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**The German Roots of the European Community's
Cartel Regulation**

PhD dissertation

Theses

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1 The basic objective and methodology of the research

With our dissertation we aim at serving several objectives. Above all, as the title already implies, we aim at discovering the German roots of the European Community's cartel regulation. We regarded this objective as relevant because, in the course of our research, we have experienced that *Hungarian and international literature handles the fact that the German thoughts and regulation had a great impact on Community cartel regulation as evident and refers to it with just a few sentences but the professional support of this statement is usually missing*. We have made an attempt to 'unpack' this statement in detail.

However, we had other objectives as well. According to our experience, Anglo-Saxon dominance is deducible in Hungarian economics literature. We regard this as somewhat regrettable, for several reasons, even if Americans have undoubtedly created enduring values in economic science. The first of these reasons is that Hungary is a European country with many strong links in its (economic) history to the German economy. Moreover, in Germany, parallel to the United States, vast progress has been carried out in economic thinking, not mentioning the 'German issue' as being the primary intention behind integration at the time of forming the European Economic Community. For these reasons, *we aim at amplifying the Hungarian professional knowledge with the German economic thoughts*.

We have also experienced that, in the perspective of Hungarian economic thought and education, competition regulation is situated somewhere in the periphery although *competition is an immanent element of the market and in most market economies there exist competition regulation schemes, with their refined set of means and objectives*. We trust that we develop Hungarian professional knowledge in this respect as well.

The deficiencies identified above may derive from the fact that competition regulation is a border area of legal and economic science that the majority defines as an area of the former, partly because competition law is an independent branch of legal science. On the contrary, we claim that it is the most important section of law and economics. Although law, especially in the eyes of economists, is just a means to reach the objectives defined in a given economic-political framework, *the differences in the legal aspects lying behind competition regulation systems have a considerable effect on the organisation and mechanisms of the market regulated by that law*.

This implies that, in our dissertation, we cite legal scientific sources as well and, *regarding methodology, we much rather apply logical deduction than matematismation*. This approach further matches with the way of thinking of the Freiburg School and as we study this school of economic thought in detail, moreover, we phrase some of our statements in connection with them or based on their works, we are convinced that the selected methodology makes us capable of achieving our goals.

2 Some starting points

In the course of our work we followed some substantial guidelines. One of these was that *competition regulation cannot be detached from the socio-economic environment in which it is applied* (this, for example, is emphasised by Vörös 1996). Nevertheless, economies and markets are under constant change, which is expressively shown for the European economy in an early I/O¹ work (Jacquemin – de Jong 1981). *Competition regulation has to adjust to this dynamic environment* (Motta 2007). Consequently, competition regulation schemes are always ‘projections’ of their own eras. To underpin this statement, we found it necessary to make excursions into economic history.

Moreover, Walter Eucken, the most prominent member of the Freiburg School discovered as early as in the 1930s that *economic formulae change by market forms which, at the same time, are also subject to constant change*. We deeply agree with this observation. For this reason, claims Eucken, *market regulation can never be ‘ready’*. Antal Mátyás highlights this thought of Eucken in his textbook on economic theory (Mátyás 2003).

Last but not least we considered the thought, all through our work, that, *since the Sherman Act of 1890, the prior objective of competition regulation has always been the protection of competition, in all competition regulation schemes but, outside this prior objective, it may serve and eventually has served other objectives as well, explicitly or implicitly* (Török 1997). In our dissertation we show that German and European competition policies have from the beginning not been clear competition policies but they have served industrial, economic or, in the case of the EEC, even integration policy objectives. Moreover, they have done so in a rather blunt manner. Pierre Buigues, Alexis Jacquemin and André Sapir capture the essence of this phenomenon by saying that all policies of the EU refer to the very same economy so the emphasis has to be on the coordination of these. Without such coordination, credibility of the policies is questioned and the security of the environment of both private and public actors is challenged. *So, the optimum is an outcome of a policy mix* (Buigues – Jacquemin – Sapir 1995). We examine competition regulation in this wider economic policy context.

¹ I/O: Industrial Organization.

3 Structure and main findings of the dissertation

Our dissertation starts with analysing the nature of restrictive behaviours. In this chapter we apply the I/O methodology. The main theses relevant for us from this American-dominated branch of economic science are the following:

- *Members of the cartel suffer from the prisoner's dilemma.* This situation destabilises the cartel, which of course does not mean that they never occur. Theory has two things to say to us, namely that collusion happens but it is not likely to last forever. Moreover, antitrust is costly so it has to be applied when collusion occurs a considerable number of times and lasts considerably long (Hylton 2003).
- *Oligopolistic collusion is executed in more and more sophisticated ways* (Pepall – Richards – Norman 2008). George Stigler warned about this phenomenon already in 1964 (Stigler 1968²). By the way, Stigler approached the public management of market failures in a rather critical way: in his view, such actions are ground to further failures (Stigler 1975). He much rather addressed the elimination of information asymmetries.
- *Entry barriers considerably determine the probability of cartels' survival* (Tirole 1988, Motta 2007). Cartelised markets become attractive to new entry due to higher prices. The more successful the actors already present on the market are in impeding new entry, the more stable the cartel will be.
- *Game theory is capable of explaining more and more of cartels' behaviour but it also has its limits.* I/O discovered decades ago that *the reasoning based on the prisoner's dilemma does not explain everything*, not even in the framework of game theory. Reinhard Selten was the economist who, by further developing the thoughts of John F. Nash, found the answer to this question³ (Shepsle 1999, Laitin 1999): *Cournot's static model has to be replaced by a dynamic one where games are repeated.* This circumstance gives the chance to cartel members to reward 'good' and to punish 'bad' behaviour. *Selten drew the attention to the fact that cooperative behaviour within the cartel becomes much more rewarding in repeated games* (Selten 1999). His thesis is the following: if a game with an individual equilibrium is played a finite number of times, the solution will each time be the equilibrium. The Nash-equilibrium of the repeated game will be the individual Nash-equilibrium a finite number of times (Tasnádi 2005).

² His study of 1964 was republished in 1968 in a collection of his works.

³ And, by doing so, he practically helped Nash to win the Nobel Prize that they were awarded, together with John Harsányi, in 1994.

How can Selten's logic be challenged? Possible solutions to the questions may be that firms do not know how long the game is played; there are more than one Nash-equilibria; and/or so-called 'credible threats' exist on the market (Zamir 1992, Forges 1992). These may, at least for some time, sustain a stable cartel. What happens if the game is played on an infinite horizon? The final conclusion of such a model is that, *in the framework of interactions repeated infinitely (for a previously non-defined time), collusion among firms is possible*. This implies that competition authorities have good reasons to worry about stable cartels lasting for long.

Without criticising the genius logic of game theory, we have to note that if we wish to analyse and assess real market situations with the tool-set of game theory, we strongly restrict our own possibilities. That is because the more factors we wish to consider that are assumed to influence the behaviour of a given actor in a given situation, the more complicated the equation becomes that we have to set up. Thus we are cautious about relying too much on game theory proofs and we would definitely not sort out intuition from the assessment of cartel situations.

The next chapter of the dissertation introduces *competition and its regulation from a German perspective*. This chapter mainly deals with the thoughts of the two influential Freiburg scholars, Robert Liefmann and Walter Eucken. *The major elements of Liefmann's unique world* (we claim that his findings eventually form a complete and unique world of thoughts) are the following (Liefmann 1930):

- *The "ruthless competition" and "extreme individualism" of Anglo-Saxon free-market competition are harmful*. Free-market competition is "ruthless" as "everybody is against everybody" in this game. Moreover, in post-war⁴ production structure examined by him, selling at "the lowest price possible" many times meant considerable losses in capital and therefore was regarded as unfavourable. According to the concept of "extreme individualism", all forms of cooperation restrict competition, including every contract.
- *In German economic history the tradition of sectoral cooperation can be traced back to several centuries (see the guilds of the Middle Ages)*. The essence of such cooperation is that, among those who "pursue similar professions", there exists cooperation, and competition is not realised among individuals or individual companies but among sectors, between industry and commerce, and between industry and suppliers.
- *Within cartels there is "healthy rivalry", which brings about considerable advantages*. Liefmann summarises the advantages which are mostly of a stabilising nature and, therefore,

⁴ From the 1924 edition it is obvious that he spoke about World War I.

are crucial in post-war Germany. *Among the advantages, he identifies reduced capital risk; more stable employment; the more successful handling of recession and inflation; or smaller volatility of prices.* In Liefmann's view, realistic disadvantages are frozen market structures, obstacles to technological development and the proliferation of bureaucracy. *A further advantage is that "healthy rivalry" impedes capital concentration;* this is a benefit that the absolute prohibition of the Sherman Act did not foster in the US.

Liefmann's observations regarding cartels can be summarised as follows: *Cartels are 'good' because employees won't revolt, because continuous supply is guaranteed and because this way concerns and trusts are not formed, of which the disadvantages at the level of the national economy are much greater than those of the cartels.*

The Freiburg School, though rooted in the same town where Robert Liefmann worked, represents substantially different views. *The common denominator in the two branches of thought is that both of them denied Anglo-Saxon capitalism just as centralised economic systems; and that neither of them trusted the state's ability to organise markets.* The beginnings of the Freiburg School can be traced back to 1933. This was the time when Walter Eucken, Franz Böhm and Hans Grossman-Doerth simultaneously dealt with the question of *what power the individual has in a free society* (Blümle – Goldschmidt 1993). The three scholars soon started to work together. The main pillars of the consistent theoretical system set up by the Freiburg School are the following:

- *Ordnung*: The word 'Ordnung' (order) has two meanings in German. In the positivist sense it refers to the form of economic coordination while, in the normative sense, it indicates the putting-together of diversity into one unity. Therefore, *order is some (economic) constitution, the set of rules of the game. It has nothing to do with the connotation of order as a 'dictate'. It can rather be deduced from the Latin word 'ordo'; and expression with which the order of nature is described in Latin.* Mankind has a need for some kind of an order which is not merely economically effective but which, at the same time, gives the chance for a responsible life and human freedom.
- *Ordnungstheorie and Ordnungspolitik*: The positive and normative logical deductions of the Freiburg School can obviously be distinguished. In order to make the distinction clear, they used separate expressions for the two. *Ordnungstheorie lays down the theoretical foundations and gives the framework for the practical economic policy recommendations of Ordnungspolitik.* In their view, an effective national economy has to meet two criteria: it has to rely on theory which has to prove to be workable in practice (Gerken – Renner 2000). Especially Eucken found it important that theory is applicable and, also applied (Schlecht 1989).
- *Wettbewerbsordnung* (competitive order): economic efficiency embedded in a socio-ethical texture, which gives the power of the order. *Wettbewerbsordnung is what ensures efficiency*

and individual freedom at the same time. Restriction of economic freedom is impeded by competition while the power of the state is controlled by *the state's own self-restrictive competition policy* that aims at maintaining competition. The orientation of Wettbewerbsordnung is clear; its objective is that competition serves consumers and that all behaviours harming consumers or restricting their decision-making are ruled out.

- *Leistungswettbewerb* (performance competition): Franz Böhm dedicated a greater role to competition than Walter Eucken. According to him *competition is the moral backbone of a profit-based economy*. Therefore, no other competition is desirable but Leistungswettbewerb when *an actor realises an advantageous market position by offering something better to the consumers* (Böhm 1980). Eucken described economic policy fostering Leistungswettbewerb as a gardener who does not create anything himself but ensures the ideal environment for natural growth. Böhm developed the metaphor even further by saying that a highly cultivated park needs constant gardening... *This way the Freiburg School gave legitimacy to active competition policy.*
- *Vollständige Konkurrenz* (complete competition)⁵, “*Entmachtungsinstrument*”: Competition is not complete as long as it can be intensified. Böhm claims that competition is the superb and most genial “*Entmachtungsinstrument*” (power-depriving tool) (Böhm 1980). He was the one who repeatedly emphasised that competition is the only instrument that can effectively restrict power (Herman – Pillath 1991).
- *Critiques*: the starting point of *Eucken's critique on the policy of laissez-faire* is that the expression is already a field for misunderstanding as it does not mean that politics does not intervene in the economy. In his view, the greatest failure of politics is that actors eventually find competition inconvenient and try to eliminate it by forming cartels, by merging, and by striving for monopole positions, thus restricting competition. In fact, *competition left on its own ends up in such monopole situations*. This has two negative effects, namely that monopoly undermines the workability of the market economy and that, by the increase of the power of a few, the freedom of the others is violated.

On the other hand, *Eucken also criticised the policy of experiments as well*. He identifies two types of these: one is the so-called middle-course policy which washes away the borderlines between economy and state; the other is the socialist and national socialist experiment to centralise the direction of economic procedures (Gerken – Renner 2000). Middle-course policy, a characteristic of the Weimar Republic, for example, brings up two problems. Firstly,

⁵ The phrase of complete competition is not the best choice as it recalls the perfect competition of the neoclassicals, especially in the German language (vollständige/vollkommene Konkurrenz) though this latter one, according to Eucken, is based on unworkable model assumptions while he talked about real, workable markets.

that *the state, by its own power, hands economic power over to powerful groups*. The other problem is that, *eventually, it results in a weakened state* as the state merely appears to be powerful; in fact, it is dependent itself. As an ultimate consequence, the individual loses its own freedom as both state and private power deprives him of it. *State intervention and subventions increase the dependency of the individual*. In this logical deduction, Eucken phrases an open critique of Keynes, which can be regarded radical in the 1930s.

Eucken's view of centralised systems, like the Nazi Germany, comes to light in 1942 when he publishes his book called *Wettbewerb als Grundprinzip der Wirtschaftsverfassung*⁶. In this work he explains that *economy cannot be directed centrally as there are numerous actors*. The problem of power is not solved either; dependency remains and results in the lack of security (Ptak 2004).

Eucken regarded *Bismarck* as one of the greatest frauds of German history. Of social problems, that have become more and more apparent with industrialisation, he regarded that these should be handled in a wider context than in which they appear. *The applied instruments are counterproductive as they support the citizen but deprive him of his freedom, and thus, at the same time, of his responsibility. In the end, a "state slavery" is created*. In fact, restricted freedom, just like dissolved responsibility, appear as the total destruction of the essence of human life. It is much better to admit that social tensions have always existed. *The state's role is to provide the possibilities to each of its citizens to care for themselves*.⁷ However, the initiative is at the individual; this is the only effective social order.

Evidently, *Eucken and the Freiburg School put the emphasis on the individual*. They were convinced that a basic order in which freedom is guaranteed to the individual has to be established. The statement is true the other way round as well: if an individual enjoys freedom in his (economic) decisions, it is accompanied by responsibility. However, if we take responsibility off the individual's shoulder, we deprive him of his freedom of decision-making and action. *In such an environment performance competition cannot unfold and, eventually, society suffers loss in efficiency, together with all its negative consequences*.

- *Although the Freiburg scholars considered private power as the greatest threat to competition, they thought that the state appeared as a similar threat*. They thought so as the state can create monopoly through its policies like industrial property rights, trade policy, tax policy etc. The state firstly creates these monopolies and then it becomes dependent of these. As for them a criterion for effective competition was the full exemption of privileges, they denied that the state provide such privileges. All in all, we can state that, according to the

⁶ Competition as the Basic Principle of Economic Constitution

⁷ See the "Hilfe zur Selbsthilfe" (help to help yourself) motto of social market economy.

Freiburg scholars, *a strong state is needed meaning that it is not exposed to interest groups but stays independent of these. On the other hand, the state should be 'weak' in the sense that it should not intervene in the procedures of the economy; the Wettbewerbsordnung should prevail over the political system.*

The dissertation continues with the analysis of *the development of regulation of restrictive behaviours*. The main message of this chapter can be summarised as follows:

- *State regulation approached by the economics of regulation*: The new expectation towards the state, namely *the protection of the institution of competition can primarily be achieved through legal regulation*. The assessment of this task of the state is determined by the quality of regulation and the institutionalised guarantees of the application and enforcement of law. Posner points out that, also in the course of the application of antitrust regulation, the Coase theorem has to be considered (Posner 2001). That is, the transaction costs of the application of the certain law have to be set against its expected benefits. All in all, *legislation itself has to be submitted to economic analysis, which brings up the question of the efficiency of competition regulation* (Don – Kemp – van Sinderen 2008). According to the theory of economics of regulation, legislative activities have to be optimised just like all other economic activities (McNutt 2005).
- *Legal policy considerations*: Following the discovery of the fact that cartels execute a behaviour that serves private interests and violates common interest, *legal policy has started to premise that state intervenes in competition* (Boytha et al. 2001). The new approach already presumes that competitors may abuse the full freedom of contracting. If we admit that the risk of such abuse is real, *economic competition ceases to be an internal issue of competitors*. The revelation brings up the issue that law has to favour public and national interest; this objective becomes prevalent over the freedom of contracting. So, the ultimate goal is that the freedom of contracting is not used to restrict the freedom of contracting (of others) (Callies – Mertens 2009).
- *Competition policy considerations*: One of the basic approaches in competition policy is the *rule-of-reason* methodology, the other one is the so-called *per se* regulation. *The greatest weakness of the rule-of-reason approach is that it is necessarily costly to apply* (each case has to be examined individually). *The difficulty of per se regulation comes up when formulating the general rule as it has to define precisely what it prohibits; otherwise it is not applicable* (Hylton 2003). On the other hand, rules that are too simple may be the source of mistakes. *It is the constant change of market forms, behaviours and corporate organisations that deprives the general rule of its general applicability*. Recently the two approaches tend to be applied in a combined way. However, competition authorities continue to face the difficulty of finding

the borderline between the two (Gellhorn – Kovacic – Calkins 2004). As for Europe, per se regulation has from the beginning contained rule-of-reason type elements (Kirchner 2007).

- The content of competition regulation has been influenced by *other economic policy considerations*. Schumpeter, for example, claimed that the entrepreneur is more likely to unfold his creativity and imagination if his circumstances are untroubled, compared to the situation when he has to dedicate his energies to constantly and necessarily meet the challenges of competition (Schumpeter 1980).

Staying exclusively within the framework of competition policy and without going into details, *let us dedicate some thoughts to small business support*. We can bring up evident arguments that small businesses have to be protected of the crowding-out effect caused by large companies, especially as the former ones contribute to employment, to innovation, and generate other positive extern effects (Kállay – Imreh 2004). The rational argument lying behind supporting SMEs is that we pay them back the positive externalities that they create. However, *the question of where this support ends* logically comes up. It is not at all easy to answer this question and competition schemes also face this dilemma quite frequently.

Further viewpoints are added to competition policy by (national) *economic interest, trade policy, or even economic power* (Nagy 2008). Regarding the competition regulation of the European Community, *the objective of integration* also comes into the picture (Remetei-Filep 2005).

The chapter concludes with the introduction of the development of cartel regulation, starting with the Sherman Act, and continuing with the German cartel regulations from the beginning (1923) to the competition law of social market economy (1957). The development path shows that competition policy is in fact the projection of the given period of economic history.

The next chapter gives a detailed insight into the article of the Treaty of Rome regulating cartels. In this chapter we show that *Passage (1) of the article formulates a general prohibition; contains and exemplificative list of behaviours; and defines the conditions of applicability. Passage (3) introduces the institution of exemption*. Behaviours exempt from the general prohibition are linked to four conjunctive conditions. The history of competition regulation started with individual exemptions but the large number of cases evoked the institution of block exemption, as early as in the 1960s.

At the end of our dissertation we give an overview of the major changes that have occurred in the common competition policy since 1957. Our first observation is that *American influence is growing* (Basedow 2007, Wigger – Nölke 2007). The most evident manifestation of this is the introduction of *leniency policy* in 1996. Most recently the framework of competition regulation has

been shaped by the triple requirement of *deregulation-privatisation-reregulation*. Moreover, the relations among the *protection of intellectual property rights, innovation policy and competition policy* have come to the forefront (Lévêque – Shelanski 2005). The Commission’s latest opinion on the *self-regulation of market actors* as being the most efficient tool to regulate markets (Ullrich 2006) can also be regarded as a shift from the early convictions. Council Regulation No. 1/2003 decentralises implementation while the ‘more economic approach’ is the expression of the *prevalence of economic aspects* (Budzinski 2007).

At the same time, *the 2001 Commission communication on horizontal agreements (EC 2001) strengthens the legitimacy of exemptions and repeatedly justifies these*. Moreover, the Barroso-II Commission of 2010-2014 aims at creating *a more intelligent and greener social market economy* in the EU. Can we interpret this commitment as some kind of a return to the German roots? We will definitely get the answer to our question in the years to come.

4 Results of the dissertation; theses

Thesis No. 1: Passage (1) of Article 101 of the Treaty of Rome manifests the Freiburg School’s intellectual heritage while Passage (3) is a reflection of Liefmann’s thoughts.

The Sherman Act of 1890 introduced an absolute prohibition on restrictive behaviours. As early as in the 1910s it came to light that the system does not work perfectly. For this reason, the rule-of-reason approach had to be applied in the practice of courts⁸. The *Freiburg School* approached the necessity of regulating restrictive behaviours in a different manner. *Their starting point was to ensure competition; they saw the greatest threat in power, be it private or of the state*. Therefore, they did not propose an absolute, per se type prohibition on restrictive behaviours but, *by examining the objective or, much rather, the effect of such behaviours, emphasised that regulation should aim to ensure competition, to control power (dominant position), and to impede the development of disproportionate market positions*. A further relevant observation of the Freiburg scholars was that *(competition) regulation has to guarantee that regulation is not abused in service of individual interests*. The American regulatory scheme does not consider such arguments, except for the rule-of-reason type case law, and in respect of certain cases only.

⁸ In the US courts act as competition authorities.

*In our view, Passage (1) of Article 101⁹ of the Treaty of Rome was much rather formulated in the spirit of the Freiburg School than according to the American way of thinking. We sustain this statement even if many experts share the view that the prohibition on cartels of the European Community is equivalent to the absolute prohibition of the Sherman Act. Nevertheless, we have to admit that the German Dekartellisierungsgesetze (decartelising laws) of 1947 initiated by the Americans, through which they intended to eliminate the links between cartelised industry and Nazi power once and for all, served as good base for the spreading of the Freiburg thoughts in the West-Germany of the 1940s and 1950s. This process can be explained by the fact that the two approaches are definitely consonant in at least one aspect, namely that *competition is the most appropriate instrument to control power*.*

We explain the second part of our statement, namely that Passage (3) of Article 101 of the Treaty is the manifestation of Liefmann's heritage in regulation, with the following. Firstly, *Liefmann was the one who emphasised that economic efficiency can be achieved not only through competition and that the legal regulation of the economy serves other objectives outside ensuring competition*¹⁰. This latter statement is usually referred to as the most significant 'European thought' in competition regulation which, through the person of Hans von der Groeben¹¹, was added in the Spaak Report and in the Treaty of Rome. As already mentioned, this aspect was reassured in the 2001 Commission communication (EC 2001). In connection with Liefmann's observation, it is sufficient to recall what he stated regarding *traditional forms of industrial cooperation and the "healthy rivalry" within these*, compared to the concepts of "ruthless competition" and "extreme individualism".

Liefmann is significant also in the sense that he was the one who, as early as in the 1920s, revealed the failure of the Sherman Act; namely that it was unable to prevent the creation of powerful trusts abusing their power, thus implying that *absolute prohibition is not a realistic form of competition regulation*.

⁹ In the Treaty signed in 1957 the respective article was No. 85. This was changed to No. 81 after the Single European Act and then, with the Lisbon Treaty that entered into force on December 1, 2009, which is called The Treaty on the Functioning of the European Union, it was renumbered to No. 101.

¹⁰ This was especially so in the Germany of the 1920s when Liefmann published his views.

¹¹ Hans von der Groeben was a German diplomat who led the German delegation besides Alfred Müller-Armack at the negotiations of the Treaty of Rome. Then, called upon by Konrad Adenauer, he became the commissioner for competition policy in the first European Commission.

Thesis No. 2: In economic theory, and especially in the interpretation of the role of competition, the market and the state, German scholars have, in many respect (and in time) forerun the Americans.

Of the examined German scholars, we firstly confront Liefmann's findings with the results of American economics. In this respect, his critique on the Sherman Act, already introduced in relation to Thesis No. 1, has to be mentioned in the first place. Outside revealing the failure of such regulation, *Liefmann has, in some way, foreseen the significance of barriers to entry regarding the formation of market structures* although the theory of barriers to entry was first laid down explicitly as late as in the 1950s and 1960s (Török 2003). By claiming that, eventually, in free market capitalism everybody is the monopolist of their own product, *he foresaw the model of monopolistic competition a few years ahead of Robinson and Chamberlin (1933)* (Kopányi 1993), even if he did not call it that way.

Regarding another concept of Liefmann, here we cite Roger R. Noll who wrote in an I/O study as late as in 1996 that "*destructive competition*" is one of the key market failures and still this fact is denied practically unanimously in economic research (Noll 2006). Quite the contrary, Liefmann consequently called Anglo-Saxon free market capitalism "ruthless competition". Last but not least, in connection with Liefmann, it is necessary to note that he made an early but rather precise attempt to project the strengthening of German trade unions; which he called "labour-selling cartels".¹²

Let us move on to analysing the thoughts of the Freiburg School. First of all, in relation to American economists, *Walter Eucken was very early in discovering a deficiency of neoclassical theory by pointing out that product and competitors are not homogeneous, as presumed by the neoclassical model*. In his theory five factors determine the economy: needs, nature, labour as a factor of production, technological knowledge and the stock of consumer products. He supplemented these with the environment: the way of life of the people, state organisation, and social structure with its own habits and laws. The legal-social organisation includes the monetary system and policy, just as the realised market structures (Marktformen). *Based on his finding that economic formulae vary by market forms, we may regard Eucken as a forerunner of the I/O methodology*.

When evaluating Eucken's work in relation to modern, American-rooted branches of economic science, we have to move towards new institutional economics and constitutional economics. New institutional economics, as widely known, interprets the concept of 'institution' as a set of norms which aims at directing individual actions in a certain way (Tsuru 1993). In fact, *Eucken's concepts of Ordnung and Ordnungspolitik project exactly this American approach*, decades

¹² This phenomenon has in the past decades developed to become the largest political barrier to the reforms addressing the German welfare state (Gedeon 2001).

ahead. So, we may say that, even if not explicitly but on the whole, *the role of institutions appeared in the work of the Freiburg School much earlier than in the US, in new institutional economics.*

If we analyse the thoughts of the Freiburg School in the theoretical framework of constitutional economics, our first observation is that *James Buchanan, in an article written together with Dwight Lee, captures the problem of cartels very similarly to the Freiburg scholars.* According to Buchanan, the essence of cartels is to restrict the freedom of others through exercising the freedom of contracting. This type of freedom must not be protected (Buchanan – Lee 1991). So, we can say that *the Freiburg traditions serve as a base for constitutional political economy in some way. What the Freiburg scholars added to the idea of liberalism is exactly what Buchanan says later, namely that the idea of free market and competition are constitutional ideas that have to be defined in the constitutional framework* (Buchanan 1985). And a constitutional framework will be accepted if there is a social consensus that it is more adequate than any of its alternatives to ensure individual self-realisation.

When introducing our dissertation, we already pointed out how important the Freiburg scholars considered the idea that *the state be strong in the sense that it do not submit to interest groups.* As for the US, the theory of public choice was the first to declare in the 1970s that politicians, parties, bureaucrats, just as market actors, follow self-interest (Johnson 1991). Stiglitz was the one who, within this theoretical framework, analysed how *economic forces, which he called special interest groups,* are able to restrict the freedom of others through exercising their power (Stiglitz 2000). Although he did not phrase it this way, this was what he dealt with, according to Eucken's logic. *Stiglitz claims that the state differs from other actors in the sense that it is capable of enforcing its decisions. This thought has already appeared at Eucken!* Both scientists come to the conclusion that *the power of the state can only be controlled and limited by a conscious society in a mature democracy.*

Eucken's thoughts *reappear at Stigler as well.* First of all, *both of them were rather sceptic regarding the state's ability to regulate markets.* Secondly, Stigler also emphasised, moreover, proved with mathematical methods, that *large company size and dominant position function as barriers to entry and thus threaten competition* (Stigler 1968). However, Eucken's and Stigler's solutions are different: while the former sees the guarantees of promoting market mechanisms and controlling state power in ensuring the basic order and performance competition, the latter targets the elimination of information asymmetries. Still, they agree that *the state's role is to foster the most efficient realisation of market self-regulation.*

In the theoretical (and practical) model of the Freiburg School the state acts as 'Hüter der Wettbewerbsordnung' (guard of the competitive order). With this idea the Freiburg scholars had to face a substantial dilemma, namely that competition has to be guarded by the state while a considerable part of restrictive behaviours originates in the state. They were not naïve, nevertheless,

they pointed out that *the state is not to be expected to voluntarily play the role of the benevolent and omnipotent agent of public interest. This way they foresaw the phenomenon of rent-seeking, and also its significance*, first defined in the US by Gordon Tullock in 1967 (Tullock 1967). The Freiburg scholars also knew that *the solution to rent-seeking is to be searched for in the political constitution* so, what has to be reformed is the legal system determining the operations of the state (Vanberg 2004).

Thesis No. 3: Regarding the EU's economic policy, its current set of objectives and way of thinking is influenced by the German thoughts in a number of aspects that are not commonly known.

We know from our History studies that the Weimarer Nationalversammlung (Weimar National Assembly) declared the establishment of the sovereign, constitutional state in 1919 (Ormos 2008). However, we think that the greatest achievement of the Weimar economic governance was that the economic stability and growth, reached in the 1920s, was based on the unprecedented cooperation between state and economy, laid down in a separate legal act¹³ (Forsthoff 1971). This act specifically ordained that *price stability, high employment and foreign trade balance has to be achieved parallel, within the framework of the market economy and accompanied by proportional economic growth*.¹⁴ The law also specified that these objectives have to be reached by the joint efforts of all interested actors. In our view, *this means not less than the economic policy framework of the EU (that is, growth and employment accompanied by low inflation) was first laid down in 1919, in Weimar*. We all know that, for post-World-War-One Germany, it took years to get on the macroeconomic path that met these criteria. We also know that the stabilisation and growth procedures launched in Germany in 1924 did not last long, mainly due to external factors. Nevertheless, we consider it essential that, already in 1919, *Germany possessed the knowledge that serves as the basis for the current EU economic policy guidelines*. However, German history may also teach us that cooperation is workable only in good times and a crisis may easily blow away loyalty.

We consider it to be less widely known that, both in West-German and in European competition regulation, *the late introduction of merger control was eventually deliberate*. The (industrial policy) objective behind this fact was that, by the time of introducing the regulation, *national/European corporations be strengthened in relation to their American competitors* and thus

¹³ Gesetz zur Förderung der Stabilität und des Wachstums der Wirtschaft vom 8. Juni 1919 (The Act of June 8, 1919 on the Promotion of Economic Stability and Growth).

¹⁴ „Die Maßnahmen sind so zu treffen, daß sie im Rahmen der marktwirtschaftlichen Ordnung gleichzeitig zur Stabilität des Preisniveaus, zu einem hohen Beschäftigungsgrad und außenwirtschaftlichen Gleichgewicht bei stetigem und angemessenem Wirtschaftswachstum beitragen.“ Gesetz zur Förderung der Stabilität und des Wachstums der Wirtschaft vom 8. Juni 1919, §1.

become able to cope with the challenges of competition in a more and more internationalised economy.

In the current set of the EU's economic policy objectives, *strategic alliances, cooperation among SMEs and clusters* hold a prominent position. We claim that *these economic policy objectives are rooted in the legal category of cooperation agreements* evoked by the exemption of the prohibition of cartels in the 1957 German competition regulation, the GWB. The exemption of *specialisation agreements* in Germany in the 1960s was similar (Kühn 1997).

Last but not least we recommend another German idea to be thought about further. Franz Böhm was the one who said that *the basic order has to be developed in such a way that the representation of individual interests eventually serves the public interest* (Böhm 1980). We are convinced that *this principle has been a driving force for European economic integration since the beginning*, even if implementation fails from time to time. However, such failures are imputable to human weakness and do not derive from the deficiency of theory.

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