

34. It would appear that, on the level of individual nations and of international relations, the free market is the most efficient instrument for utilizing resources and effectively responding to needs.

Pope John Paul II, Encyclical Letter Centesimus Annus (May 1, 1991)

1. Stability of money Relative prices should not be distorted by inflation or deflation so that individuals can direct demand and supply according to real and relative scarcity of resources.

Inflation, as the most unsocial form of concealed expropriation, should not be allowed to erode private property rights.

2. Competition in open markets Steering supply and demand by individuals, according to relative scarcities for careful use of the environment, asks for prices as result of competition in open markets. Open markets also are the best control of power in markets and politics. They encourage the social function of private property: competition is the best discovery procedure for the plenty of social chances (Hayek).

3. Private property is the strongest driving force behind a dynamic economy, individual responsibility and longterm planning.

4. Freedom of contract and accountability goes hand in hand like freedom and responsibility.

5. Longterm oriented policy: Producers and consumers need reliable data for planning, all the more when they have to be flexible

and quick in their responses to new market situations: There should be no narrowly focused policy interventions, or policy based on 'any economic order will do'.

Supplementary Reading

- *Still the standard work on the legal and institutional framework of the market economy ("Grundsätze der Wirtschaftspolitik" (1952), Ch. XVI), extract: Walter Eucken, A Policy for Establishing a System of Free Enterprise, in: Ludwig-Erhard-Stiftung, Standard Texts on the Social Market Economy, Stuttgart, New York, 1982.*
- Alan Peacock, Hans Willgerodt (Ed.), *Germany's Social Market Economy: Origins and Evolution*, London 1989.
- Wilhelm Röpke, *Free Economy and Social Order*, Cairo 1951.
- Michael Watts, *What is a Market Economy?*, U S Information Agency, 1992, also in: <http://usinfo.state.gov>
- On the global aspects: Otto Graf Lambsdorff, , *Economic Freedom Is Best Policy*, Remarks to the 2001 Annual Meeting of the Trilateral Commission in London.

Liberales Institut der Friedrich-Naumann-Stiftung
Box 90 01 64 14437 Potsdam (Germany)
T. +49 331/70 19-210
www.libinst.de e-mail: libinst@fnst.org

Liberales Institut

JEDER MENSCH BRAUCHT
FREIHEIT, UM SEINE
ANLAGEN UND FÄHIGKEITEN
ENTFALTEN UND
VERWIRKLICHEN ZU KÖNNEN.
DAS FÜR FREIHEIT ERSETZT
DAS FÜR FREIHEIT ERSETZT
VERFALLEN KULTUR UND
WISSENSCHAFTEN, STAGNIERT
DIE WIRTSCHAFT.
GEISTIGES LEBEN BRAUCHT
FREIHEIT GENAUSO, WIE DER
KÖRPER DIE LUFT ZUM ATMEN.

Market Economy

For fear of being politically incorrect, many people use the term 'market economy' only with the qualifier 'social'. There is no reason for liberals to succumb to the pressure of what is wrongly seen as political correctness, because, contrary to the propaganda spread by worshippers of state, advocates of the welfare state and opponents of globalisation, the market economy does not need qualifiers to be socially acceptable: it is social.

Even the renaissance of a market-economy order cannot achieve full employment over-night, which makes it all the more a good ethical reason to summon up the courage to promote the market economy right now. *Otto Graf Lambsdorff, 1994*

From the very beginning, the intellectual fathers of the market economy in Germany were convinced of this social function. The German economist Alfred Müller-Armack first coined the term 'social market economy', well aware that 'social' was superfluous, but it was effective against the antimarket polemics of "socialists in all parties" (Hayek). According to Wilhelm Röpke, the distinguished German economist and architect of liberty, the 'market economy' and 'social market economy' were the same. The German economic order was christened the 'Social Market Economy' ("Soziale Marktwirtschaft"), a name that won the trust of the people and encouraged export of the term.

If we trace the theoretical roots of the social market economy, we find that the idea originated from neoliberal economics, in other words, the new study of economics that drew attention to the important function of competition while trying to create a competitive order that deviated from palaeoliberalism and was in line with the ideas of Walter Eucken and Franz Böhm.(translation).

Alfred Müller-Armack, 1959

The ABC of the market economy

An antithesis of the market economy was the 'socialist market economy' in Tito's Yugoslavia, one of the many attempts to find a 'Third Way'. It is a cross between the steering element of the free market in decentralised planning, and the socialist element of collec-

tive property. This cross proved to be as infertile as another combination, namely central planning dominated by private property, promoted by the National Socialists in Germany. Finally, there was no doubt about the failure of the third combination – central planning with collective property after 1989. After the failure of these three socialist economic models, it is no wonder that socialists single out the fourth model for criticism: In contrast to all the socialist models, the market economy combines decentralised decisionmaking by individuals with private ownership of the means of production too.

Market economy = order in freedom

Individual decisionmaking, coordinated by market prices, combined with overarching private ownership are the basic elements of a system we call the market economy or "free market". In May 2002, when the EU confirmed Russia's claims to be a market economy, it may have been a shrewd political move to declare its trust in advance and prepare the ground for Russia's entry into the World Trade Organisation (WTO). However, Russia is possibly on the way to becoming a market economy, which really fulfils its criteria. Beyond a minimum, the extent to which the conditions for a functioning market economy are met in a perpetually imperfect world is not of primary concern, but the strict interdependence between individual conditions is important. This means, for example, that rapid

privatisation cannot compensate for shortcomings of truly competitive prices, which provide the coordinating mechanism for markets. Democracy and the market economy are also interwoven to promote freedom and individual responsibility.

The basic idea is simple: There can be no economic order that is more humane, economical with scarce resources, dynamic, flexible and crisisproof than one in which free individuals determine what is to be produced, when, where and how, and then decide how the goods are to be distributed. The liberal founding fathers of the German economic order called this the 'market economy' or 'competitive order' (Walter Eucken, 1950).

The muchvaunted elasticity of the free market is really the elasticity of the individual who shoulders the responsibility.

Wilhelm Röpke, 1958

The very substance of the market economy is social, with or without the prefix 'social': not in all cases, but certainly if the constituent principles of the 'competitive order' (Eucken), which form the basis of the market economy, are ensured. At a time when 'social justice' had not been reduced to a 'weasel word' (Hayek), Eucken in 1950 claimed that social security and social justice were the main concerns of the time. His solution was the market economy; its constituent principles are: