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Trade Unions in a Civilized Market Economy^{**}

The article tries to answer an old question of economic theory and institutional economics: How do trade unions fit into a market economy? Are they a constitutive element of the market order or: are they a source of irritation and disruption?

Key words: **trade unions, economic theory, market economy, labour market, collective bargaining, Germany** (JEL: J51, J53, J83)

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Trade unions and their compatibility with the liberal market order is a highly controversial issue in economic theories. Within the mainstream of market liberalism – from Adam Smith to Friedrich August von Hayek – the trade unions rarely found acceptance. However, if we look at the whole array of liberal economists we find a broad spectrum of answers – reaching from disruptive factor to functional prerequisite of the market order.

We can identify three different assessments of trade unions (according to Goetz Briefs 1965):

- 1) Trade union as a disturbing or just irrelevant factor (classical liberalism).
- 2) Trade union as an auxiliary organ (e.g. Adolf Weber).
- 3) Trade union as a functional institution of the liberal market order (Sidney Webb & Beatrice Webb; Lujo Brentano).

1. Classical Liberalism

Although *Adam Smith* is regarded as the Godfather of *classical liberalism* at the time when he wrote his “Wealth of Nations” the term “liberalism” was not yet in use. Smith spoke of “natural“ or “rational” economic order. Only a short remark on trade unions can be found in the bulky book. In Chapter 8 of the first book he states:

“What are the common wages of labour, depends everywhere upon the contract usually made between those two parties whose interests are by no means the same. The workmen desire to get as much, the masters to give as little, as possible. The former are disposed to combine in order to raise, the latter in order to lower, the wages of labour” (Smith, 1904, I.8.11).

This is, by the way, a short and most precise formulation of the paradigmatic conflict of interests between employers and wage-earners. Smith states that the masters have a clear overweight in all aspects of labour market operation (first: they can easier combine because of their fewer numbers; second: contrary to workmen, they are prevented from legal persecution when combining; third: in case of a dispute, they can hold out much longer).

“But though, in disputes with their workmen, masters must generally have the advantage, there is, however, a certain rate, below which it seems impossible to reduce, for any considerable time, the ordinary wages even of the lowest species of labour” (I.8.14). “A man must always live by his work, and his wages must at least be sufficient to maintain him” (I.8.15) ... and additionally his breed. The need of subsistence is the lowest level of wages. Smith regarded labour like any other commodity. The demand for men, he expounded, “like that for any other commodity, necessarily regulates the production of men” (I.8.39).

David Ricardo is the presumed creator of the “iron law of wages”, formulated on the basis of Malthus’s theory of population. He proposed that wages tend, in the long run, toward the minimum wage necessary to sustain the life of the worker. He called existence minimum the natural wage and consequently considered trade unions’ endeavours as useless. Nevertheless, he opposed the prohibition of trade unions. Due to his liberal opinion he challenged the parliamentary passing of the Combinations Acts

of 1799 and 1800. He thought: Why should trade unions be forbidden if they cannot influence economic laws?

One of the first of liberal economists who theoretically found it possible that trade unions could increase wages was *John Stuart Mill*. He thought that they could do so in particular trades whenever they were capable to restrain market competition. Above all, he defended the rights of skilled workers to protect their jobs by trade union organization and industrial action.

2. Adolph Wagner

The German economist Adolph Wagner assigned the trade unions a role as auxiliary organ in market economy for the following reasons: They could support workers for better use of market opportunities and could strengthen their behaviour in regard to work performance. Moreover, they could contribute to an acceleration of market adjustment in business cycles and ensure that workers would participate in monopoly profits.

3. The Webbs and Lujo Brentano

We find quite different assessments of some socially minded liberals, namely *Sidney and Beatrice Webb* (1902) on the one hand and *Lujo Brentano* (1909) on the other. Both have emphasized the fundamental differences of product and labour markets and the regulatory impact that trade unions have on labour markets. To them trade unions empower the workers to challenge the employers' overweight that allowed them to fix – actually to dictate – wages unilaterally because of the usually prevailing excess of labour supply.

The Webbs regarded trade unions as a price-setting agency providing the workers with „bargaining power“.

According to this judgement, workers were no longer exposed to the unregulated competition on the labour market. Collective bargaining supersedes the individual bargaining on wages and working conditions. In fact, it was Beatrice Webb who coined the term *collective bargaining* (Webb & Webb, 1902, pp. 173f.). Organized in trade unions the workers were relieved from the immediate constraint to sell their labour power.

Although being an opponent to the Webbs on the question about the origins of trade unionism, their contemporary Lujo Brentano agreed with them on the question of the economic rationale of trade unions.

His main argument was: only trade unions enable workers to behave like other good sellers, namely to adjust his supply to market conditions. Hence trade unions were to him an integral part of the market order, even a capstone in the architecture of a market economy.

4. Karl Polanyi / Goetz Briefs

Although Brentano argues in favour of trade unions with an apparently consistent argument, it was exactly this argument which has been challenged by Karl Polanyi and Goetz Briefs.

In his seminal book on “The Great Transformation” Polanyi (1978) signified labour as a “fictitious commodity” – fictitious, because commodities were goods to be produced for selling on the market. To him it was destructive for a civil society to treat men under the marketable label “labour” as an ordinary commodity. Class struggles and the development of social policy could be understood as movements of de-commodifying labour.

Goetz Briefs (1926) argued in a similar way. Contrary to Brentano, Briefs denied that trade unions are genuine elements of liberal market order. Defining them as a shelter to protect (*Schutzgebäude*) workers from commercialisation of labour he rather identified them as institutions for the de-commodification of labour.

Summarizing so far I think the differences between the Webbs and Brentano on the one hand and Polanyi and Briefs on the other can be dissolved if we elaborate on the specifics of the labour market.

According to *Robert Solow* everybody except mainstream economists believes that “there is something special about labor as a *commodity* and therefore about the *labor market* too” (1990, p. 3).

In a way, labour is a commodity but cannot be handled like an ordinary commodity, because for the bulk of the population labour power is an essential revenue for human life and labour power cannot be detached from the person. Her or his integrity demands special treatment. Briefs specifies the boundaries which have to be erected against the commodification of labour: they are necessary where „the existence, dignity and cultural form of working life” (Briefs, 1926, p. 1117) could be endangered.

5. Social Market Economy

Turning to the concept of *Social Market Economy* the question arises: Did the fathers of this concept reserve a place for the trade unions?

It was *Walter Eucken*, the theoretical head of ‘Ordoliberalism’, who also emphasized the fundamental differences between product markets and labour markets. He thought labour were not a commodity, therefore the labour market had to be humanely framed (Eucken, 1965, p. 185). This implies a balance of power between the social partners. Consequently, the political proponents of Social Market Economy regarded free collective bargaining (*Tarifautonomie*) and social partnership as complementary institutions, which should – as self-regulating bodies – contribute to reconcile social antagonism. Eucken even praised trade unions for their merits on the improvement of the social conditions of workers. Although trade unions were „monopolistic organizations“, they were called into action by monopolistic overweight of the employers. Trade unions could be institutions to establish equilibrium within the framework of a competitive economy. However, they also could become powerful organizations putting the competitive order at risk (Eucken, 1965, pp. 185f.).

The regulatory system of Social Market Economy looks as follows:

Market	Regulatory Law
Product Market	Act Against Restraints of Competition <i>Gesetz gegen Wettbewerbsbeschränkungen</i>
Labour Market	Collective Agreement Act <i>Tarifvertragsgesetz</i>
Capital Market	???

We can identify two basic regulatory laws,

- one for the product markets: the Act Against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen*)
- and one for the labour markets: the Collective Agreement Act (*Tarifvertragsgesetz*).

The first, the Act Against Restraints of Competition, a kind of anti-cartel law, did not find the full acceptance of the main proponents of Ordoliberalism because the provisions left to many loopholes.

The second, the Collective Agreement Act, was unanimously enacted by the common Economic Council (*Frankfurter Wirtschaftsrat*) for the British and American occupation zones of post-war Germany. Since the Act was adopted before the official foundation of the Federal Republic of Germany (FRG) there was a transition period before it became valid for the whole territory of the FRG (including the former French occupation zone) in 1953.

Regarded as the outcome of a “historical compromise” between capital and labour, the Collective Agreement Act has provided the legal framework for Germany’s highly institutionalised collective bargaining system and, in the view of some commentators, has made a major legal contribution to the ‘institutionalisation of class conflict’. Apart from a few amendments, the fundamental provisions of the Act have remained unchanged until today. The application of the law, however, has always been made concrete and further developed by Labour Court decisions.

The third category – the capital markets – has still been a blank position within the regulatory framework of Social Market Economy. Of course, there are legal regulations on the establishment and the business of financial institutions, but – as has been lamented during the current financial crises – a genuine regulatory framework for capital markets is still lacking.

There are quite a few academics (coming from social sciences, economics and labour law) who stress the close relationship between Social Market Economy and social partnership in Germany. *Birger B. Priddat*, a political economist, argues that social partnership would not have been developed without the concept of Social Market Economy (Priddat, 2011, p. 19). *Bernd Rütters*, a well-known professor of labour law states: “Social Market Economy and social Partnership belong together. The one is the necessary foundation for the other.” (Rütters, 2011). And the sociologist *Walter Müller-Jentsch* holds the view that although the concept of Social Market Economy originally contradicted the post-war program of trade unions, but both have developed a mutual affinity over the years, in fact the trade unions have contributed to the

actual profile of the existing order of Social Market Economy (Müller-Jentsch, 2011, pp. 193ff.).

6. Civilized Market Economy

The concluding section of my Paper is devoted the question: What is the future of trade unions in a civilized market economy. The term civilized market has been taken from the Swiss ethical economist *Peter Ulrich* (2010) of St. Gallen.

Peter Ulrich understand by this term a market order that is embedded in a civil society which re-defines the guiding principles of economic performance – rationality, progress, and freedom.

Principle	Liberal Market Economy	Civilized Market Economy
Rationality	economical efficiency in the use of resources (clash of 2 rationalities: business & economy) economic-technological rationality - external effects - rationalisation of work	ecological efficiency (efficiency according to ethical values: e.g., good life, justice) socio-economic rationality - internalisation of 'external effects' - work-life balance
Progress	one-dimensional economic progress	culturally & ethically reflected progress
Freedom	market freedom	freedom of the citizen (<i>Bürgerfreiheit</i>)

The freedom of citizens includes rights of citizenship in different dimensions:

- civil rights in the dimension of constitutional state,
- political rights in the dimension of democracy,
- social rights in the dimension of welfare state.

A fourth dimension should be added on the basis of T. H. Marshall’s ‘industrial citizenship’. It includes

- national and international trade union rights as well as industrial democracy.

Category of citizenship rights	Dimension of civil society
civil rights	constitutional state
political rights	democracy
social rights	welfare state
industrial rights	free collective bargaining & industrial democracy

There is a whole array of national law and international conventions that guarantee the rights to organize in trade unions, to negotiate collective agreements and to go on strike.

- Basic Law / *Grundgesetz* (Article 9, Para 3),
- Collective Agreement Act / *Tarifvertragsgesetz*,

- Charter of Fundamental Rights of the European Union (Articles 12 & 28),
- ILO Conventions (No. 87 & 98),
- European Convention on Human Rights (Article 11).

Starting with the statutory basis of trade union rights we can refer to the Basic Law (article 9, paragraph 3) and the Collective Agreement Act of 1949. Both guarantee the freedom to organize in trade unions and to negotiate collective agreements. The right to strike is not explicitly codified in both documents but has been guaranteed by Labour Court decisions of principle. The Charter of Fundamental Rights, Article 28, explicitly underlines “strike action”, too.

Judged by these provisions trade unions cannot complain about their legal status. Whether they play an important role in economy and society depends first of all on their capacity to mobilize members among the working population and to display their competence for solutions of labour market problems and as an agency to secure social justice. As to the latter it seems to me what is badly needed are national and international campaigns for minimum wages and programs to qualify working people.

The Social Market Economy is not a static concept but – as its name-giver *Alfred Müller-Armack* repeatedly emphasized – a dynamic concept open for “permanent modification” (1978, p. 13). Though the concept of “civilized market economy” or even of “ethical market economy” (Ruf, 2011) could be regarded as legitimate offsprings. Far away from being a disruptive factor, as in a neoliberal free market order, trade unions have to play an essential role for the regulation of labour markets within these market orders as long as dependent labour will prevail.

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