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Regulated miracle: Germany's post-war economic recovery is attributed in no small part to Ludwig Erhard and his influence on the social market economy. As Minister for the Economy, Erhard helped to pass legislation which promoted competition and increased social equality. Here, Erhard visits the Friedrich der Große coal mine in Herne in 1965 as Federal Chancellor, together with North Rhine-Westphalia's Minister President Franz Meyers.



PHOTO: PICTUREALLIANCE / DPA | HEINZ DUCKLAU

THE VALUE OF BUREAUCRACY

TEXT: CASPAR DOHMEN

Rules and laws have made the market economy the dominant economic system. They have not only facilitated the emergence of markets and innovations, but have also mitigated social hardships. At the Max Planck Institute for Legal History and Legal Theory in Frankfurt am Main, Jasper Kunstreich is researching how economics and the law interact. An insight from history: the law must always be adjusted in light of new developments.

Though public discourse would currently suggest otherwise, bureaucracy is at times the driving force within the market economy, especially when it comes to innovation. Without legal institutions and the enforcement of their authority by the state, capitalism cannot function. This applies, for example, to the protection of property or the enforcement of contracts, the establishment of courts, or the recognition of legal personality for companies. However, the views of conservatives, social democrats, and liberals differ as to whether government regulations outside of this scope promote economic activity. Perhaps economic history can provide some insight into how to achieve the right balance. This topic forms the focus of Jasper Kunstreich's research at the Max Planck Institute for Legal History and Legal Theory in Frankfurt am Main. He sees himself as a bridge-builder between law, economics, and history, noting that "formal education in these disciplines has very little in common, despite the fact that they all deal with the same subject matter." Kunstreich studied both economic history and law.

SUMMARY

A functioning bureaucracy is a necessary condition of economic growth. Legal measures that solve the problems of one era can later become problems themselves.

The state can facilitate innovation to a certain extent by allowing monopolies for limited periods. An example from economic history that illustrates this point is the development of bleaching processes for textiles. However, monopolies also hinder competition.

Social measures were not only intended to lift a great many people out of poverty, they also increased the acceptance of the market economy after the Second World War.

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At the present time, popular opinion suggests that the state and its regulations are generally detrimental to innovation and growth. The EU Commission and national governments such as Germany's are currently advocating for the reduction of bureaucracy. Their goal is to unlock growth through deregulation, such as in the Green Deal. But regardless of whether states opt for more or less regulation, "both approaches are connected with enacting the law," explains Kunstreich: "every act of deregulation is also a form of regulation."

The modern civil service bureaucracy, Kunstreich explains, emerged at the same time as the market economy. With the establishment of functioning bureaucracies in the second half of the 19th century, states such as Germany, France, and Britain achieved a key requirement for creating economic momentum. "The civil service bureaucracy ensured continuity in actions taken by the state. Ministerial bureaucracy existed independently of premiers and chancellors and had a longer planning horizon – not so long as the church, but longer than elected officials." Administrations set up committees to deal with specific topics over the longer term, enabling them to accumulate knowledge and develop ideas. "Today, we sometimes forget these bureaucratic achievements," says Kunstreich. One example of such an achievement is the standardization of the law governing negotiable instruments, which made payment transactions possible in the small states of the

German Confederation for the first time.

As early as the 17th and 18th centuries, European states were using the law to advance the economy. With their mercantilist economic policies, Prussia, France, and Britain aimed to achieve a positive trade balance – that is, an export surplus. In this way, they sought to grow the wealth of their nations, but above all, to increase government revenue in order to finance the military, among other things. In doing so, they also attempted to gain an advantage at the expense of other countries through customs duties. This put barriers on cross-border trade and increased the price of products for the domestic population. However, within the territories of states which were levying customs duties, this form of taxation proved to be a catalyst for economic development in some cases. Consequently, these duties are also referred to as protective tariffs, for example, in the textile industry or steel production. The first industrial enterprises also took advantage of privileges, special rights, which they hoped would



PHOTO: PUBLIC DOMAIN



Profit at any cost: industrialization was hardly subject to any regulation up until the 20th century. The consequences were exploitation and child labor, as depicted here in a cotton mill in the US state of Georgia in 1909.

chlorinated lime. Starting in 1800, these were systematically utilized in factories. However, building these factories required significant investment. In the early days of capitalism, entrepreneurs usually had to provide this investment themselves or turn to their family and friends for assistance; there was no functioning credit or capital market at that time. So, the investors were taking on considerable personal risk. Why should they do that, when they could simply use their wealth to enjoy a very comfortable life? It was an easier choice to make if the state mitigated the financial risk. This is precisely what rulers were doing when they gave one company per district exclusive rights to carry out an economic activity such as bleaching.

Over the long term, however, such monopolies inevitably came under criticism. From the perspective of Adam Smith, the Scottish father of modern economics, and other liberal economists, monopolies and cartels stifled economic momentum. Smith described this as a “conspiracy against the public.” Since then, much thought has been put into market regulation and fair competition. In spite of the fact that we now have functioning capital and credit markets, the state can still promote economic innovation in certain sectors, even within a modern capitalist framework. This principle enabled the expansion of renewable energy in Germany because the state reduced the risk taken on by plant operators by guaranteeing them purchase prices over a longer period of time. Likewise, there would be less basic research without the help of the state because it is uncertain from the outset whether a given research project will yield findings that can be utilized economically. But if the research bears fruit, everyone benefits. The rapid development and provision of a vaccine during the Covid-19 pandemic is a prime example of this. Consequently, Kunstreich does not view the state and market as antagonists. However, bureaucracies have also tended to become less dynamic and more inflexible over time.

grant them a partial monopoly, and they invested their capital solely on this basis. As far back as the Middle Ages, rulers had awarded certain concessions to individual subjects, which secured for these individuals a monopoly for a particular region, in which they could trade in salt or tobacco, transport mail, or organize overseas trade – in each case, free from competition.

Despite all the criticism of monopolies, today’s economic historians offer a more nuanced picture, says Kunstreich. In certain cases, monopolies performed the same function as patent protection. “Mercantilism likely facilitated the industrial revolution, because through corresponding concessions, the risk borne by certain individuals was reduced.” The researcher illustrates this point using the development of industrial bleaching. Traditionally, fabrics such as linen were spread out on the grass and kept moist, with bleaching left to the sun. This process could take weeks, even months in some cases. Then chemists discovered bleaching agents such as sulphuric acid, soda, and

Misguided Self-Regulation

It is also true that European countries were initially overwhelmed when industrialization, originating in Britain, began to take hold in the second half of the 18th century. Business owners paid starvation wages, made use of child labor, and mercilessly exploited their workers. The authorities let them do as they pleased. “It took half a century before states realized that they needed to intervene,” says Kunstreich. Only gradually did they change course, for example, through the creation →

of social insurance in the German Empire. However, up until the First World War, governments largely relied on economic self-regulation. Only afterwards, in the words of economic historian Werner Plumpe, did “an interventionist state with serious intentions” materialize. The policies of the Weimar Republic, for example, enabled the large-scale construction of affordable housing. This was achieved in part through measures like the property tax on older buildings, which funded the construction of new housing. Policy makers also promoted cooperatives and municipal housing associations, which built the majority of affordable housing. At the same time, legislation such as the Works Council Act laid the foundations of employee participation in company decision-making. And all this in spite of the economic crises and hyperinflation of the early 1920s. However, the late 1920s saw a global economic crisis with mass unemployment and deflation, which dealt the Weimar Republic a fatal blow. The National Socialists seized power and transformed the economy into a state-run war economy, from which monopolies and cartels profited. In this environment, competition largely came to a standstill.

within society. “Immediately after the war, the majority of the population were not in favor of a free market economy, which many people associated with the predatory capitalism and collapse of the social order at the end of the Weimar Republic,” says Kunstreich. This was true of both major political parties, the SPD (social democrat) and the CDU (conservative), which is evident when looking at the Ahlen Program adopted by the CDU in 1947, which stated: the capitalist economic system “had failed to serve the vital national and social interests of the German people;” what was needed was a new “socio-economic order.”

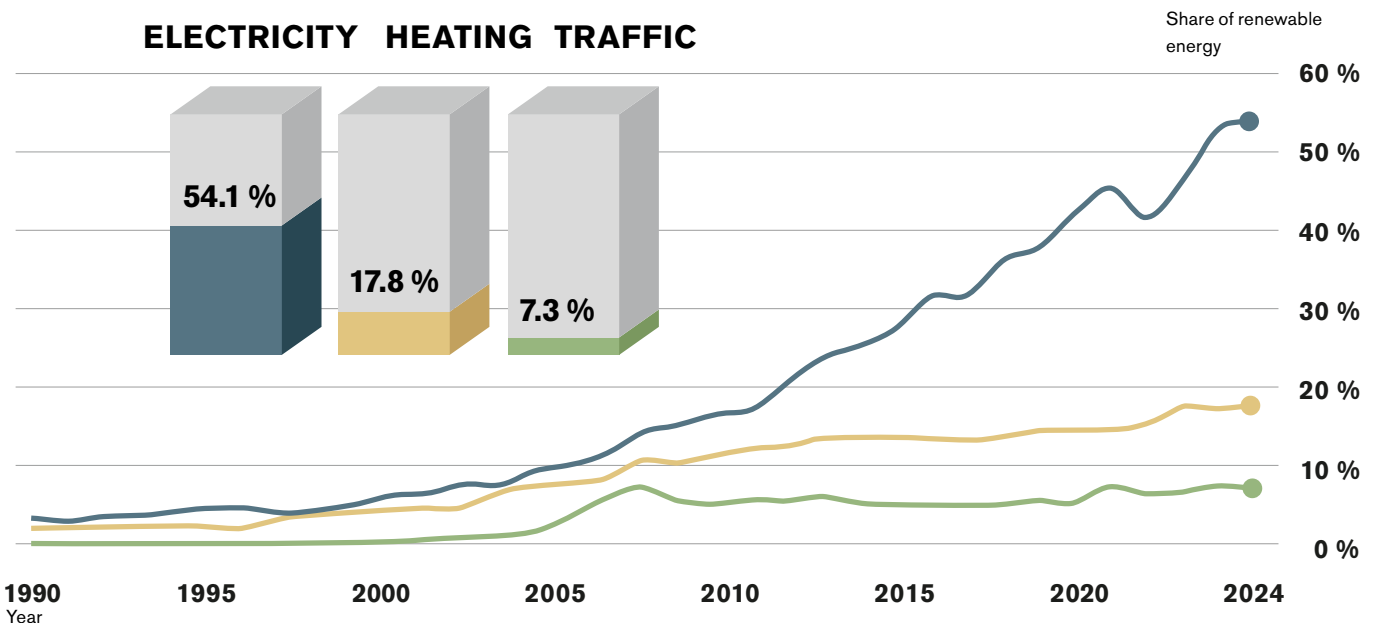
Choosing Competition

After the war, the building phase of the young Federal Republic of Germany was dominated by the economic miracle and social market economy. This was the name given to the “tamed” version of capitalism that West Germany (the FRG) opted for. In contrast, East Germany (the GDR) adopted a planned economy. The return of the young Federal Republic to a market economy after the Second World War was far from guaranteed, given the prevalence of market skepticism

The competitive economic order under a market economy in the young Federal Republic was ultimately enforced by the victorious US, which made this a condition for payment of reconstruction funds from the Marshall Plan. It also led to the dissolution of large cartels and corporations such as IG Farben, which in turn resulted in the creation of Bayer, Hoechst, and BASF, among others. At that time, the main proponents of a competitive economic order in Germany were representatives of the Freiburg School, founded in the early 1930s by economist Walter Eucken and two lawyers, Hans Großmann-Doerth and Franz Böhm, who later became a CDU member of the Bundestag. Their school of thought had a substantial influence on the regulation of the social market economy in West Germany, in particular antitrust legislation. Böhm sought to avoid cartels and monopolies through the renewed “empow-

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Inspired growth: Germany’s Renewable Energy Act made a substantial contribution to the fact that, in 2024, the share of renewable energy in electricity generation in Germany was already above 50 percent.



GRAPHIC: GGO BASED ON DATA FROM ARBEITSGRUPPE ERNEUERBARE-ENERGIEN-STATISTIK (AGEE-STAT); ACCURATE AS OF SEPTEMBER 2025

erment of the economy.” At the same time, he saw the state as having “the right and obligation to compel those in power to maintain an economically sound balance,” in other words, ensuring competition through policymaking. He was convinced that in 1923, the Weimar Republic had taken the correct course of action with its antitrust regulation, which was intended to stimulate competition and which placed “private-sector power structures” under state supervision. However, the government at that time repealed its decree and was “overcautious” and consequently “implemented inadequate instruments.” The lawyer, who championed legislation against restrictions on competition, wanted to help the young Federal Republic do better.

Conversely, the SPD’s Adolf Arndt, likewise an important instigator for the social market economy, believed that the ordoliberal approach could potentially have a detrimental effect on the economy. For him, the primary economic role of the state was the promotion of consumer welfare and innovation. “Many industries and corporations rejected the law against restrictions on competition,” says Kunstreich. During the Weimar Republic and under the Nazi dictatorship, they had benefited from their respective monopolies. Nevertheless, the government under Konrad Adenauer (CDU) was able to pass the legislation through the Bundestag in 1957. In fact, the CDU would soon adopt the US model of a market economy. The economy grew quickly and living conditions rapidly improved, so increasingly, “a positive attitude emerged among the West-German population toward market economy and competition,” says Kunstreich.

Making Legal Waves

The idea of competition was also decisive in the founding of the European Economic Community in 1957. “It began with the introduction of stringent antitrust legislation,” says Kunstreich. “German Lawyers had a considerable level of involvement in this. They contributed their experiences from the struggle for pro-competition legislation in Germany.” Here, Kunstreich stresses the importance of the underlying consensus in the participating European nations that market economy and competition had to be combined with social safeguards because, as with every economic change, there were ultimately winners and losers. In 1959, the SPD also came out in favor of the market economy with the publication of their Godesberg Program. “The period from the 1950s up to the 1970s was a time in which the social democratic welfare state prevailed in Europe, irrespective of whether social democrats or conservatives were in power,” explains Kunstreich.

The fact that this status quo was to change is linked to a phenomenon that Kunstreich characterizes as a “wave”: “The solutions of one era can become the prob-

lems of the next.” In the 1980s, the welfare state came under considerable pressure, and there was a clear focus on the market. This resulted in the liberalization of Europe’s capital markets. Restrictions on real estate loans were also lifted in the process, in order to make it easier for private individuals to borrow to finance



PHOTO: ST. JOHN'S COLLEGE OXFORD

Jasper Kunstreich searches through the history of economic legislation to find the right level of state regulation.

house building. This did indeed result in more people becoming homeowners. At the same time, a significant amount of money flowed into the real estate market due to the low low-interest-rate policy resulting from the Eurozone and sovereign debt crisis. Then came a new problem: property prices became so high that home ownership is now unaffordable for many. “This has given rise to perhaps the greatest social problem of our time, which is also prompting people to turn to right-wing populism,” explains Kunstreich.

Another current example is the treatment of international digital corporations. With regard to the digital sovereignty of Europe, there are concerns about the continent’s capacity to innovate. “We are currently experiencing a period of tremendous upheaval, in which Europe appears particularly vulnerable,” says Kunstreich. “In this situation, economic history can reconcile an understanding of legal culture with the conditions necessary for economic growth, to ensure that we are not constantly stuck in the same patterns of thinking.”



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