volume of goods, which are necessary for life, can be increased, and at the same time, the more the consumption of resources to produce these goods can be decreased - for example the consumption of scarce energy and the demands made on the natural environment to produce these goods, the less the living-conditions of future generations will be burdened. Uneconomic utilisation of the scarce economic resources, squandering of the limited economic potential violates human solidarity, or - in Christian words - breaks the commandment to love one's neighbour. The moral quality of a competitive or market economy lies primarily in its ability of using scarce and limited economic resources to the optimum. At the same time, this is the answer of Christian Social

Teaching to the question: market economy or centrally planned and controlled economy?

However, why are market and competition - in particular in the moral-ethical view - often so fiercely disputed and even attacked? Karl Homann, a distinguished economist and social philosopher, sees the main reason in the fact that the advantages of market and competition, "which create a general increase in prosperity, are scattered, spread, and in this sense 'imperceptible". Competition and market are incentives for economic activities; each economic participant tries to make a profit. At the same time, competitions put pressure on costs and prices; each producer makes every effort not to be eliminated by fellow competitors. The results are "a general increase in prosperity". These - general - advantages of competition and market, however, are "scattered, spread, and in this sense imperceptible" to individuals because the community as a whole profits from them.

In contrast to this, the burdens of market and competition "often affect and hit individual people, single groups, single sectors and branches of industry"<sup>17</sup> - for instance farmers, textile workers, miners, as happened in Europe during the recent decades. The optimal utilisation of limited economic resources requires that uneconomic production and production for which there is no longer a demand are stopped. If, in the longer term, all people will do better, changes in economic structures are unavoidable. Subsidies, which permanently preserve the production of goods are no longer in demand, and the permanent protection of single branches of industry are not only economically, but also morally, detrimental. Such permanent subsidies and the permanent protection of single sectors burden and damage the welfare of the community, which has to bear these subsidies and to pay them. Because of that, they damage the public weal. Continuous changes in structure, the "process of creative destruction"<sup>18</sup>, as the left-wing Austro-American economist Joseph Schumpeter demanded, are the market economic price for the common good.

## **NECESSITY OF THE FRAMEWORK**

The question now is: how does the community manage to cope with these costs of the public well-being, the well-being of all, in a market economy? That is to say, what kind of safeguard, what 'social net', what framework does the community establish for those individuals who have to bear the burden of changes in structure? Market and competition are only responsible and acceptable if those individuals who are hit by the "process of creative destruction" - in particular the so-called 'market passives', those unable to take care of themselves in a manner required by the market - are cushioned, supported and 'carried' by the community; in other words, a framework is to be shaped to the well-being of everyone, to the well-being of all.

At this point, state and politics must start to do their job. This task includes not only to make possible and safeguard market and competition, and then - afterwards - to correct socially detrimental results. To use an image: it is not good enough to pull the child out of the water after you have let him fall in. It is as crucial that from the very outset the social dimension is recognised as essential and equal in weight to all economic activities. The child must be protected from falling into the water in the first place. Therefore, state and politics have to provide those presuppositions and conditions, which are needed - as the above-mentioned social scientist Oswald von Nell-Breuning emphasised - which are needed for "a socially adequate economic process and its socially just results"<sup>19</sup>.

The "socially adequate production process" includes, for example, the humanisation of working conditions so that employees are not already crushed under the wheels of the production process, and it demands the involvement of the work force in economic decision-making<sup>20</sup>. The "socially adequate economic process" aims to make far-reaching changes of structure tolerable by using 'social cushions'; and above all, it should provide the conditions for the creation of new and sustaining jobs, by changing the economic structure before segments of the industry and their jobs go into decline. All these goals are examples belonging to "a socially adequate economic process".

"Socially just results" include, for instance, the integration of ecological targets that are becoming increasingly important. Destruction of the environment must not be accepted. "It is the task of the State", the Encyclical *Centesimus Annus* emphasises, "to provide for the defence and preservation of common goods such as the natural and human environment, which cannot be safeguarded simply by market forces"<sup>21</sup>. "Socially just results" also demand an equitable income distribution. An abundance of wealth alone is not a desirable aim, if this wealth is unjustly distributed, unjustly shared. Therefore, it is the task of the framework to direct the allocation of the national product "to the different groups of people so that the distribution of income and fortune is an adequate and fair one"<sup>22</sup>.

These reasons lead to the conclusion that a policy, which does not establish and shape a framework, aligned with the common good, but only reacts and deals with symptoms, misses the task of economic policy and economic ethics. Christian Social Teaching contributes these considerations and hints at shaping a humane economic order. To put it in my words: First, the bread we need to eat must be baked. For that we need a well-operating oven, that is to say, an efficiently working economy. And competition and market are able - more than all economic systems we know until today - to utilise the scarce and limited economic potential in the best possible way. The bread, however, must not be baked under inhumane working-conditions; and it must be fairly distributed; everyone must get a just share. For that we need a framework shaped by the legislator - in alignment with the well-being of everyone, in alignment with the common good - and carried through by state policy.

## **SOCIAL MARKET ECONOMY AND ITS FRAMEWORK**

The activities of individual economic participants, mainly motivated by their self-interest, are essential, but they do not automatically realize the best for all, the welfare of everyone. They put it into effect only within an adequate framework, within a proper order. This insight is the starting point and basis of the concept known as "Social Market Economy". After

World War Two, European and especially German economists and politicians, who had opposed the National Socialists and their centrally planned and controlled economy, elaborated the concept and put its theories into political and economic practice.

Social Market Economy is an economic system combining "the principle of freedom in the marketplace and the principle of social justice". The model is based on the conviction that competition is "an indispensable tool for organizing modern mass-societies", but that this competition "only works if it is safeguarded by a clear framework and strong legal regulations"<sup>23</sup>. The central core of Social Market Economy is "competition based on true achievements of output and efficiency". Competition promotes and guarantees economic efficiency and productivity. Since real competition does not automatically result from the 'free play of forces', as taught by history and modern economics, the state policy has the responsibility to enable, establish and promote competition, as well as to safeguard it from restrictions of every kind. Therefore, a monopolies law and a monopolies commission, which ensure that monopolies are not created, belong to this central core. According to the concept of Social Market Economy, the state is not a simple 'night-watchman'; on the contrary, legislators and government have to create "the *legal* framework for every economic activity, business, trade and industry"<sup>24</sup>. - Added to the "competition of achievements" are equally important social conditions and elements, social rules that form the 'second pillar' of Social Market Economy. Such social elements are the alignment of the economy and production with the needs and wishes of the consumers by 'the play of supply and demand' and not with a central state authority; an income distribution tied to individual performance and achievement and, in this sense, "a just income distribution"<sup>25</sup> and, above all, social and economic interventions of the state to complement competition.

The founders of the Social Market Economy realised that economic competition alone is insufficient to form a humane economic order. "For many things, which are inaccessible to the market mechanisms are of the greatest importance for human needs". People who are not, not yet or no

longer, able to compete "cannot be abandoned to the market". These "market passives", as the economist Alexander Rüstow called them, are unable "to take care of themselves in a manner required by the market because they are ill, weak, young, old, etc". Because of that, one "must do something for them if one wants to be responsible and humane".

State intervention is also required in order to facilitate those necessary changes in the economic structure, which are beyond the ability of the individual people affected. Such changes "cannot be allowed to regulate themselves, at some time or another, in a palaeoliberal, that is capitalistic, manner"<sup>26</sup>. It is essential that this social dimension be recognised as equal in weight to all economic activities. Social corrections must not be carried out – perhaps - only later on, 'after the child has fallen into the river; the child ought to be protected from falling into the water' in the first place. Wilhelm Röpke, one of the 'fathers' of Social Market Economy, described the essential difference to capitalism as follows: according to the capitalistic "concept, competition was a natural plant" growing by itself; according to our "conviction, it is a cultivated plant"<sup>27</sup>, which must be tended, pruned and nursed – by the framework. In other words: The essentials of Social Market Economy are two fundamental values: freedom and social justice. These two cornerstones "are inextricably linked with each other. The concept of freedom has to be integrated into the dimensions of responsibility and the common good of the society"<sup>28</sup>.

For some years, however, the model of the Social Market Economy has had to confront an additional serious problem. In the context of the growing global "interdependence of national economies"<sup>29</sup> – as the Encyclical *Pacem in Terris* states – until today the world economy lacked a global framework that would correspond to the domestic or national framework within a state. The much discussed globalisation enables economic participants and, in particular, transnational companies to act more and more outside any framework. The framework, however, is essential for the concept of Social Market Economy. The 'hot potato' of an international economic order results from this lack of a framework. The existence of the United Nations and its institutions are at best – if at all –

first steps. Europe had started to shape a kind of a regional framework by founding the European Union. In the long-term, in my view, a global framework is absolutely necessary. This must not be "a world state" – which seems neither to be possible nor, because of the danger of a global dictatorship, desirable. But "a world federation of independent states", as political scientists correctly suggest, their "organised cooperation"<sup>30</sup> on a global level is imperative – in whatever way it may be managed. The recent worldwide financial and economic crisis is the latest proof of its necessity.

### **FRAMEWORK AND INDIVIDUAL MORAL COMMITMENT**

"The framework is the main place - not the only, but the main place - where morality in the market economy is to be situated"<sup>31</sup>. This insight does not make individual moral commitment unnecessary and superfluous. The framework is sometimes accused of doing this. On the contrary, individual economic participants have to observe the rules of the framework that have been enacted to regulate their economic activities, their 'moves in the economic game', as well as to regulate the economy as a whole, and they must in no way avoid or trick them. Being honest in business, paying just wages, etc may often demand great moral strength and is not always easy.

On the other hand, as citizens, both employees and employers have the political and ethical responsibility to be involved in and to contribute to shaping this framework as well as to contribute their political and moral convictions - for instance, by the election of members to parliament. Democracy "means that the people themselves must take charge of ethics"; and in a democratic society the majority decides on the content of the framework and determines its details. Therefore, "as many as possible" should make their "consciences heard" and their "voting power felt on matters of basic principle"<sup>32</sup>.

Finally, in spite of the competition situation, within the framework the individual market participants can make additional efforts for social, ecological or - in general terms - moral purposes. As long as fellow

competitors do not exploit such efforts, which are connected with expenses and costs, but perhaps take them on and continue them, higher moral standards will emerge. Economists demand from "companies to take on more responsibility for the community". In future they "will be tested not only on the increase in their shareholder-value, but also on their contribution to and increase in social and moral value... economic success and social responsibility do not exclude each other, they will depend on each other... A good enterprise stands out due to good products and services; an excellent enterprise stands out due to additional social responsibility"<sup>33</sup>.

If we consider human nature realistically, nevertheless we recognise that 'moral appeals to the conscience of single individuals' expect too much from these individuals and overtax them whenever they are economically punished for their moral behaviour - by higher expenses or the loss of economic advantages. Therefore, the great importance of the framework must not be overlooked. Moral appeals work best in face-to-face relationships, as in a family or circle of friends. The thesis of the framework as the main place of morality in market economy emphasises that "the conscience of the individual person is not able to compensate for the failings of the institution"<sup>34</sup>. Because of that, "the framework is the main place – not the only one, but the main place – where morality in the market economy is to be situated"<sup>35</sup>.

## NOTES

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<sup>1</sup> Friedrich August von Hayek (1980-1983), *Gesetzgebung und Freiheit. Eine neue Darstellung der liberalen Prinzipien der Gerechtigkeit und der politischen Ökonomie*, 3 Volumes, Landsberg am Lech; 2<sup>nd</sup> Volume: *Die Illusion der sozialen Gerechtigkeit*

<sup>2</sup> Karl Homann (1993), *Wirtschaftsethik*, in: *Lexikon der Wirtschaftsethik*. Ed. by Georges Enderle a.o., Freiburg, 1286-1296, 1290

<sup>3</sup> Karl Homann (1994), *Wettbewerb ohne Moral?* in: zur Debatte. Themen der katholischen Akademie in Bayern 24, No. 4, 1-5, 2

<sup>4</sup> Karl Lehmann (1997), *Markt und Ethik*, in: *Die Neue Ordnung* 51, 99-103, 99

<sup>5</sup> Karl Homann (1990), *Wettbewerb und Moral*, in: *Jahrbuch für Christliche Sozialwissenschaften* 31, 34-56, 39

<sup>6</sup> Adam Smith (1776), *An Inquiry into the Nature and Causes of the Wealth of Nations*, London (Der Wohlstand der Nationen. Eine Untersuchung seiner Natur und seiner Ursachen, ed. by Horst Claus Recktenwald, München <sup>3</sup>1990, 17)

<sup>7</sup> Edith Raidt (1999), *Business Ethics and the Bonum Commune*, in: *PRAXIS – Journal for Christian Business Management*, March, 6-10, 8 (Volume 7, Number 1)

<sup>8</sup> Walter Kerber (1990), *Ordnungspolitik, Gemeinwohl und katholische Soziallehre. Der Sozialen Marktwirtschaft zum Gedächtnis*, in: *Jahrbuch für Christliche Sozialwissenschaften* 31, 11-33, 13

<sup>9</sup> Homann, *Wirtschaftsethik*, 1290 (see note 2)



- <sup>10</sup> Catholic Bishops' Conference of England and Wales (1996), *The Common Good and the Catholic Church's Teaching*. A statement, London, No. 78
- <sup>11</sup> *The Common Good*, No. 78 (see note 10)
- <sup>12</sup> Lehmann, *Markt und Ethik*, 99 (see note 4)
- <sup>13</sup> *The Common Good*, No. 78 (see note 10)
- <sup>14</sup> Oswald von Nell-Breuning (1956), Address at the 1st meeting of the Advisory Council of Economic Administration, 23<sup>rd</sup>-24<sup>th</sup> January 1948 in Königstein im Taunus (shorthand record), in: Oswald von Nell-Breuning, *Wirtschaft und Gesellschaft heute*, Vol. I, Freiburg, 156-158, 158
- <sup>15</sup> *The Common Good*, No. 78 (see note 10)
- <sup>16</sup> John Paul II (1991), On the Hundreth Anniversary of *Rerum Novarum Centesimus Annus*, No.40, 2
- <sup>17</sup> Homann, *Wettbewerb und Moral*, 40 (see note 5)
- <sup>18</sup> Joseph A. Schumpeter (<sup>5</sup>1976), *Capitalism, Socialism and Democracy*, London (*Kapitalismus, Sozialismus und Demokratie*, München <sup>3</sup>1980, 134)
- <sup>19</sup> Oswald von Nell-Breuning (1990), *Wie "sozial" ist die "Soziale Marktwirtschaft?"* in: *Den Kapitalismus umbiegen. Schriften zu Kirche, Wirtschaft und Gesellschaft*, ed. by Friedhelm Hengsbach, Düsseldorf, 222-238, 236
- <sup>20</sup> See Franz Josef Stegmann (2001), "'Worker Participation' in Economic Decision-Making: The German Model of Co-Determination and Catholic Social Teaching", in: Edith Raidt (Ed.), *Ethics in the Workplace*, Johannesburg , 97-106
- <sup>21</sup> John Paul II (1991), *Centesimus Annus*, No. 40,1 (see note 16)
- <sup>22</sup> Oswald von Nell-Breuning, *Das Lohnproblem im Zusammenhang mit der Beteiligung des Arbeiters am Sozialprodukt, insbesondere an der volkswirtschaftlichen Vermögensbildung*, in: *Wirtschaft und Gesellschaft heute I*, 410-422, 421 (see note 14)
- <sup>23</sup> Alfred Müller-Armack (1956), *Soziale Marktwirtschaft*, in: *Handwörterbuch der Sozialwissenschaften*, Vol. 9, Stuttgart, 390-392, 390
- <sup>24</sup> *Was ist Soziale Marktwirtschaft? Aktionsprogramm der Aktionsgemeinschaft Soziale Marktwirtschaft* (1960), in: *Das christliche Gewissen und die soziale Marktwirtschaft*, Offprint from *Junge Wirtschaft*, No. 2, 7
- <sup>25</sup> Ludwig Erhard (1949), *Das Problem der freien Marktwirtschaft*, in: *Vierteljahreshefte zur Wirtschaftsordnung*, 71-87, 78
- <sup>26</sup> Alexander Rüstow (1960), *Paläoliberalismus, Kommunismus, Neoliberalismus*, in: *Das christliche Gewissen und die Soziale Marktwirtschaft*, Offprint from *Junge Wirtschaft*, No. 2, 3-7, 5-6
- <sup>27</sup> Quoted according to Oswald von Nell-Breuning (1954), *Trennendes und Gemeinsames in den Hauptrichtungen der Wirtschaftswissenschaft und Wirtschaftspolitik*, in: *Grundfragen der Wirtschaftsordnung*, Berlin, 215-231, 218
- <sup>28</sup> Ursula Nothelle-Wildfeuer (2005), *Ethik – Der Unternehmer muss in Freiheit handeln können*, in: *Rheinischer Merkur*, No. 20, 23
- <sup>29</sup> John XXIII (1963), *Peace on Earth Pacem in Terris*, No. 130
- <sup>30</sup> Bernhard Sutor (1997), *Die Bedeutung der kirchlichen Friedensethik in der gegenwärtigen politischen Situation*, in: *Stimmen der Zeit* 122, 507-518, 517
- <sup>31</sup> Homann, *Wirtschaftsethik*, 1290 (see note 2)
- <sup>32</sup> Martin Prozesky (1999), *Morality of the people, by the people and for the people*, in: *Sunday Times*, 11th July
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- <sup>34</sup> Hermann Krings (1991), *Norm und Praxis. Zum Problem der Vermittlung moralischer Gebote*, in: *Herder-Korrespondenz* 45, 228-233, 230
- <sup>35</sup> Homann, *Wirtschaftsethik*, 1290 (see note 2)



# **"Worker Participation" in Economic Decision -Making**

## **The German Model of Co-Determination and Catholic Social-Teaching**

After the Second World War Germany was in a nearly hopeless condition: the country occupied, its industry destroyed, its economic structure ruined. About 80% of the residential buildings and almost 90% of the industrial plants were ruins. During six years of war, started by Germany, millions had fallen as soldiers or been killed by bomb attacks at home and millions were prisoners of war. Soviet Russia released the last ten thousand only in 1955, ten years after the end of the war. Germany was divided and its future seemed hopeless. But within 15 to 20 years the country managed to reconstruct the economy. Today it enjoys a strong economic power. The recent world economic crisis clearly shows this. As the most powerful economy in Europe many regard the country as a locomotive for an economic recovery. At the same time its social level is unusually high. Even compared with industrialised countries, Germany's social structure is surprisingly stable. The number of strike days, for example, is one of the lowest in industrialised countries.

It is true; Germany also has to face serious economic problems. Take, for example, the problems caused by the re-unification: since 1990 a sum of about 90 billion Euros has been and is still transferred each year to the former communist German Democratic Republic to reconstruct its ruined economy. Take the problems of the reversal of population pyramid: the same number of people in work must bear the cost for an increasing elderly population. And take the problems caused by the much-discussed economic globalisation. Due to the high wage level, many companies move factories from Germany to the Eastern part of Europe and to South

East Asia, where wages are much lower and the work force is well qualified. Nevertheless the country's unemployment rate, fluctuating around 6 per cent, is one of the lowest in Europe.

A number of reasons contributed to Germany's successful economic and social reconstruction after World War Two, for example, aid from the United States, the so-called Marshall Plan. But the most important one was the general policy of Social Market Economy: economic competition of achievement and efficiency and – equally important – social conditions and rules<sup>1</sup>. Closely linked with the concept of Social Market Economy, the participation of the work force in decision-making made a further considerable contribution to the economic reconstruction and the social stability. This economic co-determination prevented excessive, serious tensions between management and labour and created a general atmosphere of partnership between employers and employees, between management and labour.

The first focus of our attention will be the various forms of worker participation in general. I give a short survey of these forms (1). I will then briefly outline the development of the co-determination idea in Germany's socio-economic history (2). In a third step I explain how the "active participation of everyone in the running of an enterprise"<sup>2</sup> - as the Second Vatican Council called the worker co-determination – is assessed by Christian Social Teaching (3). The last chapter describes how the settlement of worker participation was reached and presents the existing economic co-determination laws in the Federal Republic of Germany (4).

## **CONCEPT AND FORMS OF PARTICIPATION IN ECONOMIC DECISION-MAKING**

Whenever there is talk of worker participation in economic decision-making, one must distinguish between three aspects or levels.

- The first distinction refers to the issues that are *objects* of the participation in decision-making. There is co-determination of social issues, for example, enactment or change of the factory order, administration of social services provided by the enterprise,

- regulation of holiday periods. Another form of worker participation concerns personnel affairs such as employment, transfer or dismissal of employees, regulations of further education in the company. There is, finally, a co-determination of real economic issues, for example, the taking up or ending of a particular production, the amount and kind of investments, the establishment of new production sites. The "Law on Factory Committees" of 1920 introduced co-determination of social and personnel affairs and an initial co-determination of economic matters. After World War Two a number of laws established the full participation also in economic decision-making.
- A second distinction refers to the *intensity* and *degree* of worker co-determination. One must distinguish between mere information of the workforce and a non-binding, advisory discussion on the one hand and a real participation in decision-making on the other, which must be part of the final decision. This real co-determination takes place on different levels, according to the number of workers' representatives in the decision-making body. For example, the mentioned "Law on Factory Committees" of 1920 provided for two representatives of the employees on the board of directors; according to the "Law on Regulations Governing Industrial Relations" of 1952, a third of the members of the board of directors must be representatives of the workers; the "Law on Worker Participation in Coal and Steel Industry" of 1951 demands a fifty-fifty representation of owners and workers on the board of directors and a "Worker Director" ("*Arbeitsdirektor*"), who represents the workers on the board of the executive directors.
  - Finally, one must distinguish *different levels* of participation in decision-making: The "Workplace Co-de-termination" ("*Mitbestimmung am Arbeitsplatz*") is on the lower level and refers to the shape and conditions of the workplace, which affect each individual worker. The middle level is the crucial place where the "Enterprise Co-de-termination" ("*Betriebliche Mitbestimmung*") focuses on the social, personnel and economic issues of the enterprise, such as the introduction and administration of social services in the business, the employment and dismissal of employees, the taking up and ending of

particular productions, the kind and size of investments, etc. The “Industry-wide Co-de-termination” (“*Überbetriebliche Mitbestimmung*”) outside the enterprise itself, refers to “decisions concerning economic and social conditions...on a higher level”, as the Second Vatican Council says, “on which the future of the workers and their children depends”<sup>3</sup>. This "higher level" includes, for example, Chambers of Commerce where local economic participants meet to promote industry and commerce.

In this context it should be mentioned how bodies in charge of companies in English and German speaking countries differ. In English speaking countries, the body in charge of the company is called Board of Directors. Elected by the shareholders, its members run the company and determine the general policy. They appoint the president and other executive directors who are responsible for managing the company and carrying out the everyday decisions. These executive directors are members of the board.

In German speaking countries the difference between the “Board of Directors” (“*Aufsichtsrat*”) and “Board of Executive Directors” (“*Vorstand*”) must be mentioned. The German “Board of Executive Directors” is responsible for the management of the company, for the everyday and routine decisions. The German “Board of Directors” draws up the company's policy in general, appoints and dismisses the Executive Directors and is therefore the last-deciding body. These different areas of responsibility are of some importance for the German regulations of worker co-determination.

## **HISTORY OF THE WORKER PARTICIPATION IN DECISION-MAKING**

Social and economic history tells us that the problems regarding the relations between owners and workforce, between management and labour are as old as the industrialisation itself and that these problems can be traced back to the first decades of the 19<sup>th</sup> century. In 1835 - thirteen years before Karl Marx and Friedrich Engels published the famous Communist Manifesto of 1848 - Franz von Baader claimed "the right of the emerging

work force to elect and send representatives to the bodies of estates"<sup>4</sup>. Baader was the most important social critic in the early Catholic Social Movement. The "bodies of estates" were a kind of parliament or assemblies of groups of the society, which were at that time powerful. The members of the "bodies of estates", elected by the workers, should represent their interests and bring them forward. Baader's proposal was not realised, but what is crucial for the history of co-de-termination was the fact that Baader declared the representation of the employees in the "bodies of estates" to be "the right of the proletariat"<sup>5</sup> - something that the ruling classes of that time simply did not admit.

The pioneer of Social Catholicism in Germany was Bishop Wilhelm Emmanuel von Ketteler of Mainz. In the 1860's, he made every effort to establish what he called "production associations". Each member of such a "production co-operative" would be "entrepreneur as well as worker"; as "entrepreneur" he would be involved in the "economic decision-making and running of the enterprise"<sup>6</sup>. In this way, the separation between capital and labour would be eliminated. Even if Ketteler did not succeed, he introduced the idea of worker participation into the Catholic Social Movement. These efforts show that the problems of the tension-laden relationship between employers and employees and the issue of economic co-determination are as old as the industrialisation itself.

Successor to Ketteler as leader of the Catholic Social Movement was Franz Hitze, a Catholic priest, for many years the speaker of the (Catholic) Centrum-Party for social affairs in the national parliament and a close supporter of the emerging Christian Trade Unions. Since 1893 he held the first - and for a long time, the only - German chair of Christian Social Teaching at Münster University. In the 1880s, Hitze and his friend, the entrepreneur Franz Brandts, established in Brandts' textile business a so-called "Worker Committee" ("*Arbeiter-Ausschuss*"). This "Worker Committee" may be called the predecessor of the "Works or Factory Committee" ("*Betriebsrat*") that, according to the above-mentioned "Law on Regulations Governing Industrial Relations" of 1952, today exists in every German company. The "Worker Committee", established by Hitze

and Brandts, was involved in decision-making with regard to social and personnel matters<sup>7</sup>. So the 'Worker Committee' "changed the absolute monarchy (of the owner), which the enterprise was previously", a contemporary voice said, "into a constitutional and democratic one"<sup>8</sup>. As members of the national parliament, Hitze and his Centrum faction made every effort to introduce the establishment of 'Worker Committees' by law. But they did not succeed; resistance in and outside the parliament was still too strong.

After the First World War, the step was made from the demand for co-determination concerning personnel and social issues to the demand for co-determination regarding economic matters. The constitution of the new German republic - the so-called "*Weimar Constitution*", according to the city of Weimar, where the National Assembly discussed and passed the constitution - laid down the general principle of "equal worker participation in economic development" (Art. 165). The already mentioned "Law on Factory Committee" of 1920, finally provided for the full co-determination of the employees in social and personnel affairs and an initial participation in economic decision-making. It demanded that, for the first time, the 'Factory Committee' had to appoint and send two representatives of the workforce, enjoying equal rights, as members on the board of directors.

The law was initiated and, to a great extent, formed by the long standing Minister of Labour Heinrich Brauns. Heinrich Brauns, a Catholic priest, was a leading member of the Catholic Social Movement and, by this law, put into effect an old demand of the Catholic Social Movement of the 19<sup>th</sup> century.

## **CATHOLIC SOCIAL TEACHING AND "ACTIVE PARTICIPATION" OF WORKERS IN ECONOMIC DECISION-MAKING**

Until recent times, the Church Magisterium did not deal with the problem of worker participation in economic decision-making. According to the Encyclical *Rerum Novarum*, published by Pope Leo XIII in 1891, the right of ownership excluded any economic co-determination. The Encyclical



desired, however, that the "workmen's associations... should multiply and become more effective"; and it desired that – "just as the symmetry of the human body is the result of the disposition of the members of the body" - capital and labour should "maintain the equilibrium of the body politic"<sup>9</sup>; in other words, *Rerum Novarum* demanded, that a 'balance of power' should be introduced into the relationship between employees and employers.

Forty years later, the Encyclical *Quadragesimo Anno* of 1931 emphasised that the "wage-contract is indeed not unjust... In the present state of human society, however, the wage should, when possible, be modified somewhat by a contract of partnership... For thus the workers and other executives become sharers in the ownership or management, or else participate in some way in the profits"<sup>10</sup>. The close connection between the ownership and management suggests that Pope Pius XI aimed at an equal participation of the employees in the management, based on participation in the ownership.

A few years after World War Two, Joseph Cardinal Frings, the then Archbishop of Cologne and chairman of the Catholic German Bishops' Conference, convened a committee of Catholic employers and employees in order to prepare the biennial convention of the Catholic laity. Among other things, this committee dealt with the demand for economic co-determination and firmly declared "that involvement in decision-making is of great need and highly appropriate". Therefore, "the employees are entitled to bring into force this demand"<sup>11</sup>. In 1949 this convention, called "Catholics' Day" ("*Katholikentag*"), took place in Bochum, the centre of the Ruhr-region, the most industrialised region in Germany (where I lived and lectured for 19 years). After vehement and heated discussions, the assembly passed the following resolution: "*The Catholic employers and employees agree that the right of worker participation in decision-making regarding social, personnel, and economic affairs is a natural law, based on God's will. We demand that it should be fixed by law*"<sup>12</sup>. Later, the statement that the co-determination "is a natural law" was revoked. The declaration of the Bochum convention, however, has greatly influenced the

"Law on Worker Participation in the Coal and Steel Industry", the so-called "Law of Co-Determination", that passed the national parliament 1951, two years later. It determined that the board of directors in coal and steel companies must be made up of 50 per cent of the representation from both the owners *and* the workforce.

The Encyclical *Mater et Magistra*, published in 1961, and the Pastoral Constitution of Vatican Council II, *Gaudium et Spes*, continued Church teaching on worker participation. *Mater et Magistra* was the first pastoral letter to deal with the co-determination issue and introduced new aspects into the discussion. Pope John XXIII regarded "the desire of employees to be partners in enterprises with which they are associated and wherein they work... as justifiable". The "manner and degree of such a partnership" cannot be precisely decided; "but it is of outmost importance...that the employees should have an active part in the affairs of the enterprise wherein they work, whether these be private or public," and that "enterprises assume the character of a true human fellowship". Therefore the Encyclical continues "that the greater amount of responsibility desired today by workers in enterprises, not merely accords with the nature of man, but also is in conformity with historical developments in the economic, social, and political fields"<sup>13</sup>. The basis of these statements was the great appreciation for labour, which the Encyclical shares. "Justice is to be observed... in regard to the conditions under which men, engaged in productive activity, have an opportunity to assume responsibility". For labour "proceeds directly from the human person, and hence is to be thought more than wealth in external goods"<sup>14</sup>.

The Second Vatican Council again took up this thought of *Mater et Magistra*. The Pastoral Constitution *Gaudium et Spes*, published in 1965, states that human labour "comes immediately from the person", which "stamps the things of nature with his seal and subdues them to his will". Therefore, it "is superior to the other elements of economic life. For the latter have only the nature of tools"<sup>15</sup>. After this statement of principle, *Gaudium et Spes* directly turns to the issue of worker participation in economic decision-making. "In economic enterprises it is persons who

work together, that is, free and independent human beings, created to the image of God. Therefore the active participation of everyone in the running of an enterprise should be promoted. This participation... should take into account each person's function, whether it be one of ownership, hiring, or labour. It should provide for the necessary unity of operations". Since more often, however, "decisions concerning economic and social conditions, on which the future of the workers and their children depends, are... made not within the business itself but by institutions on a higher level" - the text continues focusing on this co-determination "on a higher level" – "the workers themselves should have a share also in controlling these institutions, in person or through freely elected delegates"<sup>16</sup>.

The statements of the Encyclical *Mater et Magistra* as well as those of the Vatican Council have been intensively discussed in and outside the German Catholic community. Many experts were and are convinced that the German regulations of the worker participation in decision-making completely correspond with the teaching of the Church. Others say that the German laws concerning co-determination go beyond those statements and contradict them. In my view, the following assessments and conclusions are clear and indisputable:

- The Church sees the enterprises to be not only an economic-technical apparatus producing goods, but a community - to quote the Pastoral Constitution - of "independent human beings, persons who work together". The employers, therefore, must not treat the employees and the economic-technical apparatus on the same level and as equal and should not see the workers as a cost factor only.
- Management, owners and workers together achieve the success of the enterprise. Taking "into account each person's function" and "the necessary unity of operations", the "active participation of everyone in the running of an enterprise should be promoted".
- The council did not determine how this worker participation should be put into practice, in which forms and to what extent. It did not ask questions on the concrete and detailed realisation of worker participation and did not answer them, because the "juridical-legal

and technical solutions are beyond the knowledge and beyond the authority of a Council"<sup>17</sup>, and they are beyond the knowledge and the competence of the/ Church Magisterium as such. The Council said 'Yes' to the co-de-ter-mination; it agreed fully with the principle of an "active participation" of the workers in economic decision-making - not more but also not less. It did not go into the details of its implementation. The implementation is and remains the task of the experts, the economists, the employers and employees, and above all, the freely elected parliament.

## **THE EXISTING REGULATIONS OF "WORKER PARTICIPATION" IN GERMANY**

I have repeatedly mentioned a number of laws on co-determination. I summarise these laws and explain the existing regulations in Germany.

The first law regarding worker participation in economic decision-making was enacted by the national parliament after the First World War. The "Law on Factory Committees" of 1920 provided for the full co-determination of the workforce in social and personnel affairs and an initial economic co-determination, insofar as for the first time, the "Factory Committee" had to appoint two representatives of the employees, enjoying equal rights, to the board of directors. In 1933, at the beginning of the so-called 'Third Reich', the National Socialists immediately cancelled the rights of worker co-determination and replaced it by the so-called 'Follow the Leader' principle (*'Führer – Gefolgschaft' Prinzip*), that is to say, only the 'Leader', the director of an enterprise, was entitled to make decisions.

At the beginning of the economic reconstruction after World War Two, the West German parliament passed the "Law on Worker Participation in the Coal and Steel Industry" in 1951. In a company with more than 1000 employees, this law provides for an equal fifty-fifty representation of the owners and the workforce on the board of directors and a 'worker director' (*'Arbeitsdirektor'*) as one of the executive directors. He or she is the representative of the workforce on the board of the executive directors. The appointment of this 'worker director' needs the agreement of the

employees. The board of directors is the most important body in a company. Its members appoint and dismiss the executive directors and determine the policy of the company in general. The board of the executive directors or the executive committee is in charge of managing the company and of carrying out daily and routine decisions.

In the remaining part of industry and commerce, the "Law on Worker Participation" of 1976 demands an equal representation of the owners and the workforce on the board of directors in each company with more than 2000 employees. In a stalemate, however, the chairman of the board makes the decision; and the chairman's appointment needs the agreement of the shareholders. In companies with less than 2000 employees, according to the laws on "Regulations Governing Industrial Relations" of 1952 and 1972, one third of the board of directors are to be representatives of the employees. Now the question is whether this settlement of co-determination, that has proved itself, will also gain acceptance in the European Union and be taken on by its member countries.

These regulations of worker participation made a considerable and important contribution to the reconstruction of German industry as well as to its social standards and social stability up to now. Without the co-determination, the deep transformation process of the post-war period would have created enormous social problems. For example, 50 years ago more than 600 000 employees had worked in the coal industry of the Ruhr-region. At present the coal industry has completely disappeared in this region. Jürgen Schrempp, a former executive director of Mercedes Benz and not a close friend of trade unions, sings everywhere the praises of the German worker participation in economic decision-making: "It slows down the speed with which decisions are taken, but it makes them, at the same time, stronger and more enduring, more sustainable and it creates an atmosphere of consent and partnership"<sup>18</sup>.

Of course, not every problem could have been prevented. We are again reminded of the costs of Germany's re-unification. Since 1990, on average, 90 billion Euros per year are transferred from the western part to the

former communist German Democratic Republic to reconstruct its ruined industry. Remember the problems caused by globalisation or the recent worldwide financial and economic crisis! But unlike other countries the German economy “is strengthened by this crisis”<sup>19</sup>, experts observe. Worker participation in economic decision-making has made a considerable contribution to the reconstruction of Germany’s industry since 1945 and to its high economic and social standards of today; co-determination has proved to be worthwhile.

## NOTES

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- <sup>1</sup> See Franz Josef Stegmann (2001), Social Market Economy: A Good Chance or a Wrong Track, in: Edith H. Raidt (Ed), *Ethics in the Work Place*, Johannesburg, 59-75
- <sup>2</sup> Second Vatican Council (1965), Pastoral Constitution *Gaudium et Spes*, Art. 68,1
- <sup>3</sup> Second Vatican Council, *Gaudium et Spes*, Art. 68.2 (see note 2)
- <sup>4</sup> Franz von Baader (1835), Über das dermalige Missverhältnis der Vermögenslosen oder Proletaires zu den Vermögen besitzenden Klassen der Sozietät in Betreff ihres Auskommens, sowohl in materieller als in intellektueller Hinsicht, aus dem Standpunkt des Rechts betrachtet, München, in: *Texte zur katholischen Soziallehre* (1976), ed. by Bundesverband der Katholischen Arbeitnehmer Bewegung (KAB) Deutschlands, Vol. II, Kevelaer, 43-53, 49
- <sup>5</sup> *Ibidem* 59
- <sup>6</sup> Wilhelm Emmanuel von Ketteler (1864), Die Arbeiterfrage und das Christentum, Mainz, in: *Texte zur katholischen Soziallehre II*, 116-217, 202 (see note 4)
- <sup>7</sup> See Franz Josef Stegmann (<sup>2</sup>1978), *Der soziale Katholizismus und die Mitbestimmung in Deutschland. Vom Beginn der Industrialisierung bis zum Jahre 1933*, Paderborn, 76-87
- <sup>8</sup> Max Sering (1890), Arbeiter-Ausschüsse in der deutschen Industrie, Gutachten, Berichte, Statuten, Leipzig, 2
- <sup>9</sup> Leo XIII (1891), The Condition of Labour *Rerum Novarum*, No. 36, 2; 15
- <sup>10</sup> Pius XI (1931), After Forty Years *Quadragesimo Anno*, No. 64, 65
- <sup>11</sup> Joseph Cardinal Frings (Ed.) (1949), Verantwortung und Mitverantwortung in der Wirtschaft, Köln, 123
- <sup>12</sup> Gerechtigkeit schafft Frieden. Der 73. Deutsche Katholikentag in Bochum (1949), Paderborn, 114-115
- <sup>13</sup> John XXIII (1961), Christianity and Social Progress *Mater et Magistra*, No. 91, 93
- <sup>14</sup> John XXIII, *Mater et Magistra*, No. 82, 107
- <sup>15</sup> Second Vatican Council, *Gaudium et Spes*, Art. 67, 1-2 (see note 2)
- <sup>16</sup> Second Vatican Council, *Gaudium et Spes*, Art. 68, 1-2
- <sup>17</sup> Oswald von Nell-Breuning (1968), Kommentar zum II. Kapitel, in: *Lexikon für Theologie und Kirche - Das Zweite Vatikanische Konzil*, Vol. 3, Freiburg, 487-515, 500
- <sup>18</sup> *Frankfurter Allgemeine Zeitung* (1998), 22 July, 13. Some years ago, Jürgen Schrempp was Director of Mercedes South Africa.
- <sup>19</sup> Georg Giesberts (2011), Mit voller Kraft aus der Krise, in: *Frankfurter Allgemeine Zeitung*, 6 July, U 1

# **From 'Cost Factor' to 'Co-Entrepreneur'**

## **Christian Social Teaching, Social Market Economy and the Changing Role of the Worker in Modern Economy**

In 1868, Friedrich Engels (1820-1895), the close friend of Karl Marx (1818-1883), described the relationship employer - employee as follows: "The capitalist employs his worker. In a certain time the worker has delivered as much work as corresponds to his weekly wage. Assuming that the weekly wage corresponds to three working days, the worker, who started on Monday, has replaced the entire value of the paid wage on Wednesday evening... The capitalist, however, has bought his weekly work; therefore the employee has to work also the three last weekdays"<sup>1</sup>. Work, labour is only a commodity; the worker is just a cost factor that should be kept as small as possible!

Little less than 100 years after Friedrich Engels, in 1965, the Second Vatican Council of the Catholic Church declared in the Pastoral Constitution *Church in the Modern World - Gaudium et Spes*: "In economic enterprises it is persons who work together, that is free and independent human beings created in the image of God. Therefore the active participation of everyone in the running of an enterprise should be promoted. This participation should take into account each person's function, whether it be one of ownership, management, or labour" and "the necessary unity of operations" (Art. 68,1). In other words, all those involved in the enterprise - owners, management and workers - are persons, free, independent, self-responsible humans; the enterprise is a 'community' of producing human beings, not only a technical-economic production machine.

In seven steps the following explanation traces the changing role of the worker from a mere *cost factor* in the pure capitalistic economic system to a *co-entrepreneur* in modern economy. The two quotations above briefly describe the huge change; the keywords ‘Cost Factor’ and ‘Co-Entrepreneur’ mark its benchmark figures.

The essay deliberately focuses on the development in Germany, which may be helpful beyond its borders; and it turns the attention to the contributions, which Christian Social Teaching and the Concept of Social Market Economy made to this development.

### **PURE MARKET ECONOMY OR CAPITALISM: LABOUR - A ‘COMMODITY’, WORKER – JUST A ‘COST FACTOR’**

Let Friedrich Engels get a chance to speak once more: Despite the fact that the weekly wage of a worker corresponds only to three working days, the worker is not allowed to stop working on Wednesday evening. "The capitalist has bought his weekly work and the employee has still to work the three last weekdays too" – for nothing, in favour of the capitalist. So Engels summarises vividly the Marxist wage theory which describes the relation employer–employee in the early time and peak of capitalism. In his main work "*Das Kapital*" ("The Capital") Karl Marx did not invent the descriptions of the terrible conditions of the workers in 19<sup>th</sup> century England; they are based on official reports of Royal Investigation Commissions. The owner of the means of production buys the labour of the paid worker as a commodity and pays a wage which is just as much as the worker needs to maintain his capacity for work and to keep his species alive. The wage consists – according to Marx – of the costs for the “reproduction” of the commodity "human capacity for work", of the costs for raising and maintaining the workers who are needed by the economy at any one time: work, labour – a commodity, worker – just a cost factor, nothing else.

Marx described the situation of the workers in England. At the same time a Catholic Bishop in Germany, Wilhelm Emmanuel von Ketteler (1811-1877), drew a similar conclusion. Ketteler, Bishop of Mainz, was the



pioneer of Germany's Social Catholicism and its most influential figure in the 19<sup>th</sup> century. In 1864 he published his book "*Die Arbeiterfrage und das Christentum*" ("The Worker Question and Christianity"), which attained many editions. Ketteler's analysis reached the following conclusion: The physical existence of the worker depends on his wage; "in our time this wage is determined by the subsistence level, by what is vitally necessary in the strictest sense"; for the "wage is a commodity; every day its price is determined by supply and demand; the line which it is varying around is the minimal living income; whenever the demand (for labour, for workers) is greater than the supply, the wage rises over this axis; whenever the supply (of labour, of workers) is greater than the demand, the wage drops under this line"<sup>2</sup>. This fact went down in history as the so-called 'Iron Wage Law'.

The rational economic principle, which is essential for modern economy, forms the background of this fact. This principle demands "to expend as little means as possible for a wanted result or to get out as much as possible of available means"<sup>3</sup>: minimum possible input – maximum possible output. Due to the 'shortage of available means' and the great demand, this principle is basically right and made important contributions to the enormous increase in performance of modern economy. But the mechanical and reckless application of the rational principle to the labour market and the working people also made labour a mere commodity and the worker only a cost factor. The efforts of completely utilising the workers' capacity for work caused inhumane working conditions. Because the work capacity was the only 'commodity' of the worker, he was forced to sell it at any cost. Being without material resources, admittedly the worker was always the weaker one in the competition struggle.

The difference between Bishop Ketteler and Karl Marx consists only in three words. Ketteler limited the so-called 'Iron Wage Law' to his time - "in our time...". Marx, in contrast, declared it as an unchanging and unchangeable law and understood it as a prognosis of the future, which will go on according to natural law necessity. History, however, did not confirm his prediction – not least because people such as Ketteler and

Marx gave decisive incentives to awaken the conscience and to sharpen responsibility for the workers. But the 'Iron Wage Law' was in force in Early and High Capitalism; and it will be in force in each economic system, which sees labour as a mere commodity and treats workers only as a cost factor.

It may surprise us that even Adam Smith (1723-1790), the well-known founder of Classical Economic Liberalism and modern economics, saw this initial disadvantage. In a stirring passage of his main publication *An Enquiry into the Nature and Causes of the Wealth of Nations*, Smith described the workers' disadvantage in 1776: With regard to the struggle between "factory bosses" – he called them "masters" - and their "workmen", it is clear, who "will have the advantage in the dispute, and force the other into a compliance with their term... In all such disputes the masters can hold out much longer... They could generally live a year or two (or more) years upon the stocks, which they have already acquired. Many workmen, however, could not even subsist a week... without employment"<sup>4</sup>.

## **CHRISTIAN SOCIAL TEACHING AND WORKER CO- DETERMINATION (UNTIL WORLD WAR II)**

The described problematic relations between "factory bosses" and their "workmen", between management and labour, and the legal status of the workforce in enterprises are as old as the industrialisation itself. They can be traced to the first decades of the 19<sup>th</sup> century. Thirteen years before Karl Marx and Friedrich Engels published their famous Communist Manifesto in 1848, Franz von Baader (1765-1841) dealt with the issue of worker co-de-ter-mination. Baader was an entrepreneur, university professor and the most important social critic in the early Catholic Social Movement. As early as in 1835 he claimed "the right" of the emerging work force "to elect and send representatives to the bodies of estates"<sup>5</sup>. The "bodies of estates" ("*Ständeversammlungen*") were a kind of parliament of social classes, called "estates", which were powerful in the then society. In these "bodies" the representatives of the workers should look after their interests. Baader's proposal was not realised, but what is crucial for the history of co-de-ter-

mination is the fact that the entrepreneur Baader declared the representation of the employees in the "bodies of estates" to be "the right" of the workers. Baader claimed this right as early as in 1835, at the very beginning of the industrialisation process in Central Europe, and years before Marx and Engels published their Communist Manifesto.

In the middle of the century Bishop Ketteler made every effort to establish so-called "production associations". By "production associations" he understood co-operatives, which would eliminate the separation of capital and labour and stop the 'proletarianisation' of the work force. Each member of such a production co-operative would be "entrepreneur as well as worker". As "worker" he would be paid the ordinary "wage as an employee". As "entrepreneur he would receive his share in the profit of the enterprise" and, at the same time, would be involved in the economic decision-making and "running of the enterprise"<sup>6</sup>. This proposal referred clearly to the participation of workers as "entrepreneurs" in the "running of the enterprise" and consequently to co-determination. Even if Ketteler did not succeed, he introduced the idea of worker participation into the public discussion – as early as in the middle of the 19<sup>th</sup> century.

These efforts stand for many similar ones. They show that the problem of the employees' right to a say in the enterprise, and consequently the issue of an enterprise constitution including both sides, capital and labour - that is the issue of co-de-termination -, are as old as the industrialisation process. The problem however how to organise the co-operation within the "production association" remained unsolved. Presumably this was a main reason for the failure of the idea.

Successor to Bishop Ketteler as the leading figure of Social Catholicism in Germany was Franz Hitze (1851-1921). Hitze, a Catholic priest, held the first chair of Christian Social Teaching at a German university in Münster, acted for many years as spokesman on social affairs for the Catholic "Centre Party" ("*Zentrum*") in the national parliament and was a close supporter of the emerging Christian Trade Unions. In the 1880s Hitze and his friend, the entrepreneur Franz Brandts (1834-1914), established one of

the first so-called "Worker Committees" ("*Arbeiter-Ausschüsse*") in Brandts' textile business. These "Worker Committees" can be called the predecessors of the "Factory Committees". According to the "Law on Regulations Governing Industrial Relations" of 1952, today such a "Factory Committee", called "*Betriebsrat*", exists in every German company. The "Worker Committee" was involved in discussing personnel and social matters; and "also the employer committed himself to its decisions"<sup>7</sup>. So the "Worker Committee" granted the employees "a share of the rule"<sup>8</sup>, a contemporary voice said.

During the First World War, the so-called "Law on Help Service" ("*Hilfsdienstgesetz*") of 1916 enacted the legal introduction of "Worker Committees". The employers had demanded to cancel the free choice of the working place and the right of the free labour contract in order to increase the production capacity for weapons. The introduction of "Worker Committees" by law was the equivalent for this cancellation. So what Social Catholicism had fought for during a number of decades turned into a reality under the pressure of the war economy.

After the First World War, the development made a crucial step from co-de-termination concerning social and personnel issues to participation in economic decision-making. The constitution of the new German republic, the so-called "Weimar Constitution" laid down the principle that the employees "play an equal part with the employers in the entire economic development" (Art. 165). The "Law on Factory Committee" ("*Betriebsrätegesetz*") of 1920 made the concrete step from social to economic co-de-termination. It provided for the full co-de-termination in personnel and social affairs and an initial participation in economic decision-making: for the first time, the "Factory Committee" had to send two representatives of the workforce, enjoying equal rights, on the board of directors, the key deciding body of the enterprise. Representatives of the Catholic Social Movement were decisively involved in making the so-called 'Co-De-termination Article' 165 of the constitution; and the Minister of Labour Heinrich Brauns (1869-1939), a Catholic priest and a leading member of

the Catholic Social Movement, formed the "Law on Factory Committee" and put into effect an old demand of this movement.

One year later Matthias Erzberger (1875-1921) presented a new model of an enterprise constitution. Erzberger, also a member of the Catholic Social Movement, was Minister of Finance after the war and, within only 9 months, carried out the great financial reform of 1919-1920, a unique statesmanlike achievement. His model proposed that the workforce of each enterprise with more than 20 employees should found a "Works Association" ("*Werksgenossenschaft*"). By profit sharing and increasing the capital of the enterprise, gradually 50 % of the capital assets should become its property. Then half of the net earnings should be distributed to both the previous shareholders and the new "Works Association". It was the aim of the proposal to give the workers "a share in running the enterprise"<sup>9</sup> as well as in ownership and earnings. This concept was the first enterprise model that provided for an equal co-determination of the employees based on equal co-ownership. In August 1921, right-wing radicals assassinated Erzberger, because he had headed the German cease-fire commission after the war. So the discussion of his proposal stopped before it had started.

In 1933 Adolf Hitler and his National Socialists seized power in Germany. Only one year later they cancelled the existing co-de-termination regulations and replaced them by what they called "Follow-the-Leader Principle" ("*Führer-Gefolgschafts Prinzip*"); it gave the "Leader of the Enterprise" ("*Betriebsführer*"), the top management, the sole authority to make decisions on the enterprise including the affairs of the workforce. The workforce was called "Followers of the Enterprise" ("*Betriebsgefolgschaft*"), who had to follow the leader, as the German expression "*Gefolgschaft*" says.

## **CONCEPT AND FORMS OF CO-DETERMINATION**

Whenever there is talk of worker participation in economic decision-making, one must distinguish between three aspects or levels.

- The first distinction refers to the issues that are *objects* of the participation in decision-making. There is co-de-termination of social issues, for example, enactment or change of the factory order, administration of social services provided by the enterprise, regulation of holiday periods. Another form of worker participation concerns personnel affairs such as employment, transfer or dismissal of employees, regulations of further education in the company. There is, finally, a co-de-termination of real economic issues, for example, the taking up or ending of a particular production, the amount and kind of investments, the establishment of new production sites. The mentioned "Law on Factory Committees" of 1920 introduced co-de-termination of social and personnel affairs and an initial co-de-termination of economic matters. After World War Two a number of laws established the full participation also in economic decision-making.
- A second distinction refers to the *intensity* and *degree* of worker co-de-termination. One must distinguish between mere information of the workforce and a non-binding, advisory discussion on the one hand and a real participation in decision-making on the other, which must be part of the final decision. This real co-de-termination takes place on different levels, according to the number of workers' representatives in the decision-making body. For example, the mentioned "Law on Factory Committees" of 1920 provided for two representatives of the employees on the board of directors; according to the "Law on Regulations Governing Industrial Relations" of 1952, a third of the members of the board of directors must be representatives of the workers; the "Law on Worker Participation in Coal and Steel Industry" of 1951 demands a fifty-fifty representation of owners and workers on the board of directors and a "Worker Director" ("*Arbeitsdirektor*"), who represents the workforce on the board of the executive directors.
- Finally, one must distinguish *different levels* of participation in decision-making: The "Workplace Co-de-termination" ("*Mitbestimmung am Arbeitsplatz*") is on the lower level and refers to the shape and conditions of the workplace, which affect each individual worker.

The middle level is the crucial place where the “Enterprise Co-determination” (“*Betriebliche Mitbestimmung*”) focuses on the social, personnel and economic issues of the enterprise, such as the introduction and administration of social services in the business, the employment and dismissal of employees, the taking up and ending of particular productions, the kind and size of investments, etc. The “Industry-wide Co-determination” (“*Überbetriebliche Mitbestimmung*”) outside the enterprise itself, refers to “decisions concerning economic and social conditions...on a higher level”, as the Second Vatican Council says, “on which the future of the workers and their children depends” (*Gaudium et Spes*, Art. 68.2). This “higher level” includes, for example, Chambers of Commerce where local economic participants meet to promote industry and commerce.

In this context the difference between the “Board of Directors” (“*Aufsichtsrat*”) and “Board of Executive Directors” (“*Vorstand*”) must be mentioned. In German-speaking countries the board of executive directors is responsible for the management of the company, for the everyday and routine decisions. The board of directors draws up the company's policy in general, appoints and dismisses the executive directors and is therefore the last-deciding body. These different areas of responsibility are of some importance for the German regulations of worker co-determination.

## **SOCIAL MARKET ECONOMY – WHAT IS IT?**

Much of what the Social Catholicism had elaborated in the 19<sup>th</sup> century and after the First World War aimed at ideas, which were called Social Market Economy. After World War Two they gained increasing acceptance in Central Europe in one way or another. Social Market Economy is an economic system combining “the principle of freedom in the market with the principle of social justice”. German economists and politicians, who had opposed the National Socialists and their centrally planned and controlled economy - such as Alfred Müller-Armack, Alexander Rüstow, Ludwig Erhard, to name just a few - worked out the concept. Ludwig Erhard, Minister of Economic Affairs for many years,

translated it into practical policy and became known as 'Father of the German Economic Miracle'. The concept is based on the conviction that competition is "an indispensable tool for organising modern mass societies", but that competition "only works if a clear framework and legal regulations safeguard it". The central core of Social Market Economy is "competition based on performance, on achievement of efficiency"<sup>10</sup> ("*Leistungswettbewerb*"). This means, Social Market Economy is a private-enterprise economy with competition of performance instead of a centrally planned and controlled economy.

Real competition, however, does not automatically result from the free play of market forces – as history and modern economics teach. Therefore state policy has the responsibility to enable, establish, safeguard and promote competition and to create "the legal framework for every economic activity, business, trade and industry"<sup>11</sup>. "The state has to establish competition", demanded Norbert Walter, chief economist of Deutsche Bank, the largest bank in Germany. "Competition does not happen by itself"<sup>12</sup>. At the same time the state must "prevent restrictions of competition" and "control monopolies and cartels". Anti-monopoly laws have to ensure that monopolies are not being created and, if they are unavoidable, that they are controlled by the state "in order to make competition work most effectively to the consumers' benefit"<sup>13</sup>. Ludwig Erhard and his co-fighters for Social Market Economy managed that as early as in 1957 the national parliament passed a monopoly law and established a monopoly commission - against heavy opposition from industry and commerce. The commission has to prevent monopolies as far as possible. In the meantime the European Union took on parts of its responsibilities.

The growing globalisation and in particular the most recent serious crisis of the international financial system confirm the necessity and urgency of a global framework. Until today the world economy lacks such a global framework that would correspond to the national framework. Powerful economic participants, worldwide operating banks, transnational companies act more and more outside any framework. The framework,



however, is essential not only for the concept of Social Market Economy and for well working national economies – the framework is also essential, as the world economy and people all over the world painfully experience at the moment, for a well working global economy. "We must not accept that capital markets replace the primacy of politics"<sup>14</sup>, warns Horst Köhler, the former Director General of the International Monetary Fund and German Federal President. The Director of the World Economic Archive, one of the leading German economic research institutes, demands "to fix basic conditions of the globalised economy on a global level, to fix global rules for global economic activities"<sup>15</sup>. And even Henry M. Paulson, Secretary of the Treasury in the Bush administration and a former investment banker, changed his mind and confessed "that raw, unregulated capitalism does not work. What's needed is a regulatory setup"<sup>16</sup>. Voices like these and the experience of the global financial crisis show that these insights seem to become common knowledge: "a clear framework and legal regulations"<sup>17</sup> are essential for a well working economy also on the global level; "global rules" are needed "for global economic activities"<sup>18</sup>.

Added to the 'competition of performance', of equal importance are the social alignment and social objectives that need to be met. This social dimension forms the so-called 'second pillar' of Social Market Economy. The 'fathers' of Social Market Economy saw the social elements on four levels:

- The alignment of industry and commerce with the needs and wishes of the consumers (by the play of supply and demand) and not with a central state authority as it was in Germany's state controlled economy during the war.
- An income distribution tied to individual performance and achievements and in this way a "just income distribution"<sup>19</sup>.
- Constant improvement in economic efficiency due to the pressure of competition.
- Based on the rising productivity due to competition, the increasing ability of the state to complement competition by compensating for socially negative results of the market process and to facilitate necessary changes in economic structures.

The founders of Social Market Economy realised that economic competition alone is insufficient to form a humane economic order. "Many things are indispensable to the market, but of greatest importance for human needs", emphasised the economist Alexander Rüstow, one of the mentioned 'fathers' of Social Market Economy. Those who are not able to compete, who are not yet or who are no longer able to compete "cannot be abandoned to the market". These "market passives", as Rüstow called them, are unable "to take care of themselves in a manner required by the market, because they are ill, they are weak, they are young, they are old and so on... One must do something for them, if one wants to be responsible and humane". The community, the state has to establish a so-called 'social security net' in order to take care of these "market passives".

- State intervention is also required to facilitate those changes in the economic structure, which "are beyond the ability of the individual people affected". Such changes "cannot be allowed to regulate themselves – at some time or another"<sup>20</sup>.

Oswald von Nell-Breuning SJ, a highly respected social scientist and theologian, author of the draft of the Encyclical *Quadragesimo Anno* of 1931, doyen of Christian Social Teaching and aide to a number of German post war governments, summarised these considerations: Social Market Economy demands "a socially satisfactory economic process" and "its socially just results". "Socially just results", for example, refer to the question 'who benefits from the market'. An abundance of wealth alone is not a desirable aim, if this wealth is unjustly distributed. It is the task of Social Market Economy "to direct the allocation of the national product to different groups of people in such a way that the distribution of income and fortune is satisfactory"<sup>21</sup>. "A socially satisfactory economic process", for instance, includes the humanisation of the production process so that workers are not already crushed under the wheels of the production process. It also integrates ecological targets, which become increasingly important. Pillars, market and competition as well as the social dimension are equally essential. Not least the "socially satisfactory economic process" demands, as the German constitution of 1919 lays down, that "employees

and employers play an equal part in the entire economic development” (Art. 165) – in other words, it includes economic co-de-termination.

### **ECONOMIC CO-DE-TERMINATION: WORKERS AS "CO-ENTREPRENEURS" IN SOCIAL MARKET ECONOMY**

Already during World War Two Jesuit Father Alfred Delp, a leading member of the so-called Kreisauer Resistance Group, demanded "an effective share of responsibility of everyone in his enterprise"<sup>22</sup>. The members of this resistance group tried to overthrow the Nazi regime and developed plans for building up a democratic Germany after the war. In July 1944 one of them attempted to assassinate Adolf Hitler. But the attempt failed; many resistance fighters and critics of the Nazi regime – including Delp – were sentenced to death and executed.

In 1945 World War Two ended with Adolf Hitler's suicide and the destruction of the Nazi reign of terror. But the defeat of Germany also saw its industry destroyed and its economy ruined. At the beginning of the economic reconstruction, very soon the debate about economic co-de-termination, which the National Socialists had cancelled, started again. It played a dominant role at the Bochum convention of the Catholic laity in 1949. Each second year German Catholics meet for a big gathering, called "Catholics' Day" ("*Katholikentag*"). Cardinal Frings, the then Archbishop of Cologne and chairman of the Bishops' Conference, had convened a commission of Catholic employers and employees in order to prepare this biennial convention. Among other things, the committee dealt with the demand for economic co-de-termination and firmly declared "that involvement in decision-making is highly appropriate... the employees are entitled to bring into force this demand"<sup>23</sup>. After intensive discussions, the *Catholics' Day* passed the following resolution: "The Catholic employees and employers agree that the right of worker participation in decision-making on social, personnel and economic affairs is a natural law, based on God's order, to which the co-responsibility corresponds. We demand to fix it by law"<sup>24</sup>. This declaration of the *Bochum Catholics' Day*, which was passed by employees and employers, has decisively influenced the regulation of worker participation in Germany.

Two years later, the Bundestag, the national parliament, passed the "Law on Worker Participation in Coal and Steel Industry", the so-called 'Montan Co-Determination'. In each company of more than 1000 employees, this law provides for an equal fifty-fifty representation of shareholders and workforce on the board of directors as well as a "Worker Director" ("*Arbeitsdirektor*") as one of the executive directors. The appointment of the worker director, who is in charge of the personnel department, needs the agreement of the workforce. At this point the above-mentioned difference between the board of executive directors and the board of directors is evidenced. The executive directors are responsible for the management of the company, the daily and routine decisions; the board of directors with the fifty-fifty representation of owners and workforce determines the policy of the company in general, appoints and controls the executive directors and is the last-deciding body.

In the remaining part of industry and commerce, the "Law on Worker Participation" of 1976 demands also an equal representation of shareholders and workforce on the board of directors in companies of more than 2000 employees. In a stalemate the chairman of the board of directors makes the decision, whose appointment needs the agreement of the shareholders – therefore co-determination just a little under parity. Up to now experience shows that in practice such a stalemate almost never occurs. The pressure to reach an agreement in the interest of the enterprise is strong. In companies of less than 2000 employees the laws on "Regulations Governing Industrial Relations" of 1952 and 1972 demand that one third of the board of directors are representatives of the employees. In 1979 the Federal Constitutional Court, the supreme German court, confirmed the conformity of the co-determination laws with the constitution. The court stated that the authority of the state to intervene in property matters is the more far-reaching "the more the particular property is in a social context and has social functions"<sup>25</sup>. So far a survey of the main laws that regulate worker co-determination in Germany today!

## **CHRISTIAN SOCIAL TEACHING AND "THE ACTIVE PARTICIPATION" OF WORKERS "IN THE RUNNING OF AN ENTERPRISE" (VATICAN II)**

In 1891 Pope Leo XIII published the first so-called Social Encyclical *Rerum Novarum*. He did not deal with the issue of worker participation in economic decision-making. The understanding of the right of ownership and the contract of employment excluded any worker co-de-termination in those days. But the Pope demanded that capital and labour should maintain a 'balance of power', an "aequilibras", as the Latin term reads, and work together "in harmony and agreement" (No. 15).

In 1931, forty years after *Rerum Novarum*, Pope Pius XI published the Encyclical *Quadragesimo Anno*. He stated that the "economic system in which different people provide the capital and labour jointly needed for production... is not to be condemned" and that "the wage contract is not essentially unjust" (No. 100, 101, 64). This means that the Encyclical said 'Yes' to market economy. *Quadragesimo Anno* condemned, however, the capitalistic class society, in which "capital so employs the working or wage-earning classes as to divert business and economic activity entirely to its own arbitrary will and advantage without any regard to the human dignity of the workers, the social character of economic life, social justice and the common good" (No. 101). "In the present state of human society", the Encyclical therefore "deemed it advisable that the wage contract should, when possible, be modified somewhat by a contract of partnership... thus the workers become sharers in the ownership or management, or else participate in some way in the profits" (No. 65). The close connection, in which Pius XI saw ownership and management, suggests that he understood by "sharers in the management" co-de-termination of the workforce based on co-ownership: the employees become "sharers in the ownership" by investing parts of their income in the enterprise; the present and the 'new' shareholders own, manage and determine the enterprise together<sup>26</sup>.

The Encyclical *Mater et Magistra* of 1961 and the Second Vatican Council continued the Social Teaching of the Church. *Mater et Magistra* was the first pastoral letter to deal explicitly with the co-determination issue and

introduced new aspects into the discussion. Its author, Pope John XXIII, regarded "as justifiable the desire of employees to be partners in enterprises wherein they work.... The manner and degree of such a partnership" cannot be precisely decided, "but it is of outmost importance... that the employees should have an active part in the affairs of the enterprise wherein they work" (No. 91). The Encyclical therefore continues "that the greater amount of responsibility desired today by workers in enterprises, not merely accords with the nature of man, but also is in conformity with historical developments in the economic, social, and political fields" (No. 93).

The basis of these statements is the Pope's preference for labour. Labour "proceeds directly from the human person, and hence is to be thought more of than wealth in external goods... These latter, by their very nature, must be regarded as instruments" (No. 107). Because of that, "men engaged in productive activity" should also "have an opportunity to assume responsibility" (No. 82).

The Second Vatican Council took up this thought of *Mater et Magistra*. The Pastoral Constitution *Gaudium et Spes*, published in 1965, states that "human labour... is superior to the other elements of economic life. For the latter have only the nature of tools... labour comes immediately from the person", who "stamps the things of nature with his seal and subdues them to his will" (Art. 67,1-2). After this statement of principle on the value of human labour, *Gaudium et Spes* turns directly to worker co-determination: "In economic enterprises it is persons who work together, free and independent human beings, created in the image of God. Therefore the active participation of everyone in the running of an enterprise should be promoted. This participation should take into account each person's function, whether it be the one of ownership, hiring, management, or labour. It should provide for the necessary unity of operations" (Art. 68,1).

The statements of *Mater et Magistra* as well as *Gaudium et Spes* have been intensively discussed. Many experts are convinced that the laws on worker co-de-ter-mination in Germany correspond completely with the statements

of the Council. Others pundits say that the German co-de-termination goes beyond those statements and contradicts them. In my view, the following seems to be clear and indisputable:

- The Church's Social Teaching regards an enterprise not primarily as an economic-technical machinery producing goods, but as a community of persons, of "free and independent human beings created in the image of God". A business is not only, Pope John Paul II emphasized in the Encyclical *Centesimus Annus* of 1991, "a 'society of capital goods'; it is also a 'society of persons', in which people participate" (No. 43, 2). The employers, therefore, must not put the workers and the economic equipment on the same level and should not see them as a cost factor only.
- Management, owners and workers achieve together the success of the enterprise. The active participation of everyone in the running of the enterprise should be promoted – according to one's functions and without damaging the unity of operations. In this sense the Council sees the workers as co-entrepreneurs. Therefore an enterprise constitution is needed that bases the management, its decision-making authority, on two legs, on "the leg of the technical means of production and the leg of labour", on "both constitutive factors of the enterprise, capital and labour"<sup>27</sup>.
- The Council did not determine how this worker co-determination should be put into practice, in which forms and to what extent. The concrete "legal and technical realisation is beyond the knowledge and beyond the authority of a Council"<sup>28</sup>. It is beyond the knowledge and competence of theology and beyond the competence of the Church. The Council said 'Yes' to the principle – not more but not less either. The implementation in detail remains the responsibility of the expert knowledge of the employers and employees, the economists and political scientists, and above all – in a democratic state - the responsibility of the parliament elected by the people.

## **WORKER CO-DETERMINATION: REMARKS OF PRINCIPLE**

Sometimes critics raise the objection that the right of ownership and co-determination of the workforce exclude each other. The right of ownership

entitles to have something at one's free disposal; co-determination of those who are not owners limits or even eliminates this disposal. Against such arguments, the contra-thesis says that the owner has the right to have his property at his disposal; but it does not entitle forcing human beings to be available at his disposal. They are not his property. "The owner has to negotiate the conditions"<sup>29</sup>. The right of ownership entitles having things at one's disposal, but not persons.

A second objection claims that co-determination endangers or even eliminates any qualified management, which especially today is so important. Only owners, who are really liable with their property and carry the risk of losing it, are able "to exert properly the function of an entrepreneur"<sup>30</sup> and to carry entrepreneurial responsibility. One may ask against this thesis, whether the risk of losing the job or of suffering other disadvantages, whenever the enterprise comes into difficulties, is not a real risk too for those who are not owners – a risk that can also be the base of entrepreneurial responsibility as is the liability based on property? "In principle the entire workforce has to carry the risk that is inherent in each entrepreneurial decision"<sup>31</sup>. But the representatives of the workers on decision-making bodies should be as well qualified for their job as possible. With regard to this point the objection is right and assigns therefore particular responsibility to modern trade unions. – In this context one should not overlook that most members of the management, responsible for the running of a company, are not its owners. They too are employees – even if employees with high salaries. As a rule, those managers do a good job and show that they are able to carry entrepreneurial responsibility in spite of not being the owners.

Something similar goes for the objection that co-de-termination endangers the unity of the enterprise management and makes it incapable of acting, because too many people have a say. But co-de-termination does not mean a 'parliamentarisation' of the company in the sense that every day each individual employee can interfere in entrepreneurial decisions to be made. The running of the company remains the task of the top management. But representatives of the owners and of the workforce



should be part of it. The management should get their "decision-making authority from capital and labour together; both are the constitutive factors of the enterprise, the management should consequently be responsible to both"<sup>32</sup>.

The statement of Vatican Two that "persons, independent human beings, created in the image of God", work in enterprises, shows the crucial reason for co-de-termination. This fact forbids using the workers only as part of the economic machinery and as an unavoidable cost factor, and is the basis of partnership with equal rights. A company is not only a technical apparatus and capital investment; it is, above all, a social entity, in which human beings are at work. Therefore it is not only the task of the management to make as big a profit as possible for the shareholders; the management has to also care for the interests of the employees (and not least for the common good). Capital and labour together accomplish the achievements of the enterprise. This task demands an enterprise constitution, which bases the top management and their leadership authority "upon both constitutive factors of the enterprise, capital and labour"<sup>33</sup>.

## **CONCLUSION**

Co-de-termination, which understands and treats employees as co-entrepreneurs, made an important contribution to Germany's economic recovery after World War Two as well as to its social standards and social stability to this day. Without worker participation in economic decision-making the deep transformation process of the post-war period would have created enormous social problems. For example, half a century ago more than 600 000 miners had worked in the coal industry of the Ruhr-Region. Today all coal mines are closed. This change in structure massively transformed the entire region. Due to co-de-termination this huge change did not cause extreme social tensions. Far-reaching decisions, for example to replace coal mines by other branches of industry, had to be made together, by the representatives of capital and labour. These decisions had to take into account the interests of both sides and they had to be made

years ahead. Today the region is a centre of recycling and service industries.

Jürgen Schrempp, a former director of Mercedes Benz South Africa and not a close friend of trade unions, sings the praises of the German worker participation in economic decision-making: "It slows down the speed with which decisions are taken, but it makes them, at the same time, stronger and more enduring, more sustainable, and it creates an atmosphere of consent and partnership"<sup>34</sup>. In this sense Schrempp sees the workers as co-entrepreneurs. So does Heinrich von Pierer, former chief executive officer of Siemens, the biggest German company. He "speaks of the advantages of co-de-termination"<sup>35</sup>. Chief executive officers of other companies call the German "model of social partnership highly helpful". Very few strikes are a "peace-dividend of co-de-termination"<sup>36</sup>. They underline that "they do not know an enterprise, which fosters co-de-termination, and is not successful in the market place"<sup>37</sup>. The Federal Constitutional Court, the supreme German court, describes participation of the workforce in economic decision-making as "part of the national culture"; it should, however, be complemented by "promoting their co-ownership of enterprises"<sup>38</sup>. The future will show whether co-de-termination can gain general acceptance in the European Union.

Of course, worker participation in economic decision-making could not and cannot prevent every economic problem. Take, for example, the costs of Germany's re-unification! Since 1990 about 90 billion EURO per year is transferred from the Western part to the former communist German Democratic Republic to reconstruct its ruined economy. So the wonderful political re-unification showed itself to be a big economic burden. Then take serious demographic problems caused by the reverse population pyramid! The same number of working people - or even a decreasing number - has to bear the costs for an increasing elderly population. Therefore the government tries the utmost to improve the economic situation of young families in order to have the number of children increased. - Not least problems caused by the globalisation process must be mentioned. Because of high wages, companies transfer factories to

Eastern Europe and Asia, where the wage level is lower and the work force is not less well qualified. Despite these problems, Germany's unemployment rate, fluctuating around 6 per cent, is one of the lowest in Europe and its economic and social standards are still remarkably high.

Looking at the past, participation in economic decision-making that makes workers become co-entrepreneurs has contributed to the reconstruction of German industry in the post-war period and to its present economic and social standards. As an essential part of Social Market Economy, it prevented excessive tensions between management and labour. It created – to quote once again Mercedes boss Jürgen Schrempp – "an atmosphere of consent and partnership" between capital and labour, and it corresponds to the dignity of human beings, who are created in the image of God and enjoy the ability of self-determination. Co-determination has proved to be worthwhile.

#### **APPENDIX: EMPLOYEES AS CO-OWNERS OF THE MEANS OF PRODUCTION - "INVESTMENT WAGE" ("INVESTIVLOHN")**

As early as in 1931 the Social Encyclical *Quadragesimo Anno* had spoken of a co-determination of workers based on co-ownership (No. 65). In 1949, at the beginning of the reconstruction of Germany's economy after World War Two, the Christian Democratic Union CDU, which was to become the ruling party, demanded to extend the existing ownership-sharing of workers "to more enterprises and to develop new forms"<sup>39</sup>. Members of the Federal Constitutional Court recommend complementing worker co-determination by worker co-ownership of enterprises<sup>40</sup>; and Horst Köhler, a former President of the Federal Republic, demands "a more extensive co-ownership of workers"<sup>41</sup>. These voices are just examples of the ongoing discussion about 'co-ownership'.

The background is the understanding of the right of ownership. "The goods of the earth are assigned to all humankind"; therefore, "every human being must have the chance to share in the use of these goods". Both Christian Social Teaching and Social Market Economy agree on this basic principle. The "universal destination of goods" - as the *Compendium of the*

*Social Doctrine of the Church*, published in 2004, calls it - “should be the focus of particular concern” (No. 182); it is founded on the will of God, the creator, and "is a permanent impulse to check every existing property order again and again, whether it meets this requirement or not"<sup>42</sup>.

In this context, the unequal distribution of property - in particular the unequal distribution of ownership of the production means - is an extremely explosive subject. It offends against the primary "universal destination of goods" if only a minority owns them and the majority is excluded. Whatever industry and commerce produce, the growth of economic value, depends on co-operation of capital, management and labour. Therefore the growing economic value should become the property not only of the owners of capital, but should be shared between them and the workers?

The supporters of Christian Social Teaching and Social Market Economy are convinced that the introduction of "investment wages" is the right and most successful way to let wage-earners share in the means of production. Co-ownership of the means of production can become a reality only if parts of the earned income "are not being consumed but invested in means of production". The particular part of the gross national product, which consists in means of production, can – according to its nature – become only income of those income earners who are willing to get income "in the form of means of production" – this means, in other words, who are willing to invest that part of their income. The growing of the work force into co-ownership of the means of production demands therefore "to let an increasing part of the national income come to the wage-earners so that they invest it"<sup>43</sup>. With regard to co-determination, co-ownership (of means of production) is the basis and entitles the work force to co-determination. Proposals recommend shares in companies, wherein the employees work, as well as so-called investment trusts. Investment trusts spread the double job and capital risk in case of bankruptcy of a particular enterprise and are preferable in this respect. On the other hand, shares in the company, wherein the employees work, intensify job motivation and commitment of the employees, because they share success and failure of the enterprise.

In Germany today some two million employees hold shares in their companies. This partnership capital amounts to about 13 billion Euro<sup>44</sup>. The national parliament has enacted a number of schemes and laws to enable a better sharing of the workers in the means of production. These laws make 'asset-creating' contributions of employers to savings schemes of employees free of tax and social welfare contributions. 'Asset-creating' contributions are the parts of the wages, which the workers do not consume but invest again. But in spite of a number of 'asset-creating' wage agreements between trade unions and employers, up to now the "investment wage" could not get sufficient and general acceptance. Two million employees who hold shares compared with the total number of more than 30 million employees are too few. Management and trade unions are responsible for this situation. Employers are afraid that they would be no longer the 'master in the house' of their business, if also employees were co-owners. Trade unions fear that their influence on the workers could weaken, because the new co-owners would become more concerned about the interests of their respective company, which now to a greater extent were also their interests. Since 2008 the worldwide economic crisis unfortunately suppressed and even stopped the debate on "investment wages" and efforts to introduce them. The future will disclose whether they will revive.

## NOTES

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<sup>1</sup> Friedrich Engels (1868), *Das Kapital* von Marx, in: Herbert Pönicke (without year), *Die sozialen Theorien im 19. Jahrhundert in Deutschland*, Paderborn, 33

<sup>2</sup> Wilhelm Emmanuel von Ketteler (1864), *Die Arbeiterfrage und das Christentum*, in: *Texte zur katholischen Soziallehre II* (1976), edited by the Bundesverband der Katholischen Arbeitnehmer-Bewegung (KAB) Deutschlands, Kevelaer, 116-217, 125, 127

<sup>3</sup> Oswald von Nell-Breuning (1980), *Gerechtigkeit und Freiheit. Grundzüge katholischer Soziallehre*, Wien, 147-148

<sup>4</sup> Adam Smith (1756), *An Inquiry into the Nature and Causes of the Wealth of Nations*, London; quotes according to Joseph Höffner (1997), *Christian Social Teaching*, Cologne, 154

<sup>5</sup> Franz von Baader (1835), *Über das dermalige Missverhältnis der Vermögenslosen oder Proletaires zu den Vermögen besitzenden Klassen der Sozietät in Betreff ihres Auskommens, sowohl in materieller wie in intellektueller Hinsicht, aus dem Standpunkt des Rechts betrachtet*, in: *Texte zur katholischen Soziallehre II*, 43-53, 47-49 (see note 2)

<sup>6</sup> Ketteler, *Die Arbeiterfrage*, 202 (see note 2)

<sup>7</sup> *Arbeiterwohl* (1881), Vol.1, 101

<sup>8</sup> Max Seering (1890), *Arbeiter-Ausschüsse in der deutschen Industrie. Gutachten, Berichte, Statuten*, Leipzig, 2

<sup>9</sup> Matthias Erzberger (1921), *Christlicher Solidarismus als Weltprinzip*, M.Gladbach, 26

<sup>10</sup> Alfred Müller-Armack (1956), *Soziale Marktwirtschaft*, in: *Handwörterbuch der Sozialwissenschaften*, Vol. 9, Stuttgart, 390-392, 390

- <sup>11</sup> Was ist Soziale Marktwirtschaft? Aktionsprogramm der Arbeitsgemeinschaft Soziale Marktwirtschaft (1960), in: Das christliche Gewissen und die Soziale Marktwirtschaft des Neoliberalismus. Sonderheft aus "Junge Wirtschaft" 2 (February), 7
- <sup>12</sup> Norbert Walter (1999), Mehr Markt – weniger Moral? in: Rheinischer Merkur, No. 25, 18 January, 14
- <sup>13</sup> Müller-Armack, Soziale Marktwirtschaft, 391 (see note 10)
- <sup>14</sup> Robin Mishra (2008), Alle Macht den Mächtigen, in: Rheinischer Merkur, No. 45 / 6 November, 4
- <sup>15</sup> Thomas Straubhaar (2005), Löchrige Freiheit, in: Rheinischer Merkur, No. 19 / 12 March, 13
- <sup>16</sup> Justin Fox, Henry Paulson (2008), in: TIME, Vol.172, No. 26 (December 29 / January 5), 56-58, 58
- <sup>17</sup> Müller-Armack, Soziale Marktwirtschaft, (see note 10)
- <sup>18</sup> Straubhaar, Löchrige Freiheit (see note 15)
- <sup>19</sup> Ludwig Erhard (1949), Das Problem der freien Marktwirtschaft, in: Vierteljahreshefte zur Wirtschaftsforschung, 71-87, 78
- <sup>20</sup> Alexander Rüstow (1960), Paläoliberalismus, Kommunismus, Neoliberalismus, in: Das christliche Gewissen und die Soziale Marktwirtschaft, 3-7, 5,6 (see note 11)
- <sup>21</sup> Oswald von Nell-Breuning (1990), Wie "sozial" ist die "Soziale Marktwirtschaft", in: Friedhelm Hengsbach (Ed.), Oswald von Nell-Breuning – Den Kapitalismus umbiegen, Düsseldorf, 222-238, 236
- <sup>22</sup> Günter Brakelmann (2007), Moltke und die Jesuiten im Kreisauer Kreis, in: zur Debatte/ 3, 4-7, 6
- <sup>23</sup> Joseph Cardinal Frings (Ed.) (1949), Verantwortung und Mitverantwortung in der Wirtschaft, Köln, 123
- <sup>24</sup> Gerechtigkeit schafft Frieden. Der 73. Katholikentag in Bochum (1949), Paderborn, 114
- <sup>25</sup> Mitbestimmungsurteil des Bundesverfassungsgerichts vom 1.3.1979, in: Bundesminister für Arbeit und Sozialordnung (Ed.) (1979), Mitbestimmung, Bonn, 261-346, 311
- <sup>26</sup> It seems also reasonable that the Encyclical regards "sharers in the management" and co-determination as possible without co-ownership: the one side invests the capital, the other side does the work; both manage and determine the enterprise together. Thus Oswald von Nell-Breuning commented on the issue (see Liederick de Witte (1964), Kirche – Kapital – Arbeit, Limburg, 142-143). Jesuit Father von Nell-Breuning had worked out the draft. The text of the Encyclical itself is not quite clear. I prefer the first interpretation.
- <sup>27</sup> Oswald von Nell-Breuning (1969), Mitbestimmung und Unternehmensverfassung, in: Mitbestimmung – wer mit wem? Freiburg, 170-183, 179-180
- <sup>28</sup> Oswald von Nell-Breuning (1968), Kommentar zum II. Kapitel, in: Lexikon für Theologie und Kirche – Das Zweite Vatikanische Konzil, Vol. 3, Freiburg, 487-515, 500
- <sup>29</sup> Oswald von Nell-Breuning (1968), Heisse Eisen in der Gesellschaftspolitik, in: echo der zeit, No. 31, 1 August
- <sup>30</sup> Alfred Christmann (1964), Wirtschaftliche Mitbestimmung im Meinungsstreit, Vol. 1. Ed. by Otto Kunze, Köln, 176
- <sup>31</sup> Eduard Gaugler (1968), Die Auswirkungen der Mitbestimmung auf die unternehmerischen Entscheidungen, in: Anton Rauscher (Ed.), Mitbestimmung, Köln, 80-112, 95
- <sup>32</sup> von Nell-Breuning, Mitbestimmung, 67 (see note 27)
- <sup>33</sup> von Nell-Breuning, Mitbestimmung, 179-180 (see note 27)
- <sup>34</sup> Frankfurter Allgemeine Zeitung (1998), No. 167, 22 July, 13
- <sup>35</sup> Rheinischer Merkur (2004), No. 30, 22 July, 14
- <sup>36</sup> Rheinischer Merkur (2006), No. 3, 19 January, 11
- <sup>37</sup> Frankfurter Allgemeine Zeitung (2006), No. 150, 1 July, 16
- <sup>38</sup> Rheinischer Merkur (2006), No. 11, 16 March, 13
- <sup>39</sup> Christlich Demokratische Union, Düsseldorfer Leitsätze vom 15. Juli 1949, in: Ossip K. Flechtheim (Ed.) (1963), Dokumente zur parteipolitischen Entwicklung seit 1945, Vol. 2, Berlin, 58-76, 73
- <sup>40</sup> See note 38
- <sup>41</sup> Frankfurter Zeitung (2006), Nr. 147, 28 June, 11
- <sup>42</sup> Franz Klüber (1968), Katholische Eigentumslehre, Osnabrück, 29-30; Friedrich Beutter (1976), Die theologische Begründung der katholischen Lehre vom Eigentum, in: Gesellschaft und Politik, Vol. 12, No. 2, 34-41, 39
- <sup>43</sup> Oswald von Nell-Breuning (1956), Wirtschaft und Gesellschaft, Vol. 1, Freiburg, 411,450, 406; in detail see Franz Josef Stegmann / Peter Langhorst (2005), Geschichte der sozialen Ideen im deutschen Katholizismus, in: Helga Grebing (Ed.), Geschichte der sozialen Ideen in Deutschland, Wiesbaden, 597-862, 801-813
- <sup>44</sup> Judith-Maria Gillies (2007), Warten auf den Chef, in: Rheinischer Merkur, No. 10, 8 March, 11

# **The Current World Economic Crisis, Social Market Economy and Christian Social Teaching**

For quite a number of years economies in both industrialised and developing countries as well as the entire world economy have been and are in a deep crisis of the global financial system and in the wake of this financial crisis, in a serious economic crisis. The world has not experienced such a crisis since the years around 1930 in the last century. Economic activities were going down; thousands of workers lost their jobs, and people all over the world painfully suffered from this crisis. In Germany experts reckoned the downturn to be about 5% of the gross-national-product GNP, which is the annual value of goods and services, in the year 2009. In the meantime the crisis seems to have passed its peak. But all over the world economic experts and politicians of different backgrounds agree that one main cause of the crisis is a kind of an unlimited capitalism, and - as a decisive part of this unrestricted 'elbow-capitalism' - the insufficient economic framework in many countries and the almost complete lack of a global framework. Therefore it is reasonable and makes good sense to look into the reasons for the world economic crisis as well as to describe the essentials of Social Market Economy, which emphasizes the importance of such a framework, and the assessment of Social Market Economy from the perspective of Christian Social Teaching.

Let me begin with a short introduction referring to my native country and its recent history. World War Two saw the defeat of Germany, its industry destroyed, its economic structure ruined. About 80% of the residential buildings and almost 90% of the industrial plants lay in ruins. Millions of workers had died during six years of war and millions were prisoners of war. The Russian dictator Stalin released the last 10 000 prisoners only in

1955, ten years after the end of the war. In addition, Germany was (and is) without any considerable mineral resources (except coal mines).

I was a young boy and remember those years very well. Even in the early 1950s, when I started attending university, the situation was still pretty bad. For example, we could not enter Munich University through the main entrance because there was a huge bomb crater. In wintertime, each student had to bring a bundle of wood every week to heat the stoves of the lecture halls. The heating system, destroyed by bombs, was still out of order and we would have been freezing at ten and more degrees below zero. All in all the economy was truly shattered and Germany's economic future seemed hopeless. I have many memories of those dark days and could continue telling of them for some time. All in all the economy was truly shattered and Germany's economic future seemed hopeless. But within a period of 15 to 20 years the economic reconstruction was successful. To a great extent, Social Market Economy managed this unexpected reconstruction.

In 1989/90 the 'really existing socialism' in Russia and Eastern Europe had broken down with profound implications for the whole world - including South Africa. I think it hastened the end of Apartheid. In these political and social upheavals the concept of Social Market Economy has again played a central role. The majority of people in the former Communist countries considered Social Market Economy as the 'way of hope' into a better future. We are reminded of the slogan going around in the Communist German Democratic Republic during and after the 'peaceful revolution' of 1989: "If the DM (deutschmark) does not come to us, we shall move to the DM!" The DM was the symbol of Social Market Economy.

Today Germany enjoys strong economic power. It is just the world economic crisis and in its wake the current debt crisis in the United States and in a number of European countries, which clearly show this. As the most powerful economy in Europe Germany stands surety for some hundred billion Euros to support banks affected by the crisis and to



strengthen the Euro currency affected by the debt crisis in countries like Greece, Portugal and Spain. In Germany “most companies and enterprises are getting strengthened by the economic crisis” and “are doing better in terms of sales, quality of their products, efficiency and the number of employees than before the crisis”<sup>1</sup>. Economic experts called the surprising strength of the German economy “a locomotive for the recovery in Europe and beyond”<sup>2</sup>. At the same time – what is astonishing is that Germany’s social level is unusually high. Even compared with many industrialised countries, its social structure is surprisingly stable. The number of strike days, for example, is one of the lowest in industrialised countries – quite apart from developing countries.

It is true; Germany also has to face serious economic problems. Take, for example, the problems caused by the re-unification! Since 1990 a sum of about 90 billion Euros has been and is transferred each year to the former communist German Democratic Republic to reconstruct its ruined economy. Take the problems caused by the reversal of the population pyramid! The same number of people in work must bear the costs for an increasing elderly population. And take problems caused by the much-discussed economic globalisation. Due to the high wage level, many companies transfer factories from Germany to the eastern part of Europe and to South East Asia, where wages are much lower but the work force is as qualified. Nevertheless, economic and social standards are remarkably high.

Many factors contributed to Germany’s economic and social development. But the most important one was the general policy of Social Market Economy. On the other hand many do not know what this economic order means, or what it ought to be. As a result, it is associated with the cruel capitalism that arose in the 19<sup>th</sup> and 20<sup>th</sup> centuries – a capitalism, which did not know and even excluded social responsibility, ethics, social justice; those words were not even in its vocabulary. This connotation is still valid and seems to be confirmed by the recent financial and economic crisis – a painful experience for people all over the world.

In a first step I outline the basics of Social Market Economy (1). In this context, the theoretical concept will be the focus of attention. Whenever everyday practice does not correspond to this model, one should first enquire why the concept was not realised instead of blaming it. The second chapter presents Christian Social Teaching on Social Market Economy, which regards it as a sound and just economic order (2). In the concluding part, I ask about the causes of the current economic crisis, describe its consequences and look for ways to overcome it (3).

## **SOCIAL MARKET ECONOMY – WHAT IS IT?**

After World War Two the concept of an economic order gained acceptance in Central Europe in one way or another, which became known as Social Market Economy. Politicians and in particular economists, who had opposed the German National Socialists, among them Alfred Müller-Armack, Alexander Rüstow, Ludwig Erhard – I mention just these few, because I refer to them later on - had worked out the essentials of the concept already during the war. They had experienced the consequences of a pure market economy in the great world economic crisis around the 1930's and the shortcomings of a centrally planned and controlled economy, which the German National Socialists had introduced before and during World War Two (1939-1945). The concept takes up elements of both economic systems, but tries to prevent their mistakes and failure. What are the essentials of Social Market Economy?

### **Competition of performance and efficiency – safeguarded by a clear framework**

Its founders understood by Social Market Economy, an economic system, which combines “the principle of freedom in the market with the principle of social justice”. Ludwig Erhard, Minister of Economic Affairs for many years, translated it into practical policy and became known as 'Father of the German Economic Miracle'. The concept is based on the conviction that competition, competing activities of economic participants are “an indispensable tool for organising modern mass-societies”<sup>3</sup>. So the central core of Social Market Economy is “competition based on performance, on achievements of efficiency”<sup>4</sup> (*“Leistungswettbewerb”*). This requires a

private enterprise and competitive economy instead of a centrally planned and controlled economy. Competition between economic participants prevents self-interest, the driving force for economic activities, from being excluded. This exclusion is a main problem of centrally planned and controlled economies, which fix prices of goods and salaries of workers in advance, without taking into account their efforts and achievements.

Competition between economic participants, however, does not automatically result from the 'free play of market forces' - as history and modern economics teach. Competition "only works if a clear framework and legal regulations safeguard it"<sup>5</sup>, emphasised Alfred Müller-Armack, a highly respected economist, one of the mentioned founders of Social Market Economy and for many years aide to Ludwig Erhard, Minister of Economic Affairs. *We shall come back to the crucial importance of the "clear framework and legal regulations" in detail, when we ask about the causes of the recent world financial and economic crisis*<sup>6</sup>. Competition only works within a proper order. Therefore, state policy has the responsibility to create "the legal framework for every economic activity, business, trade and industry"<sup>7</sup> in order to enable, establish, and safeguard competition. According to the concept of Social Market Economy, the state is not a simple night-watchman; on the contrary, "the state has to establish competition between the economic participants", possibly forcing them to compete - demands Norbert Walter, chief economist of Deutsche Bank, the largest German bank. "Competition does not happen by itself; the state has to establish it"<sup>8</sup>. State authority has to safeguard it, "to prevent restrictions of competition and control monopolies and cartels". Rid of competition, monopolists are tempted to increase prices to the consumers' disadvantage, thereby gaining a monopoly profit. Wherever, for example, only one oil company runs petrol stations in a region, it must not compete with other companies and can fix prices as high as it wants. This misuse of the legitimate principle of profitability can be prevented if each economic subject must permanently compete with fellow competitors in the market place. Competition forces enterprises to set their prices as low as possible in order not to be eliminated by fellow competitors, who set lower prices.

Anti-monopoly laws have to ensure that monopolies are not being created and, if they are unavoidable, that they are controlled by the state "in order to make competition work most effectively for the consumers' interest, advantage and benefit". Ludwig Erhard and his co-fighters for Social Market Economy managed that as early as in 1957 - the national parliament passed a Monopoly Law and established a Monopoly Commission against heavy opposition from industry and commerce. In the meantime the European Union took on parts of its responsibilities.

But competing economic participants do also not automatically realise the best possible supply to all people, the common good. Competition realises good supply only within "a clear framework and legal regulations". Already more than 50 years ago Alfred Müller-Armack spoke of "a fatal error to expect a perfect social order from market automatics"<sup>9</sup>. State policy therefore has to establish "a clear framework and legal regulations"<sup>10</sup> that make individual economic participants act in their own interest as is demanded by the well-being of all. We must distinguish between the 'framework for activities' and 'activities within the framework'. We must distinguish - to use the example of a soccer match – between 'rules of the game', which each soccer player has to observe, and 'moves in the game', which depend on the efforts and skills of each player. For example, whenever a soccer player violates the rules of the soccer match – maybe by committing a foul – he will be punished and get a 'yellow' or will even be disqualified and must leave the soccer field. Whenever in the 'economic match' players, the butcher, the baker, small enterprises or big companies or somebody else, violate the 'rules of the economic match' – maybe by cheating customers or by damaging the environment or by fixing prices and undermining competition –, the players must be punished and in grave cases lose their business. So in their own interest they will observe the regulations set by the state for a fair and sound economic life. Each 'economic player' must observe the rules of the framework; and the state authority has to ensure that everybody does observe them.

## **Important legal regulations of the framework**

I give examples of regulations, which in Germany are parts of such a legal framework.

- Laws on the humanisation of working conditions so that employees are not already crushed under the wheels of the production process: These laws include health and safety regulations at work (it seems that South African mines often are lacking sufficient safety rules and safety equipment as many accidents show); protection against wrongful dismissal: employers must inform staff about the reasons for retrenchment, keep periods of notice and pay certain amounts of compensation; limits of working hours, which have to be agreed by employers and employees, referring to days and weeks - for example, 8 working hours a day, 40 working hours a week.
- Laws referring to the field of insurances: Each person must have a – public or private – health insurance (or be included in a family health insurance); the same goes for the retirement insurance; employees must have an unemployment insurance, whose contributions are equally paid by employers and employees.
- Measures for providing a satisfactory income distribution by adequate taxation: High income earners pay a bigger percentage of taxes than low income earners. An abundance of wealth alone is not a desirable aim, if this wealth is unjustly distributed. So taxation laws aim at allocating the national product in such a way that the distribution of income is just and fair.
- Laws on worker co-determination in the running of enterprises: In large German companies these laws provide for an equal representation of the owners and the workforce on the board of directors. In smaller companies one third of the board of directors are representatives of the employees. This board determines the major policy of the company. So the workforce is involved in economic decision-making and running of the business in which they work<sup>11</sup>.
- Laws referring to the integration of ecological targets, which are becoming more and more important: Businesses of every size have to recycle their waste themselves or through special recycling enterprises. The expulsion carbon dioxide CO<sub>2</sub>, which causes the

dangerous climate change to a great extent, is limited. If the expulsion exceeds a certain amount the company must pay charges. Already in 1991 Pope John Paul II demanded in the Encyclical *Centesimus Annus* that “the State must provide for the preservation of the natural and human environments” (No. 40.1).

- Satisfactory laws on the transparency of financial transactions and the liability of banks (which also in Germany are still partly missing): Bank consultants should be obliged to inform their clients in detail what the shares and all the financial products consist of, which they offer them, and should be obliged to explain the risks, which the clients take, when they buy those products. On the national and global level, clear liability rules must force banks and bank managers to pay for the damage whenever they trade in faulty, doubtful financial products and whenever they give incorrect advice to clients or do not – or not sufficiently – inform them about the risks. Banks must increase their own capital to a higher percentage of the turnover so that they and their managers can be liable for financial mismanagement. In the wake of the recent financial crisis these measures have been intensively discussed and are being improved.

### **Social alignment of the economy and social rules**

Added to the competition of performance and efficiency, the social alignment of the economy and social rules are equally essential. They form the so-called 'second pillar' of Social Market Economy. The founders of Social Market Economy saw these social elements on four levels:

- The alignment of the economy with the demand and needs of the consumers (by 'the play of supply and demand') and not with a central state authority as was in Germany during the war and is still existing in centrally planned and controlled economies.
- Income distribution tied to individual efforts and performance, therefore "a just income distribution"<sup>12</sup>. Those who work hard are entitled to earn more than lazy workers.
- Constant improvements in economic efficiency and productivity due to the permanent pressure of competition.

- Interventions of the state to complement competition by compensating for socially negative results of the market and facilitating necessary changes in economic structure.

During the war the German economy was planned and controlled by a central state authority. Individual consumers were not allowed to buy what they wanted or as much as they wanted. It was the government that prescribed, for example, how much bread and butter per month one could eat, how many coats and pairs of shoes per year each person was entitled to buy. The same goes in a figurative sense for the entire economy. Every economic participant, small enterprises and big companies, had to fulfil the economic plan set by the state. Against the background of this centrally planned and controlled economy, the alignment of economic activity to the needs and wishes of the consumers appeared in itself to be a social achievement. Sometimes the emphasis on economic efficiency, aligned to consumer wishes, is criticised as being materialistic. The highly regarded social philosopher and economist Alexander Rüstow, also one of the 'fathers' of Social Market Economy, responded to those critics that "as long as all human beings do not enjoy at least the subsistence level, the improvement of economic efficiency is more than an economic demand, it is a social demand, a moral demand"<sup>13</sup>.

The founders of the Social Market Economy realised that economic competition alone is insufficient to form a humane economic order. "Many things, which are inaccessible to the market mechanism, are of the greatest importance for human needs", emphasised Alexander Rüstow. People who are not able to compete, because they are old, they are young, they are sick etc, "cannot be abandoned to the market... One must do something for those market passives", as Rüstow called them, "if one wants to be responsible and humane".

Because of that, the community, the state, has to establish a so-called 'social security net' to take care of these people. Market and competition are "not an end in themselves but rather a means to an end", a tool for

supplying people in the best possible way; they must be “at the service of human needs”.

State intervention is also required to make easier those changes in the economic structure, which "are beyond the ability of the individual people affected". For example, half a century ago more than 600 000 miners had worked in the Ruhr Region, the most industrialised region in Germany. Today all coal mines are closed; recycling industries and service industries replaced them to a great extent. Assisted interventions by the state were very important. Without these interventions serious social tensions would have been unavoidable. Such huge changes, Rüstow demands, "cannot be allowed to regulate themselves, at some time or another"<sup>14</sup>, in a pure market economic or capitalistic way. The strict economic framework and the described social dimension, the 'second pillar' of Social Market Economy, prevent powerful economic participants from misusing freedom and people from being crushed in changes of the 'economic match', which are beyond the ability of those affected. Because of those reasons, a regulatory framework is needed and is imperative.

### **“Socially just economic process” and “socially just results”**

Growing economic efficiency, due to the pressure of competition, increases the capability of the state to correct negative results of the market, to make tolerable necessary changes to the economic structure and so to complement competition. Economic efficiency enables the state community to help those who are unable to help themselves: sick people, old people, handicapped people etc. Economic efficiency is the condition of social efficiency. ‘Economic downswing’ results in ‘social downswing’. Economic efficiency is not everything, but without economic efficiency everything is nothing.

However it is crucial to include the social dimension in economic activities from the very beginning and as equal in weight. It is not good enough to make possible and to safeguard market and competition, and afterwards - perhaps - to correct socially negative results. To put it in a metaphor, it is not good enough to pull the child out of the river, after he has fallen in. It



is just as crucial that from the very beginning the social dimension is recognised as essential and equal in weight to all economic activities. To use the metaphor again, the child must be protected from falling into the water. Because of that, state and politics have to provide those conditions, which are needed for "a socially just economic process and its socially just results"<sup>15</sup>. – demands Oswald von Nell-Breuning. He was a foremost social scientist, a highly respected theologian and doyen of Christian Social Teaching. As a young lecturer, he has worked out the draft of the Encyclical *Quadragesimo Anno* of 1931. Therefore he had great influence on Christian Social Teaching in the last century and, as an aide to a number of German governments, on the country's social policy after 1945.

"A socially just economic process" includes the humanisation of working conditions so that employees are not already crushed under the wheels of the production process; and it includes the involvement of the work force in economic decision-making. Such a satisfactory production process also aims to provide the conditions for the creation of new and sustaining jobs, by changing the economic structure before segments of industry and their jobs go into decline. All these goals are examples, which belong to a "socially just economic process".

"Socially just results" demand, for instance, the integration of ecological targets, which are becoming increasingly important. Destruction of the environment must not be accepted. "It is the task of the State", Pope John Paul II in the Encyclical *Centesimus Annus* of 1991 firmly stated, "to provide for the defence and preservation of common goods such as the natural and human environments, which cannot be safeguarded simply by market forces" (No. 40,1). And "socially just results" include a fair and just income distribution; an abundance of wealth alone is not a desirable aim, if this wealth is unjustly distributed. A satisfactory distribution of income and fortune does not result straight away from the 'free play of market forces' as, for example, huge differences of income between qualified employees and top earners show, who not infrequently earn some hundred times more than the average employee. Therefore, it is the task of Social Market Economy "to direct the allocation of the national product to

different groups of people by appropriate taxation in a way that the distribution of income and fortune is adequate and fair”<sup>16</sup>. A regulatory framework needs to be set.

I summarise: the aim of Social Market Economy is to combine the free initiative of individuals in the market place with a socially just development. Two economic systems are to be rejected:

- the so-called "free economy of 'liberalist' character", the pure market economy, what I call 'elbow-capitalism' or 'Manchester capitalism', in which the weak are exploited by the mighty;
- the "socialist system of a centrally planned and controlled economy", which is not able to manage the problem of both "efficient production" and "just distribution" <sup>17</sup>.

Social Market Economy takes up elements of both economic systems, but tries to prevent their shortcomings and failings. According to its founders, the core of Social Market Economy is "competition of performance", established and safeguarded by a clear framework. This regulated competition is the precondition and guarantee for economic achievement and efficiency and enables the best possible supply of all people. Added to economic competition are, as important, social elements and objectives. This social dimension forms the 'second pillar' of Social Market Economy. From the very beginning both pillars, market economy and the social dimension, are essential and equal in weight. It is not good enough to make possible and to safeguard market and competition, and afterwards - perhaps - to correct socially negative results. To put it in a metaphor, it is not good enough to pull the child out of the river, after he has fallen in. It is just as crucial that from the very beginning the social dimension is recognised as essential and equal in weight to all economic activities. To use the metaphor again, the child must be protected from falling into the water.

Therefore, the State must safeguard competition by law, must prevent and compensate for socially negative results of the economic process by social policy, and must make necessary changes in the economic structure

endurable by economic policy. Because of that, Social Market Economy and what I call 'Manchester Capitalism' or pure market economy are fundamentally different, and Social Market Economy requires a powerful state. According to the concept of Social Market Economy, the State is not a simple 'night watchman'. The essential difference between both economic systems might be described as Wilhelm Röpke, again one of the founders of Social Market Economy, described it: "According to the capitalistic concept, competition was a natural plant" growing by itself; according to Social Market Economy, competition "is a cultivated plant"<sup>18</sup>, which must be tended, pruned, and nursed. So Social Market Economy is the so-called 'third way' between a pure market economy or capitalism and a centrally planned and controlled economy or collectivism.

## **CHRISTIAN SOCIAL TEACHING ON A SOUND AND JUST ECONOMIC ORDER: SOCIAL MARKET ECONOMY**

Now I present Christian Social Teaching on a pure market economy – some call it 'market economy without an adjective' or 'Elbow-Capitalism', on Social Market Economy and on the advantages of market and competition, which consist in the optimal utilisation of limited economic resources.

### **Christian Social Teaching on a pure Market Economy**

From the very beginning the attitude of Christian Social Teaching towards a pure market economy was a critical one. The first Social Encyclical "On the Condition of Labour" *Rerum Novarum*, published in 1891 by Pope Leo XIII, criticised "unrestrained competition", which led to "the concentration" of trade and industry "in the hands of a few individuals" (No. 2), but did not deal in detail with the issue. Only 40 years later the Encyclical *Quadragesimo Anno* of 1931, published by Pope Pius XI, discussed the problem of competition and free market. "Free competition, though justified and quite useful within certain limits, cannot be the guiding principle of economic life". Some translations read: free competition "cannot be the ruling principle of the economic world" or "cannot be an adequate controlling principle in economic affairs". The Latin text says: "*Liberum certamen... rem oeconomicarum dirigere plane*

*nequit* - Free competition cannot direct the economy". By "free competition" the Encyclical understands "unregulated competition" and demands, "that economic affairs be once more subjected to a true guiding principle". Then it strongly condemns an economic system, in which "capital so employs the wage-earning classes as to divert business and economic activity entirely to its own arbitrary will and advantage without any regard to the human dignity of the workers, without any regard to the social character of economic life, social justice, and the common good" (No. 88, 101). So far the Encyclical *Quadragesimo Anno* about 80 years ago!

Today Christian Social Teaching on a pure Market Economy is just as clear. I go along with the *Compendium of the Social Doctrine of the Church*, published by the Roman Pontifical Council for Justice and Peace in 2004. It recognises "the market as an irreplaceable instrument for regulating the inner workings of the economic system" (No. 349). "Market operators must be effectively free to compare, evaluate and choose from among various options" (No. 350). But the *Compendium* firmly declares "The idea that the market alone can be entrusted with the task of supplying every category of goods cannot be shared" and calls this idea "an 'idolatry' of the market" (No. 349). The market is unable to satisfy important human needs. These needs require goods, says John Paul II in his Encyclical *Centesimus Annus* of 1991, which by their nature are not and cannot be mere commodities, which "by their very nature cannot and must not be bought or sold" (No. 40,2).

The founders of Social Market Economy shared the same conviction. "Many things, which are important for human needs, are inaccessible to the market", emphasised the already mentioned Alexander Rüstow, one of the 'Fathers' of Social Market Economy. Competition and market "are a means to an end, not an end in themselves"<sup>19</sup>. They "must be at the service"<sup>20</sup> of human needs.

## **Christian Social Teaching on Social Market Economy**

The strongly critical assessment of a pure Market Economy points already to the stand of Christian Social Teaching on Social Market Economy, which gained increasing acceptance in Central Europe after World War Two. The Encyclical *Mater et Magistra*, published by Pope John XXIII in 1961, emphasises, "that in economic affairs first place is to be given to the private initiative of individuals", whereas public authorities must intervene in order "to promote social progress for the benefit of all citizens" (No. 51 and 52). That is nothing but what the founders of Social Market Economy demanded: to establish and safeguard competition of the individual economic participants by a clear framework as the core of Social Market Economy and to complement it by social and economic state interventions, by creating a 'social net' – I quote again Alfred Müller-Armack, one of the founders of Social Market Economy - "to make competition and market economy work most effectively for the advantage and benefit of all"<sup>21</sup>. - In 1985, Joseph Cardinal Höffner of Cologne, a former Professor of Christian Social Teaching and chairman of the German Catholic Bishops' Conference, declared the Church in favour of "a socially tempered, socially oriented market economic order"<sup>22</sup>: market economy – yes, but it must be socially tempered, socially orientated.

The already mentioned Encyclical *Centesimus Annus* of 1991 judges "business economy, market economy or simply free economy certainly in the affirmative" sense, if it is "within a strong legal framework which places it at the service of human freedom" (No. 42,2). There is certainly a legitimate sphere of autonomy in economic life which the state should not enter. The state, however, has the task of determining the legal framework within which economic affairs are to be conducted". Pope John Paul II avoided the expression 'Social Market Economy', which is specifically European (or even German). But he used the concepts "freedom" and "social justice" to show the ethical basis of Social Market Economy; and he used "market mechanisms" and "legal framework" (No. 15,1) to name its "fundamental regulatory elements"<sup>23</sup>. Commentators, therefore, correctly call the Encyclical "a declared belief in Social Market Economy"<sup>24</sup> - The *Compendium of the Social Doctrine of the Church*

finally describes the "fundamental task of the state in Economic affairs" almost in the same way. The state has to determine "an appropriate legal framework for regulating economic affairs". However, "Economic activity, above all in a free market context, cannot be conducted in an institutional, legal or political vacuum... the State must therefore adopt suitable legislation" (No. 352), must adopt a suitable legal framework.

This understanding corresponds exactly with the way Social Market Economy sees itself. Competition is not the only "guiding principle", but one "guiding principle of economic life", the Encyclical *Quadragesimo Anno* says (No. 88); it must be safeguarded by a clear framework and complemented by equally important social elements. The task of the economy is the best possible provision of goods to all people. Only freedom and creativity of the economic participants can realise this objective. Therefore market and competition are one essential of Social Market Economy. Competition, however, does not automatically result from the 'free play' of the market participants and does not automatically realise social justice. Because of that, a clear framework must regulate competition, and a social alignment and complement are needed as the equally important 'second pillar' of Social Market Economy. *We shall come back to the importance of this 'clear framework' – I repeat once more – when we deal with the current world economic crisis and ask about its causes.*

### **Optimal utilisation of economic resources by competition**

Christian Social Teaching on Social Market Economy points to a main, maybe **the** main advantage of this economic system: competition of efficiency. In principle, market and competition are to be approved, because they utilise best the limited economic resources. I refer to the already mentioned Jesuit Father Oswald von Nell-Breuning, a highly respected social scientist and theologian and of great influence on Christian Social Teaching in the last century and on Germany's social policy after 1945. His whole life was committed to the labour movement, no one could suspect him of sympathy with any kind of capitalism.

I already mentioned the destruction of Germany's economy through World War Two; about 80% of the residential buildings and nearly 90% of its industrial plants lay in ruins. In this disastrous situation, Oswald von Nell-Breuning, then a member of an Advisory Council of the government, demanded as early as in 1948: First eliminate the centrally planned and controlled economic system and "get market economy going as much as possible"<sup>25</sup>! The main reasons for this assertion were: Material resources, when compared with the material needs of humankind, are in short supply. The commandment of solidarity demands, therefore, that sufficient material goods, vital for life, are made available to as many people as possible. Competition and market - more than all the other economic systems we know to date - are able to utilise the scarce and limited economic potential in the best possible way and so to stimulate a more effective economy. Economic inefficiency and squandering of resources in the 'really existing socialism' in the former Soviet Union, Eastern Europe, East Germany, which has broken down in our time, are an obvious and concrete proof. In this context the Encyclical *Centesimus Annus* of 1991 says: "The free market is the most efficient instrument for utilising resources and effectively responding to needs. Its mechanisms offer secure advantages: they help to utilise resources better; they promote the exchange of products; above all they give central place to the person's desires and preferences" (No. 34,1; 40,2).

The more the volume of goods, which are vital for life, can be increased, the more the living conditions of the huge population of the planet earth can be improved. And the more the consumption of limited resources, the consumption of scarce energy can be decreased, the less the living conditions of future generations will be burdened. Uneconomic utilisation of the limited economic resources, squandering of the economic potential in 'centrally commanded economies', violates human solidarity, or - in Christian words - breaks the commandment to love one's neighbour. Because of that, the moral quality of market and competition lies primarily in their capacity to use scarce and limited economic resources to the optimum. Competition and market - more than all the other economic systems we know to date - are able to utilise the scarce and limited

economic potential in the best possible way and so, on the whole, to stimulate a more effective economy.

Let me give an example of uneconomic utilisation and squandering of economic resources in "centrally commanded economies". My brother-in-law grew up in the German Democratic Republic. After World War Two, the Communists seized power in this part of Germany, dispossessed the private farmers and amalgamated their property into huge so-called collective farms (*Landwirtschaftliche Produktionsgenossenschaften*). The former independent farmers became employees of these collective farms.

One day - it was late summer and harvest time - we visited his family. The villagers were just harvesting wheat. Because there was not enough space for the threshed wheat grain in barns, they made huge piles of grain in the central village square. The wheat grain had been lying there in the open air – maybe – for ten days, two weeks or even longer. In the meantime thunderstorms came, there was lots of rain and the grain had started rotting, coming out and growing again. Nobody took care of the wet piles. We asked the villagers "why don't you cover them or bring the grain into barns". "That's not our job. Other teams are responsible for that. Our job is to cut as much wheat as possible each week. For that we get money – and some brandy and a winner flag at the end of the week whenever we are the team that has cut the biggest amount of wheat. But we are not interested in what happens afterwards. That's not our 'cup of tea', that's not our business". So much for the villagers! What was missing was their self-interest in the outcome of the harvest, their interest in a good harvest as such. The fact that the Socialist system did not take into account this self-interest of people, the self-interest of those villagers, was a main reason for the breakdown of the centrally planned and controlled economies in Eastern Europe and the former Soviet Union.

I repeat: Uneconomic utilisation of the limited economic resources, squandering of the economic potential violates human solidarity, or - in Christian words - breaks the commandment to love one's neighbour. Competition and market - more than all the other economic systems we



know to date - are best able to utilise the limited economic resources and so, on the whole, to stimulate a more effective economy. The repeatedly quoted *Compendium of the Social Doctrine of the Church* summarises the advantage of market and competition as follows. "Market and competition have the "capacity to guarantee effective results in the production of goods and services. A truly competitive market is an effective instrument for attaining important objectives: responding to consumers' demand, bringing about more efficient use and conservation of resources and rewarding entrepreneurship and innovation" (No. 347).

### **Globalisation, the current world economic crisis and Social Market Economy**

In recent years economic life in industrialised as well as in developing countries and the entire world economy is suffering from a serious crisis of the financial system and is affected by the financial crisis from a serious crisis of the real economy. Economic activities are going down, thousands of workers are losing their jobs and people all over the world are painfully suffering from this crisis. I mentioned at the beginning that - according to many economic experts and politicians of different backgrounds - one main cause of this financial and economic crisis is the insufficient framework in many countries, especially in the United States, the worldwide leading economic power, and the almost complete lack of a global framework.

The much discussed globalisation enables powerful economic participants, worldwide operating banks, and transnational companies to act more and more outside any framework. By the push of a button they transfer millions and billions from New York to Tokyo, from Europe to South Africa and vice versa. In 1990, for example, "the total amount of financial transactions was fifteen times the gross global income. In 2011 the relation was seventy to one"<sup>26</sup>. The framework, however, is essential not only for the concept of Social Market Economy and for well-working national economies – the framework is also essential for a well-working global economy. It has to enable and establish competition and to ensure that individual economic participants act as is demanded by the well-being of

everyone - in other words, that "competition is carried out within rules that safeguard the public good"<sup>27</sup>. The 'hot potato' of an international economic order results from this lack. The existence of the United Nations and its institutions are at best first steps. The growing globalisation and in particular the current worldwide economic crisis confirm the necessity and urgency of a really global framework. "The present international financial crisis would not have happened", the German Chancellor Angela Merkel emphasises, "if the principles of Social Market Economy had been applied in the international financial markets"<sup>28</sup>. I fully share this opinion.

### **Reasons for the global financial and economic crisis**

It was in the United States where the crisis started with excessive debts of house owners. In order to help low-income people acquire houses of their own, the Clinton Government had ordered mortgage banks "to give loans to borrowers with only little creditworthiness. So the so-called 'ninja-loans' developed: no income, no job, no assets"<sup>29</sup>. In 2001, after militant Muslims had attacked the Twin Towers in New York and killed more than 3000 people, the US Reserve Bank massively lowered the interest rates to prevent an economic downswing and to stimulate economic activities. Low interest rates intensified the willingness to take loans as one liked. In this respect the policy of 'cheap money' was successful. But today we know that the interest rates were too low and that it was (and is) extremely risky to grant loans without taking into account the ability of the borrowers to pay the debts back. Low interest rates were popular and the 'cheap money' policy of the US Reserve Bank encouraged people to borrow money on a big scale from banks to build houses, to buy cars, other expensive goods and even to finance every-day needs and expenses. They were tempted to do so only on credit, without sufficient, or without any, resources of their own. So life on credit and getting into debt became a trendy habit. It was reported that a nurse, who owned 10 000 Dollars, had bought seven houses for more than one million Dollars; or that a student, who owned 500 Dollars, was advised by his bank to buy a big multiple family house only on credit<sup>30</sup>. Bank consultants promised them and their fellow borrowers that within a few years the increase in value of the houses (or other goods bought on credit) would make it easy to pay the debts back. For some years

this was possible and went well. But when the interest rates started to rise again, more and more people could not pay the rates any longer, let alone pay back the loans, and the promise turned out to be wrong. So the US policy of 'cheap money,' summarised the Director of the *Center for Finance Studies* at Frankfurt University, "was the driving force of the American housing bubble"<sup>31</sup>.

And, the more clients the bank managers could persuade to borrow money without taking into account their ability to pay the loans back – that means to go into debt - the more the managers' salaries increased, because "their payment depended on short term maximisation of profits"<sup>32</sup>. They earned millions, got bonuses and "regarded salaries running into millions as natural"<sup>33</sup>. When they left the bank, because it was going to be bankrupt, they demanded and got millions in compensation. The President of the German Federal Audit Office criticised this behaviour "as unjustifiable" and the Minister of Economic Affairs condemned it "as not acceptable"<sup>34</sup>. Obviously the managers' greed was a main motive; they wanted to make a profit as big and quickly as possible.

In this way banks tempted people to use extreme credit, and many clients – one must emphasise this – were easily tempted to go into debt. Bobby Godsell, the former President of the South African Chamber of Mines described this situation as follows: "Banks have been lending money to people who could not repay. Consumers have been spending money they did not have"<sup>35</sup>. So "the debt of private US households doubled between 1980 and 2008 and a huge mountain of debt was growing up"<sup>36</sup>. The chairman of the German Action Group Social Market Economy summarised: "The cheap-money policy of the US Reserve Bank prepared the crisis; greedy bankers carried out and completed it for the sake of their short-term quick profits"<sup>37</sup>. And even as the housing market already started to collapse, bank executives still fraudulently inflated the value of those mortgage bonds "just in order to protect their bonuses". The Attorney of the Southern District of New York, which includes Wall Street, called this "a creeping culture of greed... in Wall Street and in business generally"<sup>38</sup>.

The economic crisis “is not a crisis of expertise, in the first place human beings have failed”<sup>39</sup>.

The banks for their part bundled their claims against the borrowers, tied these liabilities, these debts of the clients, up into what they called 'new finance products' or 'new finance certificates', and passed those 'new products' on to other finance institutions. These banks mixed them up again with other 'certificates' and sold them - sometimes on the same day. The whole procedure continued again and again; the one bank passed the new finance products or 'subprime credits', as they became known, on to the other and made a profit – all over the world, without any surveillance. No goods have been sold or bought, but claims, expectations - called 'new finance products'. The total sum of sub-prime credits “has grown from 100 billion US Dollars in the year 2000 to 62 000 billion US Dollars in 2008”<sup>40</sup>; and “their market share increased from 5 percent to about 40 percent of the whole credit volume”<sup>41</sup>. At the end even bank managers, who persuaded their clients to buy such 'new finance products', were often unable to assess them and “did not even know the real value”<sup>42</sup> or 'worthlessness' of sub-prime credits, which they kept in their safes. Above that, banks deliberately gave wrong information on the quality of those rubbish credits, “and sold them over the whole world – contrary to their better judgement that they never ever could be paid back”<sup>43</sup>. In 2013, for example, JP Morgan Chase, one of the top banks in the United States, had to pay “a fine of 600 million Dollars”<sup>44</sup>, because they had sold such rubbish credits. These disastrous practices were possible, because the United States and other countries had only insufficient regulations on the financial sector; and on the global level there was no regulatory framework at all. Bank managers, investment bankers, bank consultants acted outside any framework and could do whatever they liked.

### **Consequences of the disastrous bank practices**

Many people, who had borrowed money from banks, had overestimated their abilities to pay the loans back, as did the student, who bought a multiple family house with only 500 Dollars and was supposed to pay 4000 Dollars of interest alone each month, or the nurse, who bought seven

houses for one million Dollars with only 10 000 Dollars of own capital<sup>45</sup>. And contrary to the promises of the bank consultants, the more houses had been built the more the market price of individual houses decreased. In USA the price of houses went down by about 40 percent within two years<sup>46</sup>. The afore-mentioned nurse and student were forced to sell their houses for a small fraction of the original price to pay back just a part of the loan. The bank had to resign itself to its losses. Like them, hundreds and thousands of borrowers could not pay the interest rates any longer, quite apart from paying their debts back. So the housing bubble burst and huge numbers of so-called 'new finance products' turned out to be more or less valueless, and banks had to write them off. "The bursting of this bubble generated the financial crisis lasting until today"<sup>47</sup>, analysed the above-mentioned Director of the *Centre for Finance Studies* at Frankfurt University. On the other hand, many who had bought those "new finance products', individual people as well as finance institutions, lost their money. Greedy bank managers had gambled away large amounts of money and caused their banks billions of losses. Banks became insolvent and went bankrupt, as did the US Bank, Lehman Brothers, one of the world's largest banks, and more than 100 banks in the United States alone and many more finance institutions all over the world. Other banks, which still hold those sub-prime credits, could only survive, because governments – that means the taxpayers - helped them with millions and billions of subsidies. So it turned out that a philosophy, which kept only selfish interests in mind, proved to be self-destructive and undermined the common good and its own benefit, alike.

Banks for their part, being aware of the high hidden risks and the lack of transparency, lost mutual trust and stopped lending money to other banks and to enterprises, because they were afraid of not getting back the money. But enterprises need loans for their activities, need loans to develop new products, to do scientific research, to increase the production capacities and so on. Without necessary loans, enterprises are forced to reduce their activities, cut back the production and dismiss workers. Unemployment increases. On the other hand, ordinary people stop building houses, stop 'buying big', because they are unemployed or are afraid of an insecure

future. On the global level the economic downturn prompts countries to buy and sell less goods among one another; world trade decreases and many countries reduce or even stop investments and not least development aid. In this way the disaster of the financial economy afflicts the real economy; the financial crisis develops into an economic crisis, which people all over the world painfully experience. By the way, the crisis exactly confirms the economic theory of Friedrich August von Hayek, who received the 1974 Nobel Prize for economics: "The cause of the crisis is the boom. The cause of the boom is too much cheap credit. Too much cheap credit causes over investments and wrong investments; the crisis must correct them by big losses of jobs and capital"<sup>48</sup>.

### **The world economic crisis and the necessity of a global framework**

The starting point of the worldwide economic crisis is the fact that in the USA (and in other countries) the financial policy and financial institutions acted within an insufficient framework and on the global level financial institutions acted outside any framework. Therefore, the crisis confirms and underlines, that a solid framework, which is essential for the concept of Social Market Economy and essential for well-working national economies, is also essential for a well-working global economy.

Already years before the crisis was foreseeable, alert and far-sighted observers of the growing globalisation pleaded for a worldwide framework. This must not be "a world state", but we need "a world federation of independent states"<sup>49</sup>; we need - what these political analysts called - "global governance", a "global monitoring of globalisation"<sup>50</sup>. Hans Tietmeyer, at that time President of the *German Federal Bank*, demanded "a world-wide social order", which "ought to be established step by step"<sup>51</sup>. The *Frankfurter Allgemeine Zeitung*, one of the opinion-making newspapers in Europe and not opposed to big business, firmly stated that "in the long term a global competition authority will be necessary in order to prevent private monopolies of power"<sup>52</sup>. Norbert Walter – the above-mentioned chief economist of the powerful *Deutsche Bank* - emphasised that "a free market economy does not function without a state regulation"<sup>53</sup>, without a strong framework. Michel Camdessus, the former

Director General of the *International Monetary Fund*, demanded the "humanisation of globalisation" by a "World Social Order". He referred to Pope John XXIII, who called for the "establishment of a public authority with really universal competence" as early as in 1963. This "public authority with a global competence... will come, because we need it"<sup>54</sup>. And the repeatedly quoted *Compendium of the Social Doctrine of the Church* emphasises that "the worldwide economic-financial system" sets "the task of regulating it" (No. 371).

In respect of its region, at the moment Europe is attempting to establish a kind of a regional framework. The countries of the Euro-Zone agreed "that – beginning in 2014 –the *European Central Bank* has to control 130 big banks; insolvent banks should be liquidated according to strong rules without damaging the whole financial system"<sup>55</sup>.

With regard to the world economic crisis the German Catholic Bishops' Conference firmly stated that "the global economic system also needs a regulating framework"<sup>56</sup>. "Today the financial markets are global markets", emphasises the Director of the *European Central Bank*; "because of that they need a better set of rules; they need global rules"<sup>57</sup>. The President of the *World Economic Archive (Weltwirtschaftsarchiv)*, one of the leading German economic research institutes, demands "to fix basic conditions of the globalised economy on a global level, to set global rules for global economic activities"<sup>58</sup>. These "international rules must correspond to the extent of the international connection between the financial markets"<sup>59</sup>.

Economic experts speak of five essentials, which such a global framework should include.

- Joseph Stiglitz, winner of the Nobel Prize for Economics, proposes "worldwide valid standards for giving credit to prevent loans such as the mentioned 'sub-prime credits' from being sold as so-called solid 'innovative credits' from the very beginning"<sup>60</sup>.
- The German Minister of Economic Affairs and many others demanded that the liability rules of banks and bank managers be

intensified to ensure “that they will not even be paid for gambling away their clients’ money”<sup>61</sup>. On the national and global level, clear liability rules must force them to pay for any damage whenever they give insufficient information, incorrect advice and whenever they trade in faulty financial products.

- Banks, therefore, must increase their own capital to such a percentage of the turnover that they are able to overcome disturbing financial situations without state subsidies, which means without tax payers’ subsidies.
- As important is a general and worldwide transparency of financial transactions. The Director of the *Frankfurt School of Finance & Management* insists on "a worldwide central authority"<sup>62</sup> to supervise international financial transactions, corresponding to national bank supervision.
- Already in 1972, the American economist and Nobel Prize winner James Tobin had proposed the taxation of financial transactions to curb and reduce speculative transactions. In September 2011 the Commission of the European Union recommended introducing such a tax. “It would apply whenever at least one party to the transaction is resident in an EU country, regardless of the seat of the bank in question”. The proposed tax of 0.1 percent would affect in particular “those who frequently redistribute their shares, so-called ‘day traders’, who speculate in the extreme short term trade with financial transactions”<sup>63</sup>. Even if the United States and Great Britain hesitate to agree to this particular taxation so far, it’s reducing effects on financial speculations, which considerably contributed to the crisis, would be enormous, and the sometimes exorbitant remuneration and bonuses of many bank managers would be affected and curbed. In addition, all economic activities are liable to the turnover tax. Why should only financial transactions and speculations be excluded from taxation and be tax-exempt?

In this general context Pope Benedict XVI proposed in his Encyclical *Caritas in Veritate* “a true political world authority... to guide the economic globalisation” (No. 41, 67). Even Henry M. Paulson, Minister of



Finance in the Bush Government and a former bank manager, changed his mind, affected by the current crisis in his country, and confessed "that raw, unregulated capitalism does not work. What's needed is a regulatory set-up"<sup>64</sup>. The Chairman of the US *Federal Reserve Bank*, Ben Bernanke, demanded "effective, comprehensive financial regulations that will tame the beast (!) so that it does not create these kinds of crisis again"<sup>65</sup>. President Barak Obama announced "regulate the financial markets"<sup>66</sup>. He warned the bank managers, that days will not come back "where they were motivated by the appetite for bloated bonuses"<sup>67</sup>. In January 2010 the US Congress started "to grill top bankers about their roles in the economic downturn, about mortgage fraud and the lack of regulations"<sup>68</sup>. In July 2010, for the first time a leading Wall Street Bank, Goldman Sachs, was fined "550 million Dollars by the US *Security and Exchange Commission SEC* for security fraud by misinforming its clients"<sup>69</sup>. The Attorney for the Southern District of New York, TIME magazine reported in February 2012, is investigating "what he calls Wall Street's culture of greed"<sup>70</sup>. So far his investigations into insider trading and mortgage fraud have led to the arrests of 63 high ranking bank executives.

The Bush Government had strongly rejected financial regulations, whenever the European Union and in particular Germany demanded them. In 2007, the United States and Great Britain refused to establish a reduced global framework, which the German Chancellor Angela Merkel had proposed at the meeting of the seven most industrialised countries, the so-called G 7 states. A main reason for this refusal was probably the fact that international financial transactions are mostly carried out in the stock markets in New York and London. Both countries profit by these transactions and did not want to lose such profit. In their meetings in 2009 the governments of the so-called G 20 states, which include 85 percent of the world economy and fast-developing countries like China, India, Brazil and South Africa, agreed for the first time to set global rules for global financial activities, "to give financial markets a new order"<sup>71</sup>, and decided to establish a worldwide "Financial Stability Board"<sup>72</sup>. These examples show that the insight into the urgency of worldwide regulations becomes common knowledge: "a clear framework and legal regulations"<sup>73</sup> are

essential for a well-working economy also on the global level. The recent debt crisis in a number of European countries – Greece, Ireland, Portugal, Spain - which affects the whole Euro-zone, underlines and confirms this urgency. The recent European debt crisis calls for stronger common European rules; and "global rules" are needed for "global economic activities"<sup>74</sup>, as the mentioned Director of the *European Central Bank* rightly demands.

In my view, such a global framework, a global co-operation of that kind is essential not only – but in the first place - for economic reasons, but also for the sake of other vital goals, for example, for the sake of global peace keeping. The members of the international community must co-operate on a global level to solve the global problems. National states are no longer able to do this. I do not see any alternative.

However – and this must not be overlooked – beyond the mentioned solid framework, beyond national and international regulations, the financial sector and the economy as such, those who are responsible in these fields “must find a way back to a management based on moral values”. Laws, regulations may be as well thought out and solid as possible, but they can and will be violated and broken. Therefore, “a moral exertion of power”<sup>75</sup> is needed, moral values are vital and indispensable – beyond all the framework regulations.

## **CONCLUSION**

Social Market Economy as understood by itself and by Christian Social Teaching, demands a well-working "competition of performance and efficiency"<sup>76</sup>. Competition is "an indispensable tool for organising modern mass societies". Its main advantage is the optimal utilisation of limited economic resources. Because competition does not automatically result from the 'free play of the market forces' and because competition also does not automatically realise the best possible supply to all people, politics has to enact "a clear framework and legal regulations"<sup>77</sup>. These regulations have to enable and safeguard competition and to ensure that individual economic participants act as is demanded by the well being of all – in other

words, that "competition is carried out within rules that safeguard the public good"<sup>78</sup>. Therefore a solid framework is essential for Social Market Economy. Added to the competition are the social alignment and social rules, the so-called 'second pillar' of Social Market Economy. The economic and social policy of the state has to complement competition by compensating for socially negative results of the market and to facilitate necessary changes in economic structures, which are beyond the ability of the individual people affected. So policy has to provide conditions that are needed for "a socially satisfying economic process and its socially just results"<sup>79</sup>. Social Market Economy in this understanding is completely different from any 'elbow-capitalism' or 'Market Economy pure' and corresponds with Christian Social Teaching on a sound and just economy.

Many experts, economic experts of different backgrounds, agree that one main cause, of the recent world financial and world economic crisis is the lack of a sufficient framework in the United States and other countries and the complete lack of a global framework, corresponding to the national framework. This worldwide crisis underlines and confirms the necessity and urgency of a framework also on the global level. The policy of 'cheap money' was "the driving force of the American housing bubble". Banks bundled the liabilities of their debtors, created what they called 'new finance products', 'sub-prime credits' and passed them on to other finance institutions – all over the world, without any supervision or control. Bank consultants, investment bankers, bank managers, who often did not know the 'value' or the 'missing value' of their 'new financial products', could do whatever they wanted. They even fraudulently inflated "the value of mortgage bonds just to protect their bonuses"<sup>80</sup> and earned millions. "The bursting of this bubble generated the financial crisis lasting until today"<sup>81</sup>, which soon afflicted the real economy and developed into an economic crisis - again worldwide. Its causes, its course and its effects confirm the necessity and urgency of global regulations. In the meantime this insight seems to become common knowledge. At any rate President Obama promised "to regulate the financial markets"<sup>82</sup>, and the European Union is struggling to enact appropriate regulations. "Global economic activities" need "global rules"<sup>83</sup>.

To express it metaphorically: the bread we need to eat must first be baked. For that we need a well-working oven; that is to say, we need an economy that works efficiently. Market Economy is such a well-working oven. Market and competition are able – more than any economic system we know up to now - to utilise the scarce and limited economic resources in the best possible way. The bread, however, must be baked according to fair rules set for the well-being of all; and the bread must be justly distributed; everyone must get a fair share. For that, what is needed is a framework, shaped by politics on the national and international level in alignment with the well-being of all, the common good. One main cause of the recent world financial and world economic crisis is the lack of appropriate regulations in the United States and other countries and the almost complete lack of a global framework. The crisis underlines and confirms the urgency of such a framework.

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- <sup>70</sup> Massimo Calabresi and Bill Saporito (2012), The Street Fighter, in: TIME, No. 6, 13 February, 14-19, 16-17
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- <sup>73</sup> Müller-Armack, Soziale Marktwirtschaft, 390 (see note 5)
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- <sup>75</sup> Tiemo Kracht (2009), Der Manager-Wertekanon, in: Rheinischer Merkur, No. 44, 29 October, 12
- <sup>76</sup> Was ist Soziale Marktwirtschaft, 7 (see note 4)
- <sup>77</sup> Müller-Armack, Soziale Marktwirtschaft, 390 (see note 5)
- <sup>78</sup> Kerber, Ordnungspolitik, 13 (see note 27)
- <sup>79</sup> von Nell-Breuning; Wie "sozial" ist die "Soziale Marktwirtschaft"? 236 (see note 15)
- <sup>80</sup> Calabresi and Sapiro, The Street Fighter, 16 (see note 70)
- <sup>81</sup> Wieland, Aus Erfahrung klug, 12 (see note 47)
- <sup>82</sup> Klein, Don't panic, 11 (see note 74)
- <sup>83</sup> Issing Opfer der Lobbyisten, 11 (see note 57)

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## **About St Augustine College of South Africa**

The idea of founding a Catholic university in South Africa was first mooted in 1993 by a group of academics, clergy and business people. It culminated in the establishment of St Augustine College of South Africa in July 1999, when it was registered by the Minister of Education as a private higher education institution and started teaching students registered for the degree of Master of Philosophy and Doctor of Philosophy.

It is situated in Victory Park, Johannesburg and operates as a university offering values-based education to students of any faith or denomination, to develop leaders in Africa for Africa.

The name 'St Augustine' was chosen in order to indicate the African identity of the College since St Augustine of Hippo (354-430 A.D.) was one of the first great Christian scholars of Africa.

As a Catholic educational institution, St Augustine College is committed to making moral values the foundation and inspiration for all its teaching and research. In this way it offers a new and unique contribution to education, much needed in our South African society.

It aims to be a community that studies and teaches disciplines that are necessary for the true human development and flourishing of individuals and society in South Africa. The College's engagement with questions of values is in no sense sectarian or dogmatic but is both critical and creative. It will explore the African contribution to Christian thought and vice versa. Ethical values will underpin all its educational programmes in order to produce leaders who remain sensitive to current moral issues.

The college is committed to academic freedom, to uncompromisingly high standards and to ensuring that its graduates are recognised and valued anywhere in the world. Through the international network of Catholic universities and the rich tradition of Catholic tertiary education, St Augustine College has access to a wide pool of eminent academics, both locally and abroad, and wishes to share these riches for the common good of South Africa.

# Instructions to Contributors

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St Augustine Papers is the journal of St Augustine College of South Africa and is published twice annually. It publishes scholarly, refereed articles and book reviews in all the fields in which academic programmes are offered at the College. Interdisciplinary articles are especially welcome. Publishing decisions are made by the Editorial Committee.

## PRESENTATION OF MANUSCRIPTS

Articles may be around 6 000 – 12 000 words in length and should be an original contribution. Articles may be e-mailed using software that is compatible with MS Word. The first page of the manuscript should carry the proposed title and author's name with highest degree. Under the name should appear an identification line, giving title and position held, the institution and its location. Personal details and a short biography (10-15 lines) should also be submitted. A brief abstract (no more than 150 words) should follow the author identification data.

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The Harvard method should be used. All references should be specified in parentheses in the text (and in the text of notes) by surname(s) of the author(s), the year of the publication and page number(s), for example (Dworkin 1986:45-52). The complete citation should appear at the end of the manuscript (after the notes, if any) under the caption 'References'. Such citations should be listed alphabetically by surname of author; for authors cited more than once, by year of publication, with the most recent references first. Please note the use of capital letters, punctuation marks and italics in the following examples:

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Notes should be numbered serially throughout the text by superscript numbers (without parentheses) to the right of any punctuation marks. The notes themselves should appear at the end of the manuscript but before the references, under the caption 'Notes'.