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From free to civilized trade: a European perspective

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ABSTRACT
In the context of unfettered international competition, free trade tends to undermine basic moral concepts such as justice, dignity, and fairness. Therefore, we suggest moving to a new understanding of markets in international trade, which we call 'civilized markets'. A civilized market tries to ensure that free entrepreneurship and open markets are eventually compatible with those basic and universal values that also serve as moral cornerstones of the European project. In order to accomplish a civilized market, we propose to establish a new European institution with a mandate to set and enforce minimum standards for goods sold on the European market.

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1. Introduction

The European Union needs a new understanding of markets in international trade. While markets are highly useful institutions for fostering innovation and welfare, we assume that utilizing these properties does not afford a collective submission to whatever market forces dictate. On the contrary, Europe should try to actively govern and direct market forces in order to render them more useful and socially acceptable. This perspective is not only grounded in the fact that market outcomes are not always efficient or socially desirable, but also refers to the observation that crude and completely unrestrained global market forces tend to undermine basic moral and social standards.

To put it briefly, we argue that on a global scale, unfettered market forces violate the basic universal concepts of a 'good' or 'civilized' society, including concepts such as justice, dignity and freedom. Therefore, we suggest moving

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to a new concept of markets, which we call 'civilized markets'. A civilized market tries to ensure that free entrepreneurship and open markets are eventually compatible with those basic and universal values that also serve as moral cornerstones of the European project.

The normative foundations of European societies have undergone significant changes since the Age of Enlightenment. Due to the Enlightenment, European societies slowly but inevitably tended to replace traditional feudal bonds with new conceptions of the individual, community, and society. In their theoretical arguments, the thinkers of the Enlightenment age often extended the idea of equality from the political to the social (and thus to the economic) realm (Smith 2000 [1759]). This extension is important since equality in the formal sense still leaves ample room for oppression and coercion by means of socioeconomic inequality. Extension of equality to the social and economic realm is essential for understanding the moral and political impetus of the Enlightenment and its enduring consequences, such as the Universal Declaration of Human Rights (UN 2014). This declaration catalogs a series of ideas of basic moral rights in the guise of formal equality, thereby mirroring not only the Enlightenment's basic contribution, but also its most important extension, that is, social equality or 'fairness'.

Since this moral heritage has only a minor influence on the European Union's trade policy, current trade practices often neglect, or even violate, the basic tenets associated with this heritage. Against this backdrop, this paper suggests implementing a different trade policy that promotes the universal values incorporated in the European heritage as a vantage point for policy-making at the global level.

2. The social embeddedness of markets and the relation between competition and morality

The question of how markets and societies interact has a long tradition. One main contribution in this context was the realization that the transformation from a regulated market system to an unfettered market system at the end of the eighteenth century in Europe had an immediate impact on the social structure of society (Polanyi 1978 [1944]). This 'Great Transformation' was neither natural nor automatic, but was driven by conscious decisions related to the aim of economic liberalism to introduce a self-regulated market system. However, achieving such a separation by itself required a transformation of politics and society to separate the 'economic' from the 'social' via political means. This drastic change in the *social embedding* of market activity led to a disruption of conventional social bonds, creating social instability as well as ecological problems.

In a similar vein, Rüstow, Maier-Rigaud and Maier-Rigaud (2001: 88) argue that those who strive to institutionalize unfettered competition fail to see that market interaction necessarily entails social and cultural foundations.[1] Among these foundations are norms and laws that serve as preconditions for the functioning of the market economy (Granovetter 1985). Contrary to the purely market-based view of modern economics (Rodrigues 2004), this mutual relationship between social relations and market interaction indicates that markets are not 'self-sufficient', and may alter or even destroy their foundations when allowed to operate unconstrained. In this context, the basic mechanism of competition not only replaces other means of social organization such as sympathy, empathy, solidarity, and cooperation (Rothschild 1992), but also utilizes and exhausts these social or moral foundations to foster its own development. *Essentially, market competition not only breeds on social and moral foundations, but it also feeds on them.*

In a recent study, Streeck (2011) explicitly focuses on this aspect of competition. He points out that it can be assumed that those who act under market competition always try to evade rules with their own interests in mind. While such behavior might be difficult to implement in some specific setups, it eventually contributes to the erosion of moral standards, especially in the context of international trade. Streeck describes this relationship by referring to 'Grenzmoral' or 'marginal ethics', a term initially introduced by the German economist Briefs (1957), which he translates from the German original as follows:

> By "marginal ethics" I mean the ethics of those least restrained in the competitive struggle by moral, that is of those who because of their minimal ethics have under otherwise equal conditions the best chances of success and who on this account force competing groups, at the penalty of elimination from competition, gradually to adapt in their trading to the respectively lowest level of social ethics (i.e., to the "marginal ethics"). (Streeck 2011: 145)

The idea of marginal ethics implies that the lowest level of social ethics prevails because of the threat of elimination by competition. The underlying mechanism operates within as well as between countries. Between countries lower moral or regulatory requirements can give one country a competitive advantage, thereby putting pressure on other countries to lower their standards.

The tension between competition and morality can also be found in the history of economic thought (Kapp 1963; Keynes 1972 [1926]) as well as in behavioral economic research. Schwieren and Weichselbaumer (2010), for instance, provide empirical evidence that the pressure of competition enhances cheating as a form of competitive advantage. Shleifer (2004) argues that competition leads to a decline in ethical behavior, thereby mentioning child labor, corruption, excessive executive pay, and earnings manipulation as phenomena reinforced by competition. Falk and Szech (2013) present evidence that a framework of market competition leads participants to downplay or suppress moral considerations.

[1]Cooke (2007) shows, for example, that firms need social networks and social capital to function in markets.

One way to prevent this tension between moral standards and market competition is to modify and improve the social embedding of market activities in international trade by introducing appropriate institutions and politics in order to achieve a better alignment between social standards and market competition. In this context, we suggest a mode of social embedding that not only tries to preserve social and moral standards, but also aims to moderate the innovative capabilities of markets to bring forth social change in a way that facilitates the extension and application of these standards.

3. Civilizing markets

The tendency towards moral erosion inherent in market competition is especially forceful in the context of international trade where gaps with respect to different social standards can be exploited to a much greater extent (Davis 1999; Hobbs and Tucker 2009). Exploiting these gaps represents a form of regulatory arbitrage leading to marginal ethics. In this context, the main question becomes whether it is possible to halt or even reverse this erosion of social foundations. In confronting this phenomenon, we suggest designing a 'civilized market', which aims to align the moral cornerstones of the European project with free entrepreneurship and open markets. This is achieved by introducing obligatory standards related to working conditions and product characteristics in order to confine the possibilities for regulatory arbitrage, and thereby constrain the tendency of marginal ethics.

One possible empirical archetype for addressing this question is exemplified by a principle that has been successfully applied in Japan for the last 14 years, called the *Top Runner Program* (JMETI 2010). It serves as a model for governing the impact of competition on certain product dimensions that are deemed relevant from the perspective of social welfare, but are only of minor interest to ordinary consumers, or hardly observable at all.

The Top Runner Program imposes energy efficiency standards for 23 product categories sold on the Japanese market. Inclusion of product categories is thereby based on three basic criteria: (1) products must be used in large quantities; (2) their usage consumes a considerable amount of energy; (3) there is a detectable scope for technical improvement of products. Standards are set for a period of 3 to 10 years, and at the end of the period each product has to conform to this standard. When setting such standards, the most energy-efficient product of its class is taken as a benchmark, and the potential for future technological progress is also taken into account (JMETI 2010). If a certain product does not satisfy the standard at the end of this period, then a 'name and shame' strategy is applied. Initially, the ministry makes a recommendation to the producer. If the producer does not comply, then the authority goes public with this information. Ultimately, they may impose a cutback in sales (JMETI 2010). Although Japan already had mandatory efficiency standards in place, they decided to introduce the Top Runner program because the older standards had failed to induce sufficient improvements in efficiency as they were rarely revised, and usually had to be negotiated with members of the industry (Kimura 2010).

By extending the logic and scope of the Top Runner Program to questions of working conditions as well as ecological and other product standards, we suggest designing an institution designated to reverse the adverse effect of competition on its social, moral, and environmental foundations. This institution should rest on two divisions: one of them would be responsible for all aspects related to the working conditions under which a commodity is produced (safety, workers' health, legal rights, fair wage), while the other would be responsible for monitoring product quality as well as the overall environmental impact over the product life cycle. In this context, a conceptual blueprint for such an institution is provided by the rule-based approach of the Top Runner Program: (1) define minimum standards and a reasonable time period within which they must be met; (2) make sure that products meet these standards, advise those firms whose products violate the standards, and start sanctioning procedures if they do not comply; (3) start again at step (1). Standards will be applied to all included products sold on the European market, no matter whether they have been produced domestically or abroad.

Minimum standards related to work could build on the 'fundamental conventions' of the International Labor Organization (ILO 1998), which include: (1) the freedom of association and the right to collective bargaining; (2) the elimination of all forms of forced and compulsory labor; (3) the effective abolition of child labor; and (4) the elimination of discrimination. Furthermore, it will be necessary to set appropriate standards regarding working hours, social security benefits, and workers' rights and wages.

Decent working conditions are relative concepts, reflecting whatever is perceived as decent, and notions may be different both between and within societies. The same applies to fair working hours and social insurance. With respect to wages in particular, standards will have to be set on a country-specific basis since living costs differ widely across countries. The minimum wage should enable workers and their families to live a decent life, referred to as 'living wages' in the literature (Anker 2006). Since we observe significant differences in these areas between advanced economies and some less developed economies, a certain notion of endogeneity (or self-adaption) has to be introduced. In this context, the suggested three-step procedure should offer a feasible way to gradually raise the standard of what is perceived to be indispensable for a decent life.

Generally, such an approach could promote what the ILO recommended in its recent country report on Bangladesh, namely increasing "the collaboration between international buyers and their supply chains" (ILO 2013: 8). According to this proposition, international companies would be compelled to care about the production conditions of their suppliers if they want to continue selling their products in the European market, since they would be responsible for meeting the respective standards. As a reaction to increasing pressure from the public, a number of corporations have already introduced voluntary corporate social responsibility (CSR) programs, where corporations hire or create monitoring firms to enforce the corporation's (voluntary) labor standards. These programs, however, have some disadvantages: the funding of the monitoring agency depends almost solely on those corporations they are expected to monitor, and corporations are always free to quit. As a consequence, those programs focus on the enforcement of standards that reduce the risk of unfavorable media coverage, and neglect standards that would reduce the control of the management without affecting reputational aspects; for example, freedom of association rights (Anner 2012; Locke *et al.* 2009).

A gradual approach to reaching these goals should guarantee a smooth transition process that does not disrupt trade or overburden those economies that have to carry the largest burden of adjustment. We do not deny that standards that are too high will pose a threat to those countries that currently derive competitive advantage from exploiting moral or legal differences. However, there is an increasing literature suggesting that better labor standards can foster innovation and labor productivity if implemented in a sensible way (Milberg and Houston 2005; Pires 2013; Stiglitz 2000).

With regard to the product characteristics, we suggest establishing a second division analogous to the Top Runner Program, which focuses on the quality, longevity, energy efficiency, and health effects of goods. Some people may consider such a regulatory regime to be an unnecessary economic burden on private firms. However, a body of research shows exactly the opposite effects. Ashford, Ayers and Stone (1985) and Porter and van der Linde (1995) point out that properly crafted regulation triggers innovation, and firms' benefits outweigh the costs of complying. Beise and Rennings (2003) identify several cases in which strict regulation was one of the main success factors for environmental innovation. In a similar vein, Jänicke (2008) argues that the driving forces for ecological modernization or progress are 'smart regulation' and growing business risks for polluters. Behind this, we observe the surprising adaptability of firms. If policy makers set obligatory standards that cannot be met using existing technologies, then firms are forced to innovate, and seem to do so quite well. Therefore, if regulation is applied sensibly, it can be of great benefit to the environment, as well as to consumers and firms. In the latter case, the potential benefit is increased technological progress, and therefore increased international competitiveness. Although additional regulatory requirements may indeed raise production costs in some cases, the overall effect on Europe's competitiveness is expected to be moderate since relative production costs only play a minor role in determining the relative position of European goods in the global market, whereas technology and product quality play a much greater role here; see, for example, Carlin *et al.* (2001) and Storm and Naastepad (2014).

Although it is obvious that such an institution must be of a considerable size, it is nonetheless necessary to restrict the set of products under consideration. Similar to the Top Runner approach, we suggest focusing on the following three criteria for establishing priorities within both divisions: (1) are products sold in large quantities? (2) do they involve a considerable amount of wage labor, or do they account for considerable use of natural resources, cause environmental damage or have adverse effects on human health? (3) are there substantial possibilities to reduce this impact?

4. Concluding remarks

It is rather obvious that the kind of institution suggested here must be of a considerable size in order to have an impact and would, therefore, have to command a considerable amount of human and financial resources. While the management of product quality can be entirely situated within Europe, the monitoring of labor conditions will have to draw on extensive use of staff and expertise from outside the European Union. Therefore, this has to be done in close cooperation with local governments as well as eligible international organizations.

Moving towards a civilized market bears the opportunity to make Europe more efficient, greener, and to render international trade fairer. Such a transition would guide the innovative capabilities inherent in any market-based system into improving rather than deteriorating global as well as local standards. Similar to the Top Runner Program, this institution aims to reverse the trend of eroding social and moral standards associated with marginal ethics by making morality matter in market competition. If established, this kind of regulatory approach could serve as an international role model where the benefits may greatly outweigh the costs.

The potential impact of this institution on social and ecological standards would go beyond the immediate regulatory effects, but would also proceed through indirect channels. On the one hand, 'name and shame' policies will trigger reputational effects so that the underlying standards become a public relations issue. On the other hand, it has been found that sensible proscriptions can actually change habitual behavior and consumer attitudes, and thereby contribute to effectively reducing socially or ecologically harmful behavior.[2]

Disclosure statement

No potential conflict of interest was reported by the authors.

[2]Sharp *et al.* (2010), for instance, show empirically that a ban on single-use plastic bags in south Australia eventually changed consumer preferences, and led to increased support for the ban following its introduction.

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