

THE FREE ECONOMY AND THE STRONG STATE: THE RISE OF THE SOCIAL MARKET ECONOMY.

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I

During the last ten years the long post-war period of expansion and stability has come to an end. We are living through a crisis that should never have happened, the crisis that Keynesian techniques and social democratic policies and institutions were supposed to have banished for ever, because they had overcome the tendency of the capitalist economy towards deficient demand and underconsumption. No slump on anything approaching the scale of the 1930s has occurred, and the pattern of economic performance has been varied, but the overall slowdown in rates of economic growth has still been marked. There has been a deepseated crisis of profitability reflected both in declining short run rates of return and a fall in long-term opportunities for investment. Barriers to further rapid accumulation have multiplied and determined the ground on which major conflicts have erupted—struggles over pay, new technology and employment; struggles over the size and composition of public expenditure; and struggles over trade and financial imbalances between surplus and deficit states.

The most striking feature of the new recession which divides it so sharply from the last great crisis in the world economy is the behaviour of the price level. Unemployment has been rising steadily, but it has been inflation that has repeatedly threatened to get out of control, and in the face of which economic policy makers have appeared most powerless. Inflation is in turn a contributor to the instabilities in the financial markets, the imbalances in trade, and to the fiscal crisis of the state and has also done much to undermine the political cohesion of the major states. With the spread of uncertainty and instability it is hardly surprising that the reputation of governments for successful economic management has rapidly waned and that politicians, having benefited during the long years of boom from the identification of economic prosperity with

government economic policies, now suffer from the identification of those same policies with the dismal succession of crises and failures over which they have to preside. In Britain where the problem of relative economic decline has been aggravated by the impact of the recession, no government has won re-election after serving a full term since 1959, and there has been a significant decline in support for both major parties (most notably in 1974 but still marked in 1979).

The slow-down in the pace of accumulation has provided the opportunity for a widespread rejection of Keynesian political economy and an onslaught on the policies, values and organizations of social democracy. There has always been an element among British intellectuals which has never required much inducement to join a collective stampede to the right. We are constantly being told that 'intellectuals' are finally losing faith in socialism (this follows their previous final rejection of it in the early 1950s). They have been converted, even at this late hour, to the need to resist totalitarianism and the British Labour Party, and to reject the beliefs in collectivism and equality that were enshrined in the policies and institutions established in the 1940s.¹ Aside from these 'men who have changed their minds', swayed by the populist clamour of the new right, there has also been in recent years a real intellectual change, a remarkable revival of liberal political economy through the elaboration of the doctrine of the social market economy, a doctrine which, under different labels, has made increasing headway within the Conservative party in the last ten years. The Conservative Government elected in 1979 had a group of ministers in the crucial economic ministries (Treasury, Industry, Trade, Energy), who were all adherents of the doctrine and prepared to govern in accordance with its prescriptions.²

The term social market economy originated in Germany from the neo-liberal ideas that were current there after 1945.³ In Britain and America similar ideas have been put forward by a number of theorists including F.A. Hayek and Milton Friedman, and popularized in Britain by organizations like the Institute for Economic Affairs and the Centre for Policy Studies,⁴ by leader writers in the *Times* and *Daily Telegraph*: by economic commentators such as Peter Jay, Samuel Brittan, and Patrick Hutber,⁵ and by Conservative politicians (Enoch Powell at first; more recently, Keith Joseph).

Although many of the intellectuals prominent in this broad

tendency, (often labelled, rather inaccurately, monetarist), like to imagine themselves as romantic outsiders breaking lances against the formidable walls of the Keynesian economic and political Establishment, the ease with which they have penetrated the citadel and the speed with which the Keynesian defences have crumbled in the past few years, suggests otherwise. At any other time the jousting between monetarists and Keynesians would probably have remained a technical debate about the best instruments for economic management. But the monetarists have not been content to carve a place for themselves within Keynesianism, but have launched a broad assault on the political forces that underpin Keynesianism, the forces and organizations of social democracy. So monetarism and economic liberalism have become linked with other ideas and movements, the most significant of which is the populist right in the Conservative Party, most vigorously represented by groups such as the Monday Club and the National Association for Freedom, which are strongly critical of trends in British society since the war and are closely identified with the beliefs and attitudes of the present Conservative Leader. The populist assault on social democracy has concentrated upon the burden of taxation, the abuse of welfare, the inefficiencies of public provision and public enterprise, and the threat to public order and well-being posed by immigrants, unions, students, and other minority groups.⁶ A big attempt has been made to appeal to that section of the working-class electorate for whom the policies and organizations of social democracy have become increasingly unpopular.

The self image entertained by the new ideologues of the right and the band of vociferous converts and roving spokesmen for management that consort with them, is that Britain, having just passed through its 'watershed' election, is about to experience a renaissance of liberty and the liberal society, the creation of a new national consensus by means of which the chains of collectivism will be thrown off, the trends of the past thirty years reversed, and Britain's national and economic fortunes revived. On the left two main views of Thatcherism and the new liberal political economy are evident. On the one hand there is the strongly held belief that the underlying trend in modern capitalism is towards some form of 'corporatism' with the state constantly tending to increase its powers of direction over the economy. Hence Thatcherism is regarded simply as an ideology, a veil drawn over the real development of capitalism, and a poor guide as to how governments are obliged to behave. Liberal political economy is seen as appropriate to the era of competitive capitalism

but no longer relevant to the problems of monopoly or corporate capitalism. If any attempt were made to apply its principles chaos would result; the experience of the Heath Government in its first two years is often cited. Many on the left go on to argue that so poorly adapted is the ideology of the right to the problems of managing modern capitalist economies that often the social democratic parties like the Labour Party are better suited for it, and secretly preferred by capitalists themselves to the explicitly capitalist parties.

A second response to Thatcherism and the revival of liberal political economy is to see them not simply as ideology but as a means for reorganizing the state sector in a period of recession, increasing spending on maintaining order and reducing it on certain kinds of welfare. The rolling back of the state in some areas is seen to involve rolling it forward in others. The crisis has to be policed as well as managed, and this implies a more active role for some state agencies (as well as more ample remuneration from a grateful people). Whilst there is much more to be said for this point of view than for the first it can lead to a neglect of the scope of the right-wing revival and the sources of its strength, because it focuses on the state sector and the mobilization of populist attitudes towards welfare, immigrants and strikes. But Thatcherism and liberal political economy should not be treated as one, however important is the fact of their present linking in practice. Liberal political economy has far deeper roots and permanence within capitalist social formations and contributes ideas and programmes to the conservative 'left' as well as the 'right'. Even many of the intellectuals who currently advocate a 'social market economy' do not by any means share the populist positions of Thatcherism and are extremely unhappy that monetarism and the social market economy should appear as 'right-wing' doctrines.

2

One of the main reasons why the social market economy has acquired right-wing associations is because it is often regarded as a euphemism for laissez-faire economy, and because so many political issues are now defined as left or right depending on whether they involve the extension or the retreat of central government powers and responsibilities. The problem with the term laissez-faire is that it suggests a quiescent or inattentive state. Capitalist states have never been that. The crucial question is the dividing line between those

areas where the state feels obliged to intervene and those where it does not. There have always been issues like the protection of property and the enforceability of contracts on which the state has never followed a *laissez-faire* policy. Where the dividing line comes has often been determined by political and social struggles. The importance of the social market doctrine is not that it is against all state intervention but that it wants the state to intervene less in some areas and more in others. 'Free economy—strong state' is no idle slogan, and marks the continuity of the doctrine with the tradition of liberal political economy, not a departure from it. Nobody in this tradition has seriously suggested that capitalism could do without a strong and active state,⁸ although this has sometimes been obscured by *laissez-faire* ideologies of self-help and business enterprise. The key problem for economic liberals has always been how limits to the sphere and tasks of government should be fixed, i.e., where the strength of the state should be concentrated. This means that there is nothing in social market doctrine that rules out collective provision of welfare or public enterprise, provided that these are justified in terms economic liberals can accept.

During the boom the theoretical differences between the social welfare or 'mixed' economy in Britain, supported by the Labour Party, and the social market economy in Germany supported by the SPD was not very obvious (although the contrast in economic performance was sharp enough). There has always been a debate between liberal and collectivist social democrats about whether certain agreed ends can best be achieved through the market or through planning. The real significance of the social market doctrine has only appeared during the recession. In the vacuum caused by the discrediting of Keynesianism and the evident disarray of social democracy, the social market doctrine has provided the intellectual bedrock for the rallying of the right around a programme aimed at breaking theoretically with the universe of social democratic thought in order to establish the principles that will enable governments to break from social democracy in practice also. For the first time since the war the right has acquired a set of distinctive principles on which to base the conduct of economic policy and attempt to reverse some of the political advance made by organized labour. Social democrats, whatever their party affiliation,⁹ accurately perceive the fundamental hostility of social market doctrine to their beliefs and policies, but have found themselves on the defensive because of the translation of the theoretical principles and distinctions of social market doctrine into the

language and demands of the authoritarian populism of Margaret Thatcher.

At its most elementary level the break that social market doctrine seeks is with the basic standpoint of Keynesianism and social democracy. The standpoint of the Keynesian school in approaching problems of managing capitalism is that of the national economy. Social democrats have come increasingly to share that standpoint, particularly when they are in government, although they operate as well with an older frame of reference, usually when they are in opposition—the interests of the working class. Taking the national economy as the starting point for the development of a political economy, a set of principles for guiding economic policy, means adopting the standpoint of the nation-state and its agencies. This does not preclude reliance on free market methods, but it means they are evaluated in terms of their contribution to the success and progress of the national economy.

The true mark of a social market theorist is the rejection of this intellectual construction and the return to the concerns of liberal political economy—the standpoint of the market, the sphere of commodity relations regulated by law. This sphere is composed of a multitude of different markets, some of which reach well beyond national political structures, and their proper functioning is considered to be an important end in itself, as well as the best means to the achievement of certain national ends. This does not entail that adherents of social market doctrine are all internationalists and cosmopolitans, although some are. Others are passionate nationalists and British race patriots. But all accord an importance to markets and the voluntary relationships of exchange they establish, which they regard as setting definite limits to what national economic policy can and ought to accomplish.

The principles of liberal political economy on which the concept of the social market economy rests have been restated most fully and most influentially in Britain and America by Hayek, whose writings repay careful study." There is very little written by the popularizers of social market doctrine that is not already contained (somewhere) in Hayek. His thought revolves around three crucial distinctions—those between liberty and democracy, law and bureaucracy, and the market and planning. From these oppositions flow most of the practical conclusions of the social market theorists. Hayek makes it very clear that whilst he is by no means hostile to democracy, it is liberty that is more important. A democratic state may protect liberty, if it is properly organized, but it is not the only kind of state

that can do so. Liberty is defined as 'that condition of men in which coercion of some by others is reduced as much as possible in society'.¹¹ Coercion by individuals can be greatly reduced if one social agency, the state, is able to punish individuals who infringe laws governing individual exchange. The problem then becomes how to reduce coercion by the state itself; the answer is the construction of a private sphere free from public interference. Such a private sphere can only come into existence if there are certain activities and rights which are protected and cannot be infringed by the government. This requires that the state as well as individuals be bound by laws (the idea of a *Rechtstaat*, or constitutional state), and that decisions of government agents be subject to legal appeal and reversal in the courts. Such a notion of liberty naturally clashes with the notion of popular sovereignty because it implies that there are many laws which should be beyond the power of a government to alter, whereas the doctrine of popular sovereignty suggests that a government elected by the people has the right to overturn and refashion all laws.

It is not surprising therefore that in the era of mass democracy and popular sovereignty, liberal political economy should frequently inspire dreams of an apolitical state—a state whose agencies are so constituted that they supply the least possible scope for interference by the temporary democratic majorities that inhabit legislatures. Montagu Norman's¹² search for a system of central bank co-operation which would take the important questions of monetary policy out of the hands of politicians has found a recent echo in the advocacy of a Currency Commission which would remove control of the money supply from the Treasury and the Cabinet. The thinking behind such proposals is simple. A sound currency is one of the conditions for markets to function, hence for liberty to exist. 'Politicians and bureaucrats' are prone to interfere with the money supply in pursuit of other objectives, so its regulation should cease to be a matter of discretion and become a constraint within which all governments are obliged to operate.

What gives such notions credibility is that the modern state is organized in precisely this manner with many agencies, for example the judiciary, but also the military, and parts of the bureaucracy, enjoying varying degrees of autonomy from the government and constituting an orchestra which governments cannot command but must persuade to play. The great bulk of state agencies are not subject to democratic election and control and the liberal proposal is to strip away a few more functions of government and hand them to

agencies who can be more readily trusted with the public interest than can politicians swayed by short-term political pressures.

An alternative approach to removing certain areas of state activity from political scrutiny and democratic pressure is the attempt to limit government activity by identifying individual rights which are presumed so fundamental that no government can infringe them and still be called free. This approach leads to Bills of Rights and written constitutions, which have enjoyed a considerable revival in recent years." Robert Moss, a former director of the National Association for Freedom and speech writer to Margaret Thatcher, puts forward a list of measures which he argues should be beyond the powers of any elected government: the abolition of democracy, the banning of religious beliefs, the destruction of the family, the withdrawal of the right to own or bequeath property, and the prevention of the exercise of individual choice in health and education."

The idea behind both approaches is that the preservation of liberty requires that there be very precise limits to legislation, however democratically constituted the legislative authority may be. Democracy is seen as the least harmful form of government, but still suffers from major flaws—there is for instance no 'budget constraint' to limit what the voter can vote for in the same way that there is limiting what the consumer can buy. Since voters are not obliged to consider costs, competitive bidding between the parties develops, and democratic governments come to offer more than they can deliver with serious consequences for their handling of economic policy. As Milton Friedman has put it:"

The fundamental defect of the political mechanism (is that) it is a system of highly weighted voting under which the special interests have great incentive to promote their own interests at the expense of the general public. The benefits are concentrated; the costs are diffused; and you have therefore a bias in the market place which leads to ever greater expansion in the scope of government and ultimately to control over the individual .. In the economic market .. each person gets what he pays for. There is a dollar-for-dollar relationship. Therefore, you have an incentive proportionate to the cost to examine what you are getting.

Democracy therefore encourages ever greater bureaucratic interference with the privileged private sphere—the sphere of market relationships between individuals. As bureaucracy rises, so the law

declines—the second of Hayek's basic distinctions. He does not suggest that bureaucracy can be dispensed with (his thought is never utopian in that sense), but he does argue that for liberty to flourish the realm of law must dominate the realm of bureaucracy. General laws, i.e., known rules that are applicable to all, must regulate social behaviour over as wide an area as possible and discretionary administrative decisions be minimized as much as possible. The essence of collectivism (what makes it, for Hayek, the prelude to totalitarianism and allows him to range welfare state and New Deal policies in the same continuum as socialism, fascism, and communism) is the disregarding of the distinction between law and administration, so that law becomes not a means for checking the growth of administration but a means of facilitating it, by providing new unspecified discretionary powers for government agencies. From this flows the opposition between planning and the market. The market is potentially the sphere of free, voluntary individual behaviour regulated by law, and protected from the coercion practised either by other individuals or by the state. Planning signifies the intrusion of the unregulated discretionary power of politicians and bureaucrats,¹⁶ supposedly acting in the national interest, in accordance with the wishes of the electorate, but in practice interfering with and reducing the only kind of liberty that is possible.

The message that bubbles from the fermenting pot of social market writings is that democracy is dangerous and can threaten liberty, so needs to be rigorously controlled and limited. The attachment of these thinkers to democracy is precarious, because during times of economic difficulty the workings of democracy are one more burden that the liberal society must carry. It becomes very hard to pursue the right economic policies because the immediate consequences in terms of unemployment and living standards, and the active opposition of many parties, organizations, and groups, soon lead to the collapse of both electoral support and the political confidence and determination of the government.

How much easier the restoration of the liberal society would be, muse these theorists, if the need to secure a renewed popular mandate and to maintain civil liberties were removed or at least suspended for a time. Great play is made in this literature of the distinction between authoritarianism and totalitarianism. Authoritarian regimes, like Chile, are regarded as far preferable to totalitarian regimes like Russia and Nazi Germany, because whilst they interfere with political freedoms, they do not interfere with

economic freedom; trade unions are of course disbanded or repressed, but foreign investment is not interfered with and citizens are still free to own and bequeath property, and to buy and sell their products and their labour power. The intellectual dishonesty of this position is glaring because Nazi Germany is regarded as totalitarian rather than authoritarian, despite the overwhelming evidence that, like Franco's Spain and Pinochet's Chile and Papadopoulos's Greece the regime did not interfere with the economic freedom of private capital, but considerably increased it, by suppressing trade unions and providing stable financial and commercial conditions and a climate of expansion. The destruction of political freedom is always regrettable, according to Friedman, but clearly it is not to be compared to the far more serious loss of economic freedom for capital.

3

Defining freedom as they do, and distrusting democracy and bureaucracy as a result, certain definite consequences follow for economic policy—a set of principles which rooted in the notion of the individual are extremely durable, capable of wide application, and form the backbone of the current intellectual revival on the right. The state has to be both strong and active—maintaining the conditions which guarantee 'individual liberty'. Three main ones are identified—the security of property and contract; free competition; and stable money. Or as Keith Joseph has put it more discursively:"

Governments can help hold the ring, provide infrastructure, maintain a stable currency, a framework of laws, implementation of law and order, provision of a safety net, defence of property rights and all other rights involved in the economic process.

The contrast with Keynesian political economy is very marked. Post-war Keynesian thinking proposed four targets for economic policy—full employment, economic growth, stable prices, and a surplus on the balance of payments—and conceived managing the economy as a matter of fine tuning, of steering, of adjusting the economic aggregates through a constant process of intervention to keep the national economy in balance. The social market doctrine would still set targets, but only for those things like money supply

and public expenditure that were specifically under government control. On all other detailed questions of economic policy—particularly employment, the rate of economic growth, and the exchange rate for the currency—the government would adopt a 'neutral policy stance', so disclaiming responsibility for economic outcomes." Responsibility for employment would be passed to the trade unions, and responsibility for growth to the individual preferences of savers, investors, consumers, as well as external circumstances and divine providence. This means that no one need be unemployed so long as they are prepared to accept a wage low enough (negative if necessary), to make someone want to employ them, and so long as trade unions do not try to 'prevent' people taking or being forced into employment at such wages.

The centrepiece of this strategy is money, so it is no accident that monetarism has received such wide attention as the spearhead of the economic liberal assault on Keynesianism. Monetarism, however, as its advocates point out, is not a new doctrine and for most of the past two hundred years has been the orthodox approach of economists to monetary questions.¹ The ideals of sound money and a balanced budget and exchange rates fixed in terms of an incorruptible standard, gold, dominated the early development and spread of industrial capitalism. The idea of inflation as a 'monetary phenomenon' that can be traced to an over-expansion of the money supply by governments, has long been a central tenet of liberal political economy and conservative statesmanship. The significance of the restatement of this doctrine now, lies not in its efficiency as a technical device but in its implications for policy in other fields, particularly the management of demand and the public sector. As a technical device monetarism is merely one further instrument that can and has been added to the armoury of governments seeking to keep the confidence of the financial markets and external creditors. As the most recent Labour Government showed, monetarism, in the sense of firm monetary guidelines and control of public expenditure through cash limits, is quite compatible with incomes policies, price controls, industrial strategies, and all the other interventionist paraphernalia. The conversion of all governments to monetarist ideas is a concession that was forced on them in order to maintain the confidence of the international financial markets. The price of continuing to fund the public sector borrowing requirement and maintain external confidence in the currency was that governments had to reduce the domestic rate of inflation by restricting the money supply, announcing monetary targets and holding back the growth

implications as to how governments should attempt to manage the economy.

For economic liberals, however, monetarism is not simply a means for easing the management problems of interventionist governments, but the only central obligation laid upon government in economic policy. The link between an expanding public sector and inflation is constantly stressed—inflation being regarded as a tax that is constantly redistributing income to the advantage of the state, and therefore one of the chief sources of finance for the government, whilst at the same time it destroys savings, enterprise and investment (although it greatly boosts speculation). At the root of this position is the notion that only in exceptional and highly temporary circumstances (some economic liberals think the 1930s was one) can unemployment be reduced by an expansion of demand that is initiated by central government and does not make the prospects for unemployment worse in the long run. If governments cannot reduce unemployment by tolerating a slightly higher rate of inflation, then commitment to expansionary demand policies undermines prosperity both by distorting the pattern of demand (stopping firms going bankrupt that otherwise would), and facilitating a constant transfer of resources and employment into the public sector.

Keynes's benevolent tolerance of inflation as a lesser evil than unemployment is what economic liberals so bitterly attack now, because they regard any acceptance of inflationary policies as undermining the basis of the market order. When Keynes argues that 'Inflation is unjust and Deflation is expedient. Of the two perhaps Deflation is the worse; because it is worse in an impoverished world to provoke unemployment rather than to disappoint the rentier', or again that 'the right remedy for the trade cycle is not to be found in abolishing booms and thus keeping us permanently in a semi-slump; but in abolishing slumps and thus keeping us permanently in a quasi boom', he was making practical suggestions as to how governments could mitigate the impact of the Depression by using their control of the already vast state sector to manipulate the level of demand in the economy. Governments in many capitalist economies had long been interventionist, particularly in industrial and trade policy. Keynes, however, provided one of the first persuasive theoretical justifications for suspending the principles of orthodox finance, and so unwittingly provided a set of principles that underwrote the great inflationary boom of the 1950s and 1960s, which was certainly assisted, though not caused, by the relaxation of

controls on private credit and the remarkable expansion of public sectors everywhere.

If the government's monetary policies are sound, then one major check to the encroachment of the public sector onto the private and to the undermining of thrift, industry and enterprise has been established. It relieves government of its responsibility for expansion and prosperity, but it does not relieve it of its obligation to make markets function as they should, nor does it rule out specific government expenditures or interventions in the private sector. The whole tradition of liberal political economy has insisted that governments have a duty to undertake the provision of 'public goods', defence being the case that is always cited. Aside from these, the presumption is that the market will normally supply goods at much lower cost than the state, and should be preferred. This argument turns on the notion of competition and the contrast between the 'imperfect' market and the 'imperfect' state—the imperfections of the state being so much greater because it has monopoly powers. John Jewkes expresses this standard liberal idea:²¹

the efforts ... of governments to manipulate or 'restructure' a system as subtle and complex as competitive private industry are as likely to fail as would the efforts of a group of curious and playful children to repair a modern chronometer.

The industrial policy that would accompany sound money would therefore require drastic restrictions on all state economic activities, whether investment and regional subsidies, or help for mergers. It is typical of this approach that most economic liberals would think it more important to introduce competition into the nationalized industries by decentralizing them and ending their legal monopoly and accountability to ministers, than by handing them back to private owners.²² It also follows that the government's chief role in preserving competition is to ensure freedom of entry into all industries and this necessarily involves a basic commitment to free trade, particularly in view of the growth of world trade and the increased interpenetration of capital and national economies over the last thirty years.

An emphasis on free competition and freedom from state interference is often regarded as a cardinal belief of shopkeepers and small manufacturers, and generates demands for the control and dispersal of private monopolies. Social market literature, however,

at least in Britain and America, sees no need to present its proposals as the demands of an oppressed petit bourgeoisie or even of consumers. Corporate capital is explicitly vindicated. ICI is as respectable an economic individual as the next man and entitled to the same consideration, freedom, and rights. As Hayek says with his usual clarity:"

The most conspicuous gap in the following survey is probably the omission of any systematic discussion of enterprise monopoly. The subject was excluded after careful consideration mainly because it seemed not to possess the importance commonly attached to it. For liberals anti-monopoly policy has usually been the main object of their reformatory zeal. I believe I have myself in the past used the tactical argument that we cannot hope to curb the coercive powers of labour unions unless we at the same time attack enterprise monopoly. I have, however, become convinced that it would be disingenuous to represent the existing monopolies in the field of labour and those in the field of enterprise as being of the same kind ... I have become increasingly sceptical ... about the beneficial character of any discretionary action of government against particular monopolies, and I am seriously alarmed at the arbitrary nature of all policy aimed at limiting the size of individual enterprises.

After inflation and anarchy the main threat to the foundations of the market order is seen as the privileges and organizations of trade unions. The legitimacy which is accorded to corporate capital is not extended to the unions. This might seem odd since most theories that justify corporate capitalism also regard trade unions as a necessary adjunct for the efficient planning and integration of the labour force. British and American social market theorists do not take this view because they regard monopoly powers of unions in the labour markets as the principal reason for growing government regulation of the economy and lax monetary policy. This is because trade unions 'distort' relative prices in the labour market, making many activities unprofitable that would otherwise be profitable, so creating unemployment; and they impede the introduction of new technology, so reducing mobility and freezing the pattern of employment whilst the pattern of demand is shifting. The economy performs less well than it should, and governments under pressure to retain and win votes intervene in private industry to try to make it more efficient, and expand demand to reduce unemployment. This creates inflation which keeps the economy prosperous for a

while but at the expense of making the final crash and the scale of reorganization more extensive.²⁴ What is particularly irksome for economic liberals about the existence of trade unions is that they cannot discover any economic role for them at all. They are one of those unfortunate natural events like the Sahara Desert. Hayek grants that unions have social functions and assist in simplifying the bargaining process in large organizations, and thinks they perform a most valuable service as friendly societies, when they insure their members against illness and unemployment. But the idea that the unions have had anything to do with the permanent raising of absolute wages is vigorously resisted. They can only introduce artificial rigidities into the setting of relative wages, so pricing some non-unionists out of work and preventing the most rapid adjustment of the economy to new technology.

The basis of union power is seen as private coercion, the interference with the individual liberty of workers and employers. Enoch Powell argued in 1968²⁵ that union power rested on three legal privileges; the freedom to intimidate (i.e., picketing); the freedom to impose costs with impunity; and the immunity of trade unions from actions of tort. Withdrawal of these three privileges would certainly revolutionize the workings of the labour market; it would certainly keep the courts busy and, if successful, it would change decisively the balance of forces between the classes in production itself. In Marxist terms it would restore the full operation of the industrial reserve army of labour. The perennial problem of labour supply in capitalist social formations—the right labour, in the right quantity, at the right price, would be alleviated.

In its attitude towards trade unions the political character of social market doctrine becomes clear. This is corporate liberalism, but a corporate liberalism which in a period of recession chafes under the extra burdens which trade unions and interventionist bureaucracies impose on their operations. Social democracy could be afforded in times of expansion; in a period of recession it suddenly becomes costly. If the economy is to remain free the state has to become strong; and nowhere stronger than in its dealings with organized labour. The unions are excused direct responsibility for inflation (since wage rises can only cause inflation if the government allows the money supply to increase to finance higher prices). But they are made directly responsible for all other ills of the market economy—unemployment, stagnation, and disruption; and so the strongest measures can be justified against them as being in the 'public interest'. Social market doctrine offers intellectual

reasons to fortify the political onslaught on social democracy and its main organizational support, the trade unions.

4

The doctrine of the social market economy as it has been presented here can be seen to be a restatement and revival of some of the key themes of liberal political economy, which have tended to be buried with the ascendancy of Keynesianism and the increasing specialization of economics as a branch of mathematics. What the social market economy is not, is any simple reversion to the ideal of a competitive laissez-faire economy which acts as an ideological veil for the present problems of capital accumulation. The continuing strength and new relevance of liberal political economy has to be sought in the basic structure of capitalist social formations. It is not just a question of ideological beliefs but of the social practices on which they arise.²⁶

From this standpoint liberal political economy is the theory which treats capitalism primarily as a system of simple commodity production, what Marx termed the sphere of circulation or commodity exchange, 'a very Eden of the innate rights of man'. The problem of maintaining capitalism and improving its functioning is viewed almost entirely from the standpoint of how markets work. The market is viewed as the most efficient way of finding solutions to the problem of satisfying material needs because it searches out those methods of social co-operation that ensure maximum individual choice and minimum (measurable) costs. The key concerns of the social market doctrine are therefore with the basic conditions that make markets work—sound money, security of property, competition--and such is the commitment to the idea of individual exchange as a supreme value that all the problems of capitalism are ascribed to rigidities and inflexibilities in institutions and practices which prevent the market economy from working. One of the most notorious examples was the doctrine of the 1920s and 1930s that unemployment only existed because wage rates would not fall far enough. It is an idea that has been reborn today with Milton Friedman's doctrine of the natural rate of unemployment²⁷—a rate which is determined primarily by the degree of 'imperfection' in the labour market, which includes such incidentals as trade union organization, subsidized council housing, and social security benefits. Two liberal economists were able recently to conclude that the real wage necessary for full employment was now some way below the social security minimum.

The social market doctrine seeks to dispose of unemployment as a matter for political concern or government intervention, by putting the blame for unemployment on the failure of individuals and institutions to adapt themselves to the requirements of the market, whatever the cost in low wages and poverty, demoralization and uprooted communities, lost skills and lost purposes. As Keith Joseph recently told workers on Clydeside faced with redundancy-100,000 workers change jobs in Britain every week, and you may have to do the same. With more than 15 million unemployed in the major capitalist states this doctrine serves to reconcile governments and electorates to permanent high levels of unemployment.

The power of the social market economy, therefore, is not that it revives an ancient ideology, but that it restores a way of looking at capitalism and its problems which has been pushed aside by other conceptions and by the political intervention of the working-class movement, but which has revived because of the continuing importance of the sphere of commodity exchange in the actual workings of capitalist economies. Indeed this sphere has not shrunk but expanded since the heyday of the so-called *laissez-faire* economy, as more and more areas of social life have been commercialized, i.e., brought within the sphere of exchange and made alienable. In a fully developed exchange economy, a *catallaxy* as Hayek prefers to call it,²⁸ everything has its price, and everyone is forced to become a merchant and live by buying and selling. A nation of self-acting commodities experience the truths of liberal political economy daily.

The grave defect, however, of liberal political economy lies in its handling of capital, in its failure to perceive how radically the structure of the market economy is transformed by first the emergence, and then the development of capital within it. To the logic of individual exchange is added the logic of capital accumulation. If simple commodity production were undisturbed and all men were merchants and independent producers the theory of the social market economy would accurately describe the economy that existed. But it is because it is possible for some of those independent producers and merchants to become capitalists, buying labour power, organizing production, and selling commodities to realize a surplus value, that imparts a quite different dynamic to the development of the market economy. Accumulation has to work through exchange, but it gives rise to a different order of problems and a different direction social development.

The first of these problems is class conflict between the two classes

of agents that, having bought and sold labour power in the market, now confront one another in production. This conflict of interest brings the creation of defensive organizations which break with individual choice and exchange in favour of the benefits from collective action and solidarity. In acting thus they seriously impair the free working of labour markets. Such organizations have at times been suppressed but more often allowed to become legal institutions as trade unions and political parties. Since for social market theorists labour power is a commodity just like any other ('the worker has only his productivity to sell' is a favourite aphorism) they need to recommend either repression of trade unions in order to recreate an atomized labour market or a programme of measures which will strip away the harmful effects of the concessions that have been made to working-class organizations in order to reduce and control class conflict. The problem is that the benefits of collective action and defence normally outweigh the benefits from greater individual market freedom and choice. As many of its warmest admirers have noted regretfully, the legitimacy of market institutions is difficult to secure, because the market is essentially amoral, directionless, and to some extent arbitrary in the way in which it distributes income and wealth, rewarding luck and status as much as skill and effort. The older thorough-going petit-bourgeois moral justification for capitalism, which Thatcher regularly trumpets forth, is that reward is related to effort and skill. But such a crude notion has long been discarded by Hayek and the other advanced thinkers of liberal political economy." They argue that it is fruitless to seek either merit or fairness in the pattern of market outcomes. Attempts to establish either lead to grave distortions of the market order. The way in which society develops means that unfair and unmerited opportunities and rewards are constantly being created. The sophisticated message of these theorists is that the amoral outcomes of the market should be accepted by everyone as legitimate because of the general benefits everyone receives from a maximizing of opportunities for individual exchange and choice. This notion has not proved a great popular success as yet, and has certainly either been misunderstood or ignored by those who write speeches for the Conservative Leader.

It points to a permanent weakness in the populist ideology of self-help, because only a minority can ever help themselves to the abundance the ideology promises. If the best hopes of Hayek were realized, and the legitimacy of capitalism were to be founded no longer on the traditional authority of Church and State or on

populist ideologies of Race, Religion, or Empire, but squarely on the market order, then at the very least a capitalism of some abundance would be required, so that the vast majority of the population without property, without inheritance, and without luck, would at least derive some tangible benefit, and give thanks to the great international capitalist catallaxy which rules their lives. Such abundance is hard to guarantee due to the second set of problems which capital accumulation poses for the market order—the profitability of its enterprises. Since the driving purpose of production is no longer consumption but accumulation, profits assume great importance and at the same time appear highly precarious, a quality which increases as the scale of capitalist production expands. As a result capitalist development has been punctuated by severe crises, instabilities and depressions. The relentless search for new sources of profit has brought constant reorganization of its productive base, leading to increasing concentration and centralization of capital, rapid technological innovation, the gradual expulsion of living labour from the production process, and the establishment of a world division of labour.

So massive has been this development of social production and so radical its transformation of social institutions that it required the growth of public responsibilities and new state agencies in many fields. The social market theorists are mostly blind to this rather obvious fact. Milton Friedman ascribes the steady growth of public spending from 1906 onwards to a misplaced charitable intent. "Politicians and intellectuals wanted to do good to improve society, but they chose a method which was ultimately destructive of their intentions. According to Friedman the eleventh commandment should read 'everyone shall be free to do good at his own expense'. This would solve the problem of the growth of the state. Such extreme political naivety arises from a theoretical system in which the problems of capital accumulation for the organization of industrial societies do not appear, so the material basis for state intervention is generally not glimpsed. It is ascribed simply to political 'will' and mistaken ideas. This imposes severe limitation on the theory, because it means it contains no means for thinking through some of the most important problems confronting capitalist societies and their governments.³¹

One implication of the analysis in this essay is that the real test of the seriousness of a social market strategy in Britain does not lie in policies it prescribes for money supply, taxation and public expenditure, which only amount to an orthodox deflationary policy,

but in the readiness to tackle the main obstacle to the realization of a social market economy—the organized working class.³² Without measures to radically reduce trade union 'monopoly' powers, the success of a monetarist policy might be seriously hampered through the creation of a level of unemployment and rate of growth that would be hard to tolerate politically or electorally. One of the structural features of the political market which social market theorists often overlook, is that the great majority of electors are not capitalists and savers but workers and consumers. The achievement of prosperity has become something that is expected from government policies, not something that is the responsibility of each individual. Deflation if pursued for long enough may make money sound again and halt the encroachments of the state, but it will not bring prosperity unless the free functioning of the labour market is restored. The only alternative (the one U-turn this present Conservative Government might contemplate, despite doctrinal scruples and EEC opposition) would be to introduce the kind of import controls urged by the Cambridge Economic Policy Group, the one technical policy for managing the British economy which seems to have any chance of rescuing it from heavy and continuing deflation and stagnation to protect the balance of payments and keep control of the money supply for as long as the current recession lasts.

Social market doctrine encourages passivity and resignation by policy makers faced by stagnation and recession. Talk is already being heard of the 'libertarian' advantages of cuts in taxes and public expenditure, regardless of whether they succeed in stimulating expansion. Whether such policies can be maintained depends on whether the populist scapegoating of trade unionists, immigrants and welfare claimants, can retain sufficient political and electoral support, and further intimidate and demoralize the labour movement, so weakening its political opposition.

5

The argument presented here is that the social market economy must be distinguished from the populist presentation of some of its key themes in order to understand the driving force it has imparted to the intellectual revival on the right. It is its material basis as the theory of the sphere of commodity exchange that gives it its range and allows it to dominate so much of the intellectual assessment of the modern state and to prescribe policies for the recession that are rapidly becoming orthodoxy.

On the left the same clarity and fundamental rethinking has not occurred. The alliance between the state and the labour movement during the war created the political basis for the social democratic Keynesian consensus and the belief in the efficiency, desirability, and justice of state action. This consensus maintained a remarkable social peace through the long boom, but now that the problems of managing capitalism loom so large it is visibly failing. The revival of the perspective of liberal political economy is one response, and is proving extremely powerful, reinforced as it is by its easy translation into the themes of populism where all economic ills are seen both as the result of an overbearing and inefficient state, *and* as the work of ill-intentioned, subversive minorities who disturb order and threaten security.

The major response to this within the British labour movement has been the alternative economic strategy, a reaffirmation of the old collectivist faith of social democracy—the preference for solutions that involve greater centralization, more public ownership and more public expenditure, all of which entail the strengthening of parts of the existing state. The fight is for a socialist incomes policy, a socialist National Enterprise Board, and socialist import controls. The extension and strengthening of the state that was achieved by social democracy and Keynesianism is regarded as part of the conquests of the labour movement, to be defended against attack and to be used as the base from which to make the next advance.

Another response starts from the ideological and political weakness of the left and seeks to recreate the oppositional and independent role of socialists and the labour movement within capitalist society. It asks why the best efforts of socialists should go towards strengthening the existing agencies of the state or to extending their powers. This response is often criticized because it appears to accept much of the case for the social market economy, at least where the attitude to collectivism and state interference is concerned. It covers both the defensive celebration of the pluralism of the free market, on the grounds that free collective bargaining best preserves the ability of working-class organizations to defend working-class interests, and the currently strong revival of interest in guild socialism, industrial democracy, and co-operatives in housing, industry and education—attempts to create new socialist communities and experiments, using the freedoms a market order provides.

These two principal responses on the left to the current recession and the political challenge from the right both attempt to mark out an independent socialist line based on a class standpoint, one in

terms of policies, the other in terms of institutions, but they are often too easily contained within the universe of thought and practice they seek to challenge. One reason why the social market doctrine is proving such a successful catalyst for populist ideologies on the right is that it goes back to fundamentals. Since exchange and the market do provide a basis upon which all social relations in capitalist society can be grasped and evaluated, social market doctrine has a universal reach, constantly suggesting ways of approaching and solving practical problems. If the right currently enjoys the advantage in arguments about how to cope with the recession, it is partly because of the skilful populist translation of its key themes into grievances about taxes, strikes, and bureaucracies, but it also because the social market doctrine goes deeper than the instrumental and managerial approach of Keynesianism, and restates the case for capitalism in its most fundamental and strongest form—as a market order which maximizes individual freedom and choice.

It is the case which Marx set out and analysed at length in the *Grundrisse* and in *Capital*, because he believed it was necessary to base socialist politics and socialist strategy upon a critique of it. He wanted to go beyond either a 'socialist political economy' or a 'socialist market economy' by providing instead a socialist critique of the assumptions on which liberal political economy was based, in order to assist the practical efforts of the working-class movement in transforming the social relations of a class society. It is this critique which needs reviving again today, now that fundamentals are once again at stake. It emphasizes the sphere of production relations and the labour process as the starting point for criticizing the bourgeois ideal of the market—the individual calculation and pursuit of self-interest, and the accommodation and adjustment of interests through competition—as the model of all social relations.

Fundamentalism, in the sense of a dogmatic adherence to the writings and precepts of past thinkers, is always sterile, but fundamentalism, in the sense of a rediscovery and rethinking of the essential positions of a political movement, is a necessity if its independence and vigour are to continue. In the present period technical and managerial doctrines will not by themselves provide the basis upon which socialists can win back the initiative in arguments and struggles, and develop a coherent strategy for socialist transformation. To do this it is not sufficient to know which institutions and policies have to be defended, but also which features of capitalist social relations have to be changed for a socialist society to come into existence. How, for example, does socialist theory cope

with the three oppositions which lie at the heart of the social market doctrine: democracy/liberty; bureaucracy/law; planning/freedom? Can any set of social relations other than the market limit bureaucracy and state power? Must the basic forms of exchange relations, such as money, law, and the commodity be eventually superseded if a stage of social development is to be realized which does not reproduce the social relations and individual experience of a market order? Social market doctrine urges the furthest possible extension of alienated relations of commodity exchange and, through them, the rule of capital. Socialists can regain their intellectual conviction and confidence if they confront the arguments for the social market economy by restating and rethinking the basic premises on which the intellectual and practical case for socialism has been and must continue to be based.³³

NOTES

1. Typical products of the right-wing upsurge are recent collections such as P. Cormack (ed.), *Right Turn*, London, 1978; and *The Coming Confrontation*, (IEA) London, 1978. The contributors range from Paul Johnson to Julius Gould, Reg Prentice, and the Duke of Edinburgh. They mostly see themselves as engaged on a crusade against evil doctrines and vested interests.
2. I have examined in greater detail the changing Conservative Party in two recent essays: 'The Conservative Party', in H.M. Drucker (ed.) *Multi-Party Britain*, London, 1979; and 'Conservative Economic Policy' in Z. Layton-Henry (ed.) *Conservative Party Politics*, London, 1979.
3. They are surveyed by C. J. Friedrich, 'The Political Ideas of Neo-Liberalism', *American Political Science Review*, 49 (1955), pp. 509-25.
4. The IEA was founded in 1957 and has produced a constant stream of pamphlets (over 250 publications). It recruits its writers mainly from academic economists. The Centre for Policy Studies was founded by Keith Joseph and Margaret Thatcher, in 1974 and has produced a number of pamphlets, including the keynote, *Why Britain Needs a Social Market Economy*, London, 1975. It has also published collections of the speeches of its two founders as well as a range of pamphlets the intellectual level of which has been variable.
5. Apart from their journalism they have all written more extended studies, especially Brittan, who has written pamphlets for both the IEA and the CPS. See also his recent and important book, *The Economic Consequences of Democracy*, London, 1977.
6. Cf. Stuart Hall *et al.*, *Policing the Crisis*, London, 1978.
7. See, for instance, S. Brittan, *Government and the Market Economy*, IEA, London, 1971 and *Participation Without Politics*, IEA, London, 1975.

8. Rustow, one of the German neo-liberals set forth his ideas under the engaging slogan 'Freie Wirtschaft—Starker Staat' (free economy, strong state). See Friedrich, *op. cit.*
9. See the onslaught contained for example in T. Russel, *The Tory Party*, Harmondsworth, 1978. Russel, a former Labour Party member is an active member of the Tory Reform Group.
10. *The Road to Serfdom* (London, 1944) is rather a slight work, although the best known of all Hayek's writings. Much more important are his later writings, particularly *The Constitution of Liberty*, London, 1960; *Law, Legislation, and Liberty* (3 volumes), London, 1973; and *Studies in Philosophy, Politics, and Economics*, London, 1967.
11. Hayek, *The Constitution of Liberty*, p. 11. This notion of coercion is absolutely vital to liberal theory and it leads to the notion of the state enjoying a monopoly of legitimate force, a notion that is often incorporated uncritically into Marxist theories of the state. The error of this conception is brilliantly demonstrated by Q. Rudland in *The Capitalist State as History and Logic*, mimeo, Sheffield, 1979.
12. Moreau's assessment of Norman was as follows: 'In his view politicians and political institutions are in no fit state to direct with the necessary competence and continuity this task of organisation (economic and financial organisation of the world) which he would like to see undertaken by central banks, independent at once of governments and of private finance', quoted by A. Boyle, *Montagu Norman*, London, 1967, p. 205
13. They make loyalty tests and the *Berufsverbot* much easier to impose.
14. R. Moss, *The Collapse of Democracy*, London, 1975.
15. M. Friedman, 'The Line We Dare Not Cross', *Encounter*, November 1976. See also G. Tullock, *The Vote Motive*, IEA, London, 1976.
16. A brief perusal of the social market literature will reveal how profound is the distrust of these writers of the state. The IEA has taken to translating the term 'state' as politicians and bureaucrats, to strip away from it the aura of omniscience and omnipotence and reveal the fallible agents that the term conceals. They have not yet shown the same readiness to translate their own idol 'the market' as entrepreneurs and lawyers. That would be consistent, for these are the agents that liberal political economy regards as essential for upholding the market order.
17. Keith Joseph, *Conditions Fuller Employment*, CPS, 1978, p. 20.
18. See, for example, A. Walters, *Economists and the British Economy*, IEA, London, 1978. The bitterness of liberal economists against Keynesian economists is extraordinary. Cf. W. R. Hutt, *Politically Impossible?*, London, 1971.
19. See, for example, 'F. Congdon, *Monetarism*, CPS, 1978, and W. Rees-Mogg, *Democracy and the Value of Money*, IEA, 1977.
20. J. M. Keynes, *The General Theory of Interest, Employment, and Money*. London, 1973, p. 322.
21. J. Jewkes, *Delusions of Dominance*, IEA, 1977. See also the Centre for Policy Studies series on government intervention, 'The Way the Money Goes'.

22. Cf. S. Brittan, *Government and the Market Economy*.
23. Hayek, *The Constitution of Liberty*, p. 264. This represents a considerable shift from the position he adopted in *The Road to Serfdom*.
24. Hayek's views on inflation and the consequences of Keynesianism are usefully collected in *A Tiger by the Tail*, IEA, 1972. See also his Nobel Lecture, *Full Employment at any Price?*, IEA, 1975.
25. J. E. Powell, *Freedom and Reality*, London, 1969, ch. 10. When Powell first emerged as an exponent of economic liberalism he was dismissed as a crank and widely derided. But he pioneered the analysis which has now become orthodox.
26. This is not the same, however, as arguing that the idea of the social market economy must be attributed to this or that fraction of capital. I regard the evidence for this as slim and the underlying argument unsound.
27. For an exposition of it see Friedman's Nobel lecture, *Inflation and Employment*, IEA, 1977; and S. Brittan, *Second Thoughts on Full Employment Policy*, CPS, 1975.
28. See Hayek, *The Confusion of Language in Political Thought*, IEA, 1968.
29. See, in particular, Hayek, *Law, Legislation, and Liberty*, vol. 2 and S. Brittan & P. Lilley, *The Delusions of Incomes Policy*, London, 1976.
30. Friedman, 'The Line We Dare Not Cross', *op. cit.*
31. A very different way of looking at capitalism comes from those who analyse capitalism as a system of production rather than as a system of markets. W. W. Rostow's *The World Economy*, London, 1978, is an example of the former approach which assigns a very small role to monetary factors. Rostow, whose own allegiance to capitalism is hardly in question, argues that the present recession will only be overcome and capitalism placed on a stable basis again if there is a further massive extension of state powers and investment, particularly in the energy field.
32. This is of course recognized and the necessary measures fully discussed. See, for example, K. Joseph, *Solving the Union Problem is the Key to Britain's Recovery*, CPS, 1979; and S. Brittan, *The Economic Consequences of Democracy*, ch. 19. One of the most drastic suggestions is for the creation of a professional specialized strike-breaking force, a kind of permanent 01\4S which would be available to man essential installations in the event of strikes, and would presumably allow lockouts to be threatened and implemented more easily in some sectors.
33. One recent major attempt to rethink socialist strategy, although from a different position from the one proposed here, is A. Cutler *et al*, *Marx's Capital and Capitalism Today*, London, 1977.