

Chapter 4

The Market, Market Failures, and Market Interventions



4.1 Competition as a Battle

Humans want to discover and dominate. Competition and innovation have always been the driving forces behind development. However, competition should not go so far as to lead to the destruction of mankind, whose preservation, obviously, is essential. In the days when individual tribes or clans fought, killed, or conquered each other, mankind was not endangered. Nor was its survival threatened when nations went to war. This changed with the introduction of nuclear weapons. We must hope that for the sake of our self-preservation, conflicts can be settled in a manner which does not compromise our survival¹ or destroy the foundations of life on this planet. Because humans are the only living creatures who can destroy themselves, it would, of course, be better if military conflicts could be avoided entirely. When going to war, we must be conscious of this.

Mankind must find a way to limit its urge to fight and engage in conflict to methods which are tolerable for everyone. This requires the rule of law as well as international norms, which are respected and can be enforced.

One aspect of conflict is competition. Economic warfare has replaced traditional warfare and satisfies the human need to fight and conquer. Considering the brutality of modern weapons, it is vital that mankind's propensity to fight and conquer be limited to economic conflict. Liberalism and international laws make this possible.

The readiness to fight when in competition stands in direct contrast to the human tendency towards lethargy or comfort. These characteristics contradict each other and are in constant conflict. Sometimes the desire to compete or fight prevails; sometimes the desire for comfort does.

¹When a clan that is currently in power perceives its downfall to be inevitable, there is the danger that out of malice it will drag others down with it to destroy them i.e. accepting or even striving for the downfall of mankind. For example, if the regime in North Korea were on the brink of collapse, it might well use the atomic bomb, causing the destruction of all mankind.

4.2 Optimizing Supply to Meet Demand

Every consumer has a purchasing power corresponding to his or her income. If consumers can use their funds freely, they buy what they consider to be the best; they receive the most for their money. Producers or suppliers, on the other hand, want to meet existing demands. If they are also free when designing their products and services, they will best be able to meet the demand. Theoretically an absolutely free market leads to the optimization of supply and demand and consequently to the greatest possible prosperity for society.

However, the market is in a state of flux. Products and service are continually being improved. Production, work, and leadership methods in companies also change, which in turn leads to an improvement or an optimization of the range of goods and services on supply. And finally, consumer needs change and with them the demand for products and services. Therefore, the optimal relationship between supply and demand is not a static parameter. Rather it is in a constant state of flux and must continually be adjusted. Products and services come, are improved, replaced by other products, or are pushed out of the market. Demand changes according to customer needs, their purchasing power, or simply according to trends.

The market steers not only supply and demand but also resources. Wherever products are successfully manufactured, the investment in labor and capital pay off. It is here that investors can allocate additional funds and employers can pay good salaries. The region can flourish. On the other hand, companies that fail to modernize run the risk of being overtaken by the competition causing a downward trend, which soon leads to an economic crisis.

4.3 Objective Market Failure

There is no such thing as an absolutely free market. The optimal business relationship between supplier and consumer is influenced by market interventions that are justified by *market failures*. We differentiate between objective market failure and subjective market failure. Objective market failure occurs when, for technical reasons, the market mechanisms do not allow the most favorable business climate. Subjective market failure, on the other hand, occurs when market mechanisms lead to a result that we do not want for political reasons because it doesn't meet our expectations of what we feel is "fair" or "right".

Objective market failure was at the root of the 2008 financial market crisis. The market mechanism in the capital and money markets was no longer leading to optimal results. The state intervened with guarantees, with aid to banks and with measures taken by the central bank. Market distortions are also caused by customs duties, difficult access to the labor market, quotas, or subsidies i.e. when the producer of a product or service benefits from government services and no longer has to bear the cost of producing alone. This includes basic research done by

universities, if this research not only serves the general public but individual businesses as well. Other points included in this category involve environmental restoration by the state if it involves correcting damage done during the production of a product. If the cost of restoration is not borne by the producer in keeping with a “polluter-pays” principle or corrected by banning environmentally hazardous substances, then the market will be distorted. Failing to do so yields profits that are not based on performance but on a supported market.

The state should intervene in the case of such market failures. These interventions are justified if they result in a better allocation of costs and lead to market restoration. Examples of such interventions include the Cartel Act, which largely prevents price agreements as well as legal guarantee regulations, regulations on product information, or general business conditions that diffuse asymmetrical information availability, which can lead to market distortions when one market participant knows more than the others.

However, interventions always impede absolute free trade, even in the case of objective market failure. The consumer pays for this through higher prices. Both their purchasing power and their prosperity decreases. If, due to market regulations (for example, those for environmental protection), the most suitable producer no longer manufactures products in the cheapest region, competitiveness suffers which, in turn, reduces the purchasing power of the consumer.

4.4 Subjective Market Corrections

There are diverse *subjective* reasons for implementing the many price-increasing measures that affect the cheapest products. Often the results of the free market are deemed unfair and not politically acceptable. Such market interventions are based on a consideration of interests. The overarching interest in a functioning free market and the resulting maximum possible prosperity is weighed against the specific interest that serves as the basis for the market intervention.

Numerous interests justify such market interventions. We know that the free market leads to injustices that must be remedied. For this reason, the imposition of actions within the *social sector* to protect the welfare of the poor, the weak, and minorities is justified.

Other market interventions are implemented because people prefer convenience, reject efforts to change, and look for opportunities to gain advantages outside of competition. They try to regulate the market for their own benefit. This type of market intervention is increasing dramatically. When they occur, *we must remain aware that every market intervention will lead to a decrease in prosperity that will have to be paid for by everyone.* Well-developed countries in particular tend to lean towards regulation during economic booms by carelessly weighting other values and restricting the freedom of trade and industry. They argue that things are going well and they can afford to do so. This has resulted in the creation of labor laws, tenancy rights, planning rights, building and industry norms, tariff regulations, laws

governing shop opening times, and other such laws as well as agricultural regulations and much more. They all have the potential to raise prices.

There are organizations that wish to support the privileges of their members outside the realm of competition. In most cases, these organizations do not contribute to prosperity for everyone. On the contrary, they influence the distribution of funds outside of market mechanisms by giving their members more than they have earned. This is always to the detriment of others and ultimately to the detriment of the general level of prosperity. Trade unions in different European countries provide a striking example of this. With their shows of force (strikes, blocking traffic, etc.) they thwart all attempts to reduce the privileges of their members. However, if labor laws are too rigid, the economy becomes rigid as well and won't be able to adapt its structures to new market conditions. Departments which are no longer profitable cannot be closed due to laws protecting workers from dismissal and new, future-oriented activities will not be sufficiently fostered out of fear of being trapped in this new structure later. The prosperity of the entire country suffers—and ultimately the prosperity of unionized workers as well.

Eastern Europe during the communist era provides another noteworthy example. The planned economy, combined with the privileges granted to bureaucrats, led to a rigid societal system that could not be restructured. The economy stayed around the same level that prevailed after World War II. Differences between East and West became increasingly larger until the system collapsed. Now, with tremendous effort these countries are making up for lost opportunities.

There are also organizations that defend the privileges of their members at the expense of the economy as a whole. Lawmakers have recognized cartels as being an obstacle to competition and have limited them in the interest of the national economy. Other interest groups such as industry and professional associations or labor unions are tolerated. These organizations seek to gain advantages for their members outside of the competitive arena by influencing political institutions.

Finally, various European countries support maintaining structures in individual sectors (for example, agriculture). The following is true of all organizations that wish to maintain the status quo: the more a country is affected by organizations intent on preserving a given structure, the less a country is able to adapt existing structures to new conditions and the more likely the country will fall behind in its ability to stay competitive. In older, more stable economies, there is a danger of developing an increasing number of such organizations and an increasing number of rules and regulations, thereby losing the initial dynamic which led to success. Countries which have enjoyed long-term stable conditions are particularly at risk of losing their powers of renewal.

It bears repeating: any type of market intervention leads to a higher level of prices (initially unnoticeable). *The sum of market interventions is reflected in the general level of prices and determines the standard of living in an economy.* The opportunity provided by change is limited by the degree of regulation within a society. Whether or not an economy can maintain or even increase its powers of renewal and its prosperity can be seen in the density of its rules and regulations. The more highly

regulated a region is, the more prices will rise and the further the level of prosperity will fall.

Government is repeatedly tempted to intervene in order to preserve structures. The results are always the same: Protection leads to a short-term reprieve, which allows those affected to relax. Meanwhile the difference to unprotected competing companies in other countries or in other regions continues to grow. The burden on the government will become too expensive and the protective measures removed. The affected industry has to try to make up for missed opportunity and may even go under. Catching up will require a great deal of effort and there will be casualties.

4.5 Outdated Value Systems

There are dreamers who hold on to previous value systems although they have not stood the test of time and have long since become obsolete. Religious value systems are outdated even if the clergy in most religions continue to defend their authority. Some leftists still dream of socialism; their ideas appear periodically on the political surface when they speak of “overcoming capitalism”. They cite injustices in their argumentation and demand equality without realizing the inequality socialism has created all over the world. Often these politicians are driven by envy or they are pursuing their own political careers. Yet the centralized socialist state has long since been replaced by a free market system.

200 years ago, the German philosopher Hegel,² in his description of dialectics, noted how value systems develop. A political thesis is juxtaposed with an antithesis. From this, a synthesis emerges as a compromise. This, in turn, becomes a thesis as soon as it is juxtaposed with an antithesis creating a new synthesis and so on. The development of value systems proceeds in steps moving forward; never backwards. Similarly, evolution leads to new mutations, which as a rule are better suited to life than previous ones. Evolution never returns to previous forms.

So, when searching for the way into the future and for the value system of that future, we have to start with the present system and check which antithesis is emerging. Will the information age or data age follow the free market system? Or will it be the age of robots and artificial intelligence? And what is the synthesis of these?

Do we want to *return to socialism*? The word “return” already suggests that it would be a step backwards. Socialism has failed too often. Failed economic systems all over the world (e.g. the Soviet Union, Venezuela, Cuba, the German Democratic Republic) testify to this. There is not one single example of a socialist system that was successful and led to more equity. Of course, it is within the rights of every individual and it is a consequence of the freedom of opinion that every person be

²Georg Wilhelm Friedrich Hegel (1770–1831).

allowed to hold onto old systems. However, the intellectual left's infatuation with yesterday's failed value systems does nothing to advance humanity.

Competition has always spurred us on to greater performance. Why then does socialism still enjoy a certain amount of popularity—especially among young intellectuals? Often these people have come to a theoretical conclusion (i.e. intellectual): they emotionally associate profit maximization with the oppression of the weak, whereas in their eyes socialism emphasizes social issues and justice. They therefore reason that socialism is better. They are not willing or are not mature enough to examine the evidence neutrally. Instead, they highlight facts that support their point of view but ignore or even suppress evidence that proves the opposite. Meanwhile, they continue to benefit from the prosperity that the free market economy brought them. In other words, their behavior contradicts their beliefs.

Our perceptions are rarely based on rational evidence. They are influenced by our human network—by the value system of the people around us. Individuals tend to conform to the value system of the group to which they belong and adopt its preferences. This is true for everything from the type of music preferred by social cliques in schools to the type of clothing or food that expresses social identity, to the anti-vaccination stance, which is often religiously influenced, and on up to socialism. Surprisingly, these value systems are sometimes used to justify and support social injustices. However, they do not promote truth.

The truth about a market economy can only be established if we analyze the system without pre-conceived values or prejudices, thereby understanding it and its advantages and disadvantages without being influenced by the environment and the value system we live in.

The free market economy has brought us a degree of wealth never before seen in history. Europeans have already developed this system further. Enormous redistribution mechanisms mean that hardly anyone has to make an effort to live in dignity. The original form of capitalism has become a social market economy. The welfare state seems to have found broad recognition in all European countries. Its existence no longer relies on a political party—the social democrats. Rather it is supported by all parties and a broad section of the population. In this regard, there are no longer left-wing or right-wing parties. Instead, political debates revolve around the degree of government involvement. Should there be “more government or less government”? No other form of government has brought society a higher level of satisfaction than the welfare state. This is one of the reasons that social democratic parties are shrinking—their goals have been realized and the political party is no longer needed. However, satisfaction also brings lethargy. Therefore, we have to continue working on the concept of the free market economy—even if it means tedious discussions with leftist intellectuals.

4.6 Globalization

The liberal value system combined with the market economy requires an international network—i.e. globalization. It enlarges the market area, promotes competition, and helps consumers purchase better products at lower prices. In turn, it also gives innovative market players greater opportunities improving everyone's level of prosperity. International competition—globalization—helps all participating regions. Prosperity increases internationally.

One aspect of globalization is not given enough emphasis: when nations compete with each other economically and win or lose with different products and services, they are engaged in an economic conflict, which largely replaces military conflict, making war less likely. Global economic conflict is replacing warlike conflict and is preventing war among economically progressive nations. Countries that are doing well do not wage war. They stand to lose too much and risk putting their national prosperity in danger. However, this requires that autocrats do not try to change the rules of the game or try to provoke foreign policy tensions for their own national political reasons. This is also why democracies are necessary for peace in prosperity.

4.7 Losers as Prey for Autocrats

Globalization also has its losers. In most cases, more successful companies will replace those that have lagged behind. Prosperity is maintained or even increased. However, social safety nets are needed wherever people are negatively affected by change, so that they can receive the necessary help to be reintegrated into the labor market. Most European countries do a great deal in this respect.

For lack of alternatives, those who lose at globalization or in our meritocracy fall back into old value systems—such as nationalism or into structures based in religion. They long for an autocratic system because they believe they will be more comfortably protected. People in less well-educated regions or in regions with high levels of unemployment tend to vote for nationalism and it is the more regressive religious societies which turn to fundamentalist beliefs. For centuries, nationalists and members of fundamentalist religions have not tolerated those who deviate from their beliefs and have fought those who do not belong to their community of values. They do not accept those who think differently and protect their own ideologies with violence or even war. Because they cannot keep up technologically, they are among the losers. They fight all those they consider to be on the other side with the simple, brutal methods of terrorism. They face a highly technological world with not only drones and electronic warfare, but also the temptations of freedom. They cannot win the conflict in the long run. A solution to this asymmetrical struggle has yet to be found. It most likely lies in better education in these regions.

Totalitarian countries such as Russia, Turkey, or Saudi Arabia encourage people to return to the previous value systems of autocratic governments or religions. These

governments falsely represent themselves as democracies albeit oftentimes with manipulated elections. Such countries support political parties or movements in countries that are losing at globalization and which favor autocratic systems. Russia's use of manipulative political propaganda in the West or Saudi Arabia's and Turkey's support of local mosques is an example of such efforts. Claims by Vladimir Putin or leaders in China that suggest that liberalism is obsolete because it is losing to their system are also part of this manipulation. This assertion is not intended to strengthen their own people, but their own positions as autocrats. Such claims are absurd and are refuted by statistics. Economically, Russia lags far behind the West, and China will never completely catch up with—much less surpass—democracies. Doing so requires freedom. The assertion is even more absurd because the course of history never reverses. We have had more than enough autocratic countries since the Middle Ages. The trend is toward freedom and democracy.

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