

## The Freiburg School: Walter Eucken and ordoliberalism

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**Diskussionspapiere**  
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## The Freiburg School: Walter Eucken and Ordoliberalism\*

by

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What has become known as the *Freiburg School* or the *Ordo-liberal School* was founded in the 1930s at the University of Freiburg in Germany by economist Walter Eucken (1891-1950) and two jurists, Franz Böhm (1895-1977) and Hans Großmann-Doerth (1894-1944).

Freiburg University's "Fakultät für Rechts- und Staatswissenschaften" that included law as well as economics provided a conducive framework for the combination of legal and economic perspectives that is characteristic of the Freiburg School and of the Ordo-liberal tradition. As Böhm later said in retrospect, the founders of the school were united in their common concern for the question of the constitutional foundations of a free economy and society. In the first volume (Böhm 1937) of their jointly edited publication series *Ordnung der Wirtschaft*, the three editors included a co-authored programmatic introduction, entitled "Our Task" (Böhm, Eucken and Großmann-Doerth 1989), in which they emphasized their opposition to the, then still influential, heritage of Gustav von Schmoller's *Historical School*, and to the unprincipled relativism that, in their view, this heritage had brought about in German jurisprudence and political economy. By contrast, they stated as their guiding principle that the "treatment of all practical politico-legal and politico-economic questions must be keyed to the idea of the economic constitution" (ibid.: 23), a task for which, they said, the collaboration of law and economics "is clearly essential" (ibid.: 25).

The *Ordo-liberalism* of the Freiburg school constituted a major part of the theoretical foundations on which the creation of the *Social Market Economy* in post WWII Germany was based. The school is often subsumed under the rubric of *German neo-liberalism*, which also includes such authors as Alfred Müller-Armack, Wilhelm Röpke and Alexander Rüstow. Yet,

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\* This paper is based on Vanberg 1998.

though these authors shared important common ground, there also exist certain differences between them.<sup>1</sup> In particular, the slightly interventionist, *outcome*-oriented flavor of the concept of the *social market economy* was much more reflective of the thoughts of Müller-Armack, who coined the term, and of Röpke and Rüstow than of the founders of the Freiburg School who advocated a strictly *procedural* and *rule*-oriented liberalism. In a very brief – and, accordingly, somewhat simplifying – manner, and in anticipating some arguments that will be more fully explained later, the difference between the *ordo*-liberalism of the Freiburg School and Müller-Armack’s concept of the social market economy can be described as follows. For the Freiburg School the market order, as a non-discriminating, *privilege-free* order of competition, is in and by itself an *ethical* order. As far as the need for “social insurance” is concerned, the Freiburg *ordo*-liberals recognized that the competitive market order can be, and should be, combined with a system of minimal income guarantees for those who are, temporarily or permanently, unable to earn a living by providing saleable services in the market. They insisted, though, that such social insurance provisions must be of a non-discriminating, *privilege-free* nature, and must not be provided in ways – e.g. in the form of subsidies or other privileges granted to particular industries – that corrupt the fundamental ethical principle of the market order, namely its *privilege-free* nature. Müller-Armack, by contrast, regards the market order as an economically most efficient order, but not as one that has inherent ethical qualities. It is a “technical instrument” that can be used by society to produce wealth, but it does not make itself for a “good” society. It has to be made “ethical” by supplementary policies, in particular “social” policies. The important point is that in Müller-Armack’s case, these supplementary “social provisions” that are supposed to make the market economy - beyond its economic efficiency - ethically appealing are not constrained, as they are in for the Freiburg *ordoliberal*s, by the proviso that they must not be in conflict with the *privilege-free* nature of the rules of the game of the market. – One may well suppose that it is not least the lack of this constraint that has allowed for the erosion of market principles that has taken place in Germany during the last half century through legislation and jurisdiction, in the name of the “social” market economy, an erosion that has led to recent public calls for a “new” social market economy (“Neue Soziale Marktwirtschaft”). – But, with these comments<sup>2</sup> I have been moving far ahead of my argument, so let me return to my introductory remarks.

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<sup>1</sup> For an informative discussion on the historical roots of the Freiburg School and its relation to other ‘neoliberal’ currents in Germany see H. Grosseketler 1989.

<sup>2</sup> For a more detailed discussion see Vanberg 2002.

As the present lecture series on the “History of Liberalism in Europe” illustrates, there exist, of course, different interpretations of what liberalism is all about. Quite telling about the kind of liberalism that the Freiburg Ordo-liberals advocated is an incident that occurred at one of the early meetings of the Mont Pelerin Society, the interdisciplinary group of liberal scholars that F.A. Hayek had first brought together in 1947 at Mount Pelerin in Switzerland. In an article in which he recounts his memories of Walter Eucken, Wilhelm Röpke reports that at the Society’s meeting in 1949 an argument erupted between Ludwig von Mises and Walter Eucken about the adequate liberal outlook at the problem of monopoly and the respective role of government and law. Röpke tells us not much about the encounter,<sup>3</sup> nor have I been able to find more detailed accounts in other sources.<sup>4</sup> It is apparent, though, from Röpke’s report that he considered the exchange between Eucken and von Mises to be symbolic of a conflict of opinion that, as he notes, repeatedly resurfaced within the Mont Pelerin Society. And, indeed, Eucken and von Mises represent, with their respective works, two distinctively different perspectives on the nature of the liberal market order and the role of economic policy, perspectives that revolve around different organizing concepts. In the case of Mises this is the concept of the *unhampered market*, and in the case of Eucken it is the concept of the market as a *constitutional order*.

At first glance, the Misesian concept of the “unhampered market economy” appears to provide a clear-cut and unambiguous criterion for what kinds of policy measures are conducive to, and which are or incompatible with a market economy.<sup>5</sup> Yet, at closer inspection it turns out to be a rather ambiguous concept. Its ambiguity becomes apparent as soon as one

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<sup>3</sup> W. Röpke’s (1961: 10f.) brief report reads: “Es kam zu Zusammenstößen, unter denen derjenige besonders schwer und eindrucksvoll war, der sich zwischen Walter Eucken und Ludwig v. Mises ereignete. Auf den von dem letzteren erhobenen Anspruch, in seiner Person den allein maßgeblichen Liberalismus zu repräsentieren, war Eucken die Antwort nicht schuldig geblieben., und so wäre es denn nicht leicht gewesen, einen halbwegs versöhnlichen Ausgang zu erreichen, wenn nicht Ludwig v. Mises mit seiner Ritterlichkeit eingelenkt hätte. Jene Diskussion, in der es vor allem um das Monopolproblem und um die dem Staat und der Rechtsordnung dadurch zufallende Aufgabe ging, ist symbolisch für einen Richtungsstreit im liberalen Lager geblieben, der innerhalb der Mont-Pèlerin-Gesellschaft immer wieder hervortrat.”

<sup>4</sup> In Max Hartwell’s (1995) history of the MPS the incident is not mentioned.

<sup>5</sup> L. von Mises (1949: 238f.) defines: “The imaginary construction of a pure or unhampered market economy ... assumes that the operation of the market is not obstructed by institutional factors. It assumes that the government ... is intent upon preserving the operation of the market system, abstains from hindering its functioning, and protects it against encroachments on the part of other people.” (On the “method of imaginary constructions” Mises [Ibid.: 237] notes: “An imaginary construction ... is a product of deduction, ultimately derived from the fundamental category of action. ... In designing such an imaginary construction the economist is not concerned with the question of whether or not it depicts the conditions of reality which he wants to analyze.”) – As Mises (Ibid.: 239) notes: “The classical economists and their epigones used to call the system of unhampered market economy ‘natural’ and government meddling with market phenomena ‘artificial’ and ‘disturbing.’ But this terminology also was the product of their careful scrutiny of the problems of interventionism.”

looks at it in light of the distinction between two types of policy measures, namely, on the one hand, policies that *intervene in market processes* and, on the other hand, policies that seek to *institutionally frame market processes*, in the sense of defining the general terms under which market transactions are carried out. That we must draw a clear distinction between these two types of policy measures nobody has stressed more emphatically than F.A. Hayek. The term “interference” or “intervention,” he insists, is properly applied only to *specific orders*, aimed at particular results (Hayek 1976: 128), and is misapplied if it is used in reference to “all those general regulations of economic activity which can be laid down in the form of general rules specifying conditions which everybody who engages in a certain activity must satisfy” (Hayek 1960: 224).

It appears that Mises, when he spoke of *government interference* with the ‘unhampered market,’ primarily had in mind economic policies that employ “*authoritarian decrees and prohibitions*” (Mises 1985: 76). In “fixing the prices of goods and services” he saw the “crucial acts of intervention” (Ibid.), and he described the “hampered market economy” as one where “government interferes with the operation of business by means of orders and prohibitions” (Mises 1949: 714). And, indeed, as Hayek (1960: 221) stresses no less than Mises, “the method of specific orders and prohibitions” is ruled out, as a matter of principle, by the liberal concept of the market order (ibid.: 227). Yet, Hayek also insists that the same cannot be said about government policies that seek to shape the economic process by means of general rules.<sup>6</sup> This is not meant to say at all, Hayek hastens to add, that such policy measures may not be “undesirable or even harmful” (Ibid.: 222). It is meant to say that we must distinguish between the issue of whether we consider particular policy measures as desirable or undesirable and the issue of whether they are compatible or, in principle, incompatible with a market order. As he puts it, “so long as they are compatible with the rule of law, they cannot be rejected out of hand as government intervention but must be examined in each instance from the viewpoint of expediency” (Ibid.: 221).<sup>7</sup>

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<sup>6</sup> Hayek (1944: 37): “Any attempt to control prices or quantities of particular commodities deprives competition of its power of bringing about an effective coordination of individual efforts ... This is not necessarily true, however, of measures merely restricting the allowed methods of production, so long as these restrictions affect all potential producers equally ... To prohibit the use of certain poisonous substances or to require special precautions in their use, to limit working hours or to require certain sanitary arrangements, is fully compatible with the preservation of competition. The only question here is whether in the particular instance the advantages gained are greater than the social costs which they impose.”

<sup>7</sup> Hayek (1960: 225): “But if, for instance, the production and sale of phosphorous matches is generally prohibited for reasons of health or permitted only if certain precautions are taken, or if night work is generally prohibited, the appropriateness of such measures must be judged by comparing the over-all costs with the gain; it cannot be conclusively determined by appeal to a general principle.”

How are we, in light of the above distinction, to interpret Mises' formula of the 'unhampered market'? It can surely not be meant to imply the notion of a market *without any rules*. That the market order is a rule-based order, by contrast to the "everything-goes-game" of pure anarchy, is hardly controversial among liberals. The market simply cannot be described as, in Hayek's (1976, chpt. 10) terms, the "game of catallaxy" without reference to the *rules of the game*. Though we can, of course, imagine (and consider desirable) a market without any interference by specific orders, we cannot imagine (and consider desirable) a market without any framework of rules and institutions. If advocates of the concept of the unhampered market acknowledge the fact that there can be no market without framing rules, they cannot avoid specifying in substance which rules they consider to be constitutive of the 'unhampered' market, in contrast to a 'hampered' market. And this means, despite its apparent simplicity and definiteness, Mises' 'unhampered market' cannot be defined but in terms of its *institutional* characteristics.

The ordo-liberalism of the Freiburg School starts from the very premise that the market order is a *constitutional* order, that it is defined by its institutional framework and, as such, subject to (explicit or implicit) *constitutional choice*. It assumes that the working properties of market processes depend on the nature of the legal--institutional frameworks within which they take place, and that the issue of which rules are and which are not desirable elements of such frameworks ought to be judged as a constitutional issue, i.e. in terms of the relative desirability of relevant constitutional alternatives. Its constitutional outlook at the market order places the research tradition of the Freiburg School in close proximity to the more recent research program of constitutional political economy that takes its main inspiration from the work of James Buchanan.<sup>8</sup> At the end of my talk I shall return to the relation between these two research programs.

As noted above, Eucken developed his own approach in explicit contrast to Schmoller's program and its continuing influence on economic thought and economic policy in Germany.<sup>9</sup> With his *Staatliche Strukturwandlungen und die Krise des Kapitalismus*, published in 1932, and with his two major works, the *Grundlagen der Nationalökonomie* (1989 [1939]) and the *Grundsätze der Wirtschaftspolitik* (1990 [1952]), he wanted to provide an alternative to the Historical School's a-theoretical approach to

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<sup>8</sup> As Buchanan (1977: 5) notes on the "market economy": "But the economy cannot function *in vacuo*, it must be incorporated in, and must be understood to be incorporated in, a structure of 'laws and institutions.' Modern economists have grossly neglected the constitutional--institutional or framework requirements of an economic system."

<sup>9</sup> Eucken (1940: 504): "To criticise Schmoller is to criticise a considerable part of economic doctrine of our time."



economic analysis as well as to its unprincipled discretionary approach to economic policy.<sup>10</sup> His aim was to develop a systematically integrated approach to the theoretical study and the political shaping of a constitutional social-economic-political order, or -- to use the German terminology -- a systematic approach to *Ordnungstheorie* and *Ordnungspolitik*.<sup>11</sup>

As the term *Ordnung* (order) is *the* central concept in the research program of the Freiburg school, it is important to note that, in the context of that program, it is systematically related to the concept of the *economic constitution*, in the sense of the *rules of the game*, upon which economies or economic systems are based (Eucken 1989: 240; 1992: 314).<sup>12</sup> It is definitely not meant to imply any of the conservative or authoritarian connotations that the word 'Ordnung' – or the English term *order* – may have had, or does have, in other usages.

As Eucken insists, since all economic activities take, necessarily, place within some historically evolved framework of rules and institutions, the research-guiding question must be: "What are the rules of the game?" (Eucken 1992: 81). Economic orders, this is the main message, must be understood in terms of the underlying *economic constitutions*, by which is primarily meant the formal legal-institutional framework, but which is also meant to include informal conventions and traditions that govern economic activities in the respective communities (Eucken 1990: 377). According to Eucken (1990: 21), the large variety of specific economic orders that have existed in the past and exist in the present can be understood as varied compositions of two basic principles, namely, on the one side, the decentralised *co-ordination* of economic activities within a framework of general rules of the game, and, on the other side, the principle of *subordination* within a centralised, administrative system (Eucken 1989: 79; 1992: 118), a distinction that parallels, of course, Hayek's (1973, chpt. 2) distinction between "two kinds of order," *spontaneous order* and *organization*.

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<sup>10</sup> As Eucken (1940: 503) notes about Schmoller: "Nur eine Ansicht, seine Grundansicht, vertrat er widerspruchslos und setzte sich mit ihr nirgends in Gegensatz: Eben seine Entwicklungs- und Fortschrittsidee."

<sup>11</sup> In the seminar meeting in Paris at which this paper was presented (March 11, 2004) the question was raised of whether the Freiburg scholars in developing their version of liberalism were influenced by the Austrian tradition or Anglo-Saxon sources. A brief answer to this question is that the Freiburg ordo-liberalism appears to be an essentially original German "invention" for which no significant *direct* influences from other sources can be discerned. This is not to deny, of course, that there have been indirect influences of various sorts, including, not least, Eucken's personal acquaintance with F.A. Hayek since the late 1920s. To be sure, since Eucken developed his own thoughts in opposition to the German Historical School he was well aware of the role of the Austrian School as its principal rival. Yet, as far as the specific Freiburg approach to liberalism is concerned, neither Austrian writings nor Anglo-Saxon sources seem to have been a major direct inspiration.

<sup>12</sup> On the use of the concept of "Spielregeln" (rules of the game) in the Freiburg school see Böhm (1937: 120; 1980, fn. 3) and Eucken (1989: 204; 1990: 377).

The founders of the Freiburg school emphasised that the principal means by which economic policy can seek to improve 'the economy' is by improving the institutional framework within which economic activities take place or, as they called it, the *economic constitution* (Eucken 1990: 378). What motivated their work was an interest in applying theoretical insights from law and economics to the practical problem "of understanding and fashioning the legal instruments for an economic constitution" (Böhm, Eucken, Großmann-Doerth 1989: 24),<sup>13</sup> a concern that they saw as part of the broader project of inquiring into the constitutional foundations of a functionable and humane socio-economic-political order.<sup>14</sup> As a name for what can count as such an order Eucken adopted the Latin word *Ordo*, a term with apparent natural law connotations, which can, however, be separated from such connotations and be interpreted in the straightforward sense of an order that is desirable for the human beings who inhabitate it (Vanberg 1997).<sup>15</sup>

Eucken and Böhm emphasised that their interest was not in developing a research program as a purely academic enterprise, but in seeking for answers to the practical question of how a desirable economic order may be created and maintained, a question that they approached as a problem of *constitutional choice*, i.e. as a question of how a desirable economic order can be generated by creating an appropriate economic constitution (Eucken 1989: 240f.). The joint efforts of law and economics were to them an indispensable prerequisite for what they called "Wirtschaftsverfassungspolitik" (ibid.: 242), a policy that seeks to improve the resulting economic order in an *indirect* manner, by reforming the rules of the game, by contrast to an economic policy that seeks to improve outcomes directly by way of specific interventions into the economic process (Eucken 1990: 336).<sup>16</sup> The general aim that, in their view, such constitutional economic policy had to pursue was to create conditions under which economic actors in seeking to further their own interest also promote the common interest (Eucken 1938: 80; 1990: 360,365). In other terms, they considered it the

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<sup>13</sup> Böhm, Eucken, Großmann-Doerth (1989: 23): "We wish to bring scientific reasoning, as displayed in jurisprudence and political economy, into effect for the purpose of constructing and reorganizing the economic system." - See also (ibid.: 24): "The problem of understanding and fashioning the legal instruments for an economic constitution, however, can only be solved if the lawyer avails himself of the findings of economic research."

<sup>14</sup> Eucken (1990: 373) speaks of the problem of finding a "funktionsfähige und menschenwürdige Ordnung der Wirtschaft, der Gesellschaft, des Rechts und des Staates." – See also the preface "Die Aufgabe des Jahrbuchs" (The aim of the yearbook) in the first volume of *Ordo* (1948: VII-XI).

<sup>15</sup> As Eucken (1982: 130; 1990: 290) notes about his approach: "However, the regulative framework with which we are concerned here did not emanate from natural law or ... dogmatic axioms. ... The emphasis among all these principles lies upon their positive aim."

<sup>16</sup> Sally (1996: 8) notes about the ordoliberal approach: "It is incumbent on the state to set up and maintain the institutional framework of the free economic order, but it should not intervene in the mechanisms of the competitive economic process. This is the essence of *Ordnungspolitik*."

task of *Wirtschaftsverfassungspolitik* to *create* conditions under which the "invisible hand" that Adam Smith had described can be expected to do its work.

Against historicist notions of an unalterable course of societal evolution, whether in their Marxian or other versions, Eucken and Böhm emphasised that the socio-economic orders in which people find themselves are subject to political choice (Böhm 1960: 164). They acknowledged that all societies and economies are to a considerable extent the product of evolutionary forces and not the creation of a master plan (Eucken 1989: 51, 53; 1992: 82), and that, in particular, the market order has not been invented or implemented by deliberate design, but has gradually evolved over millennia (Böhm 1980: 236ff.).<sup>17</sup> Yet, they insisted that, nevertheless, economic orders are subject to human design, and that they can be improved upon by deliberate reform (Böhm 1950: XLf.; 1960: 163f.; 1973: 16f., 21). As Eucken (1992: 314) said about the problem of achieving a functionable and humane economic order: "The problem will not solve itself simply by our letting economic systems grow up spontaneously. The history of the last century has shown this plainly enough. The economic system has to be consciously shaped. The detailed problems of economic policy, trade policy, credit, monopoly, or tax policy, or of company or bankruptcy law, are part of the great problem of how the whole economy, national and international, and its rules, are to be shaped." The Freiburg ordoliberalists took care to point out that an effective constitutional economic policy has to pay attention to the complex ways in which the various elements of the legal-institutional framework may interact (Eucken 1942: 42f.). As the founders of the school put it, it is essential to understand that such areas of law as "bankruptcy law, ... the law of obligations, real estate law, family law, labour law, administrative law, and all other parts of the law" (Böhm, Eucken, Großmann-Doerth 1989: 24) together constitute the economic constitution, and that between them systematic interdependencies may exist that *Ordnungspolitik* has to pay attention to.<sup>18</sup>

In the sense noted, the research program of the Freiburg school can be said to comprise a *theoretical paradigm* as well as a *policy paradigm*. The theoretical paradigm is based on the premise that an adequate analysis and explanation of economic phenomena has

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<sup>17</sup> See also Böhm (1973: 30f.). – Böhm (1973: 31f.) and Eucken (1989: 52) emphasise however the importance of the deliberate constitutional reforms in Europe during the late 18<sup>th</sup> and early 19<sup>th</sup> century for the emergence of modern market economies.

<sup>18</sup> Eucken (1989: 38f.): "The actual economic policy of many countries is dominated today by an *ad hoc* treatment of economic problems. It is probably this *ad hoc* way of thinking that mainly obscures the problem of the economic system. The interrelationships of all economic activities as a whole is not recognised. Monetary policy, policy on cartels, trade policy, policy toward small businesses et cetera, are all seen as separate specialised areas to be dealt with discretely. ... For example, in many countries company law encourages industrialised concentration while cartel policy and policy toward small businesses are discouraging it."

to account for the nature of the constitutional framework, or the rules of the game, under which they occur. The policy paradigm is based on the premise that economic policy should seek to improve the framework of rules, the economic constitution, such that a well-functioning and desirable economic order results, rather than seeking to bring about desired outcomes directly by specific interventions into the economic process. *Ordnungstheorie* is the name for the explanatory part of the Freiburg research program, the paradigm of systematically studying the working properties of alternative institutional-constitutional arrangements, and the complex interdependencies between various components (company law, patent law, tax laws, labor law etc.) of a nation's economic constitution. *Ordnungspolitik* is the name for its policy paradigm, for an integrated approach to the various components of the legal-institutional framework in which a market economy is embedded.<sup>19</sup> In terms of Hayek's (1969) useful distinction between the *order of rules* and the *order of actions*, the explanatory paradigm of the Freiburg school can be said to focus on the question of how differences and changes in the order of rules result in differences or changes in the emerging order of actions, while the policy paradigm can be said to focus on the question of how the resulting economic order or order of actions can be improved by suitable reforms in the economic constitution or the order of rules.

While the founders of the Freiburg School placed themselves firmly in the tradition of classical liberalism, they emphasised, in contrast to some varieties of liberalism, that a free market order is not simply what one would find if and where government is absent, that it is not a natural event but a political-cultural product, based on a constitutional order that requires careful 'cultivation' for its maintenance and proper functioning (Böhm 1937: 74, 120f.). In this regard they found it necessary to distance themselves from a *laissez-faire liberalism* that failed to appreciate the essential positive role that government has to play in creating and maintaining an appropriate framework of rules and institutions that allows market competition to work effectively (Eucken 1938: 81; 1990: 374f.).<sup>20</sup> They took care to

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<sup>19</sup> Sally (1996: 5): "Eucken clearly opts for thinking in terms of orders, ... all acts of policy should be judged in terms of how they fit in with the total economic process and its steering mechanism, i.e. with the order of economic activities."

<sup>20</sup> One may well argue that their image of *laissez-faire liberalism* was oversimplified and their critique overstated. But there can be no mistake about the substance of the argument that they wanted to make. As Tumlir (1989: 130) comments: "Many of Böhm's readers found it difficult to understand his strong condemnation of *laissez-faire*. The term is seldom defined and is usually used as a red herring. He had a clearly defined meaning of it: an approach to legal policy in which all contracts will be enforced, including contracts intended to curtail or eliminate competition. ... The standard conclusion of economists is that if the state concentrated on the business of preventing force and fraud and refused to enforce contracts in restraint of competition, markets would be efficient. The lawyer might agree ... but he still faces great practical difficulties ... what kinds of contracts are in restraint of competition ... must be specified in considerable detail. Nor is the question of 'force and fraud' in economic transactions at all self-explanatory." – Sally (1996: 6f.) comments on the *ordo-liberals'* critique of

distinguish between the spontaneous working of markets, provided an appropriate legal-institutional framework is in place, and the issue of how the framework itself comes about. In other words, they clearly distinguished between the *sub-constitutional* issue of how market competition works within given rules, and the *constitutional* issue of how the rules that make market-competition work are themselves established and enforced.

The essence of the *free market economy* the Freiburg ordoliberals saw in its nature as an order of *free competition* in which all economic players meet as legal equals, and in which voluntary exchange and voluntary contract are the only means by which economic activities are coordinated (Böhm 1937: 105). They knew of course that the principles of equality and voluntariness are nowhere perfectly realised, and they did not think of them as descriptions of existing 'market economies.' They regarded these principles, instead, as normative standards against which existing economic orders and potential reforms can be judged, and as reference criteria that can provide guidance to efforts in constitutional reform (ibid.: 124f.). A major historical step towards the realisation of an economic order that meets these criteria they saw in the liberal movements of the late 18<sup>th</sup> and early 19<sup>th</sup> century (Eucken 1982: 124; 1990: 276) that marked the transition from the feudal society to what Böhm (1973: 31f.; 1989: 46ff.; 1980: 105ff.) called the *Privatrechtsgesellschaft* (private law society) or *Zivilrechtsgesellschaft* (civil law society). In their assessment, the driving force of these movements was the idea of transforming the feudal society with its privileges and prerogatives "into a private law society consisting of equally free people with equal rights" (Böhm 1989: 54; 1980: 140), a society in which "everyone should have the same rights and status, namely the status of a person under private law" (1989: 46; 1980: 107).<sup>21</sup>

Böhm and Eucken insisted, though, that creating and maintaining a well-functioning competitive market order requires more than replacing feudal privileges and restrictions by free trade and freedom of contract. It requires, they claimed, an economic constitution that in its entirety is tuned to upholding competition in the face of anticompetitive interests. The whole logic of the Freiburg research program rests on the distinction between the

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*laissez-faire*: "The analysis is faulty in several respects. First it is inaccurate to portray the classical theory of the period in terms of unconditional *laissez-faire*. ... Second there is an overestimation of the spontaneous emergence of monopoly in the private sector ... and a corresponding underestimation of the creation and promotion of monopoly by discriminating acts of government." – Whatever shortcomings their critique of *laissez-faire* liberalism may have, they do not play any significant role as far as the paradigmatic core of the *ordo-liberals'* approach is concerned.

<sup>21</sup> As Böhm (1989: 47; 1980: 109) emphasises, this was in itself a constitutional choice, a choice of the *rules of the game* under which social and economic interactions were to proceed: "The decision to abolish all class prerogatives and privileges was justified by the maxim: henceforth in the field of society there shall be only one single legal status for all ... This postulate that all members of society should have the same status is, of course, not a private law concept but a political one under constitutional law."

*constitutional level* at which political choices regarding a society's economic constitution are made, and the *sub-constitutional level* at which private choices within the constitutionally determined rules of the game are made. Its central claim is that the choice of the rules of the game is one that is made on behalf of the entire constituency of a jurisdiction, and that individual 'players' or members of a jurisdiction cannot be allowed to abrogate or renegotiate the rules at the sub-constitutional level by way of private contracting (Böhm 1960: 39-44, 67).<sup>22</sup> This is the issue that the ordoliberalists had in mind when they insisted that the *freedom of contract*, which is of obvious importance for a competitive market economy, cannot be allowed to be "used for the purpose of entering into contracts which restrict or eliminate the freedom of contract" (Eucken 1982: 125; 1990: 278).<sup>23</sup> They insisted, in other words, that it is incompatible with the constitutional decision for a competitive economy to allow economic agents to dispense themselves, through private contracting, from the constraints that the rules of the game of competition are meant to impose on them (Böhm 1960: 27-30; 1980: 233-236, 238, 256f., 260f.).

For the reasons just outlined the Freiburg ordo-liberals considered cartel-agreements to be in principle incompatible with a competitive economic constitution, and these reasons are also behind their view that the "selbstgeschaffene Recht der Wirtschaft," the "self-produced law of the business community" (Großmann-Doerth 1933; Eucken 1989: 56)<sup>24</sup> cannot be trusted to generally serve the common interest, but may well serve to promote producer interests at the expense of consumer interests. As Eucken (1989: 32) noted: "It must be asked whether the rules and regulations made by economic power groups to control activity among themselves in fact are tending to take the place of statute law. How far has such 'self-made' law transformed the legal order? The question is of great importance in the modern industrialised world."

The cartel issue deserves particular attention here as an illustration of the contrast between the ordo-liberal outlook at markets and Mises' concept of the 'unhampered market' that I mentioned at the beginning. The Freiburg School's constitutional approach to this issue

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<sup>22</sup> As Eucken (1982: 119; 1990: 267) notes, it is not sufficient for the state to establish freedom of trade, "it is also necessary to ensure that the restricting of the market by private pressure groups does not take place. What is the use of officially decreed freedom of trade if it is annulled in practice by the policies of the pressure groups? ... All kinds of preventive competition should be ruled out."

<sup>23</sup> Eucken (1982: 124; 1990: 276): "Freedom to contract may serve not only to promote but also to destroy competition. – See also Eucken (1989: 57; 1990: 267).

<sup>24</sup> Streit (1994: 511): "In his inaugural lecture Großmann-Doerth (1933) drew attention to what he called 'self-created law of the business community' and to the fact that, for example, standardised conditions of sale were used to restrain competition and that the state tolerated the general private law being bent into a law which served the vested interests of the business community." – See also Kasper and Streit (1993: 13).

is differs significantly from the view expressed, for instance, by one of the strictest advocates of Mises's teaching, Murray Rothbard. From the perspective of the unhampered market Rothbard sees no reason why one should object to cartel contracts. "The whole concept of 'restricting production'," he argues, "is a fallacy when applied to the free market" (Rothbard 1970: 568). As he sees it, in the free market "consumers and producers adjust their actions in voluntary cooperation" (Ibid.: 566), and that includes the freedom of producers to seek to maximize their income by "producing where their gains are at a maximum, through exchanges concluded voluntarily by producers and consumers alike" (Ibid.: 571). Cartel agreements are, from his perspective, nothing but voluntary contracts among producers, equally legitimate as voluntary exchanges between producers and consumers. As he puts it: "To regard a cartel as immoral or as hampering some sort of consumer sovereignty is therefore completely unwarranted. And this is true even in the seemingly 'worst' case of a cartel that we may assume is founded solely for 'restrictive' purposes" (Ibid.: 570). The appeal to the principle of *consumer sovereignty* is, in Rothbard's eyes, an arbitrarily limited interpretation of the principle of "individual self--sovereignty" (Rothbard 1970: 560) that is constitutive of the free market and that covers individuals in their capacity as producers no less than consumers.<sup>25</sup> – It is worth mentioning that James Buchanan, from his constitutional economics perspective, approaches the issue in essentially the same spirit as the Freiburg School when he chastises "the libertarian blunder of extending the defense of the liberties of individuals to enter into ordinary voluntary exchanges to a defense of the liberties of individuals to enter into voluntary agreements in restraint of trade."

Expressly agreeing with the classical economists of the *Scottish School* the Freiburg ordo-liberals emphasised that consumer interests are "the sole directly justifiable economic interests" (Böhm 1982: 107) and that the essential function of competition is "to place the entrepreneur's pursuit of profit in the direct service of the consumer" (ibid.: 109). Referring to Adam Smith's view that the impulse of human selfishness loses its "anti-social aspects under the impact of competition," Böhm described competition as "the moral backbone of a free profit-based economy," invoking the basic theme that runs through his entire work, the notion that, as he phrased it in later writings, "competition is by no means only an incentive-mechanism but, first of all, an instrument for the deprivation of power (Entmachtungsinstrument), ... the most magnificent and most ingenious instrument of deprivation of power in history" (Böhm 1960: 22).

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<sup>25</sup> Rothbard (1970: 560): "Rather than 'consumers' sovereignty,' it would be more accurate to state that in the free market there is a *sovereignty of the individual*: ... *individual self--sovereignty*."

The Freiburg ordoliberalists made it clear that the desirable working properties that the classical liberals attributed to market competition can not be expected from any unqualified competitive process per se, but only from what they called *Leistungswettbewerb*, i.e. competition in terms of better service to consumers (Eucken 1990: 43),<sup>26</sup> as opposed to *Behinderungswettbewerb*, 'prevention-competition,' i.e. competition by means that are directed at preventing competition from other producers, rather than improving one's own performance in the service of consumer interests (Böhm 1937: 107, 123-127, 153; 1960: 29, 32; Eucken 1938: 81; 1990: 267, 329, 358f.). Creating and maintaining an appropriate framework of "rules of the game of *Leistungswettbewerb*" (Eucken 1942: 38) is, in their view, a genuine and indispensable political task, a task for *Wirtschaftsverfassungspolitik* or *Ordnungspolitik* (Eucken 1990: 266f.). This task they likened to the activities of a gardener who does not construct things, like an engineer, but provides for conditions that are conducive to the natural growth of what is considered desirable, while holding back the growth of what is not desired. As Böhm (1980: 115; 200) put it, to maintain a well-functioning market economy requires a continuous nursing and gardening, comparable to creating and maintaining a highly cultivated park.<sup>27</sup>

*Ordnungspolitik* in the Freiburg sense is foremost *competition policy*, a policy that aims at securing a competitive process with desirable working properties, one that works to the benefit of consumer interests. It should be mentioned, though, that, while the ordo-liberals were fairly clear about the general aim that they wanted competition policy to pursue, namely to realise to the largest extent possible *consumer sovereignty*, some ambiguity arose in their more specific recommendations for how such policy should proceed. Ambiguity has been caused, in particular, by the fact that, in addition to the criterion of *Leistungswettbewerb* (performance competition), they referred to the concept of "complete competition" (*vollständige Konkurrenz*), a concept that, because of its outcome-oriented focus, does not square well with the general procedural logic of the Freiburg paradigm. There is no room in the present context to discuss this issue in any detail. Suffice it to say that, even if some of the original views of the Freiburg School on competition policy were in need of further clarification,<sup>28</sup> this does not affect at all the validity of their central claim, namely that an

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<sup>26</sup> As Röpke (1960: 31) worded it, *Leistungswettbewerb* means "that the only road to business success is through the narrow gate of better performance in service of the consumer."

<sup>27</sup> Tumlrir (1989: 135) notes about Böhm: "All his work consists of describing and analysing the conditions that must be satisfied for the competitive system of free enterprise to function satisfactorily and be secured against drift. ... Maintenance of these conditions is a matter of constant attention."

<sup>28</sup> Willgerodt and Peacock (1989: 7f.) note: "The theoretical concept of competition for Ordo-liberals has changed considerably ... In general, however, it was always more realistic than some static concepts of 'perfect' competition." - They also note that modern day Ordo-liberals consider the policy goal of perfect competition



appropriate competitive order, one that exhibits desirable working properties, is not a self-generating and self-maintaining gift of nature but something that needs to be actively pursued and cultivated. There is clearly scope for arguments on what may be the most suitable kind of *Ordnungspolitik* to serve that purpose, and one may well disagree with some of what the founders of the Freiburg school had to say on this issue, while still agreeing with their principal argument that *market competition* is not just any kind of competition but one that requires appropriate rules of the game.

While the founders of the Freiburg School mostly focused on the threat that "private economic power" poses to a properly working competitive market order (Eucken 1990: 359), they ignored by no means the fact that the deeper roots of anti-competitive contrivances must be sought much more in the political than in the private arena per se. When Böhm (1960: 32) argued that the essence of economic power lies in the ability of inferior suppliers to prevent customers from accessing more attractive alternatives, he knew that such power is difficult to obtain within a properly enforced order of private law, in the absence of legal privileges. Neither he nor Eucken were blind to the fact that many of the problems which they discussed under the rubric of 'private economic power' are indirect consequences of misguided government interventions or of defects in the existing legal-institutional framework. As Eucken (1989: 33) noted: "The formation of monopolies can be encouraged by the state itself through, for example, its patent policy, trade policy, tax policy *et cetera*. This has happened often in recent times. The state first encourages the formation of private economic power and then becomes partially dependent on it."<sup>29</sup>

In fact, most central to the research program that they initiated, and very much in line with modern political economy, is what the Freiburg ordo-liberals had to say about a problem that they described as "*refeudalisation*," and that in contemporary economics is discussed as the problem of *rent-seeking* (Streit 1992: 690f.).<sup>30</sup> As noted before, the ordoliberalists saw the essential feature of the competitive market order in the fact that it is a privilege-free, non-discriminating constitutional order within which economic actors meet as legal equals, and they regarded as the essential liberal principle that "the state should on no account be allowed to confer privileges" (Böhm 1989: 57; 1980: 141). Accordingly, they regarded the granting of

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both, impossible to achieve in all markets and also an undesirable goal to pursue (Peacock and Willgerodt 1989: 7). - On this issue see also Kasper and Streit (1993: 21) and Tumlir (1989: 127).

<sup>29</sup> Eucken (1982: 120): "In many sectors of German industry, cartels would disappear immediately if tariffs were to go. ... Despite certain legal precautions, patent law has unexpectedly triggered powerful tendencies toward the formation of monopolies and concentration processes in industry." – See also Eucken (1942: 43).

<sup>30</sup> Tumlir (1989: 135) notes about Böhm's essay "Privatrechtsgesellschaft und Marktwirtschaft": "The last part of this essay could easily be translated into the contemporary analytical language of rent-seeking."

special privileges, in whatever form, as a violation of the very principles on which a competitive market order is built, as a violation of the fundamental constitutional commitment that is entailed in opting for the market order and the privilege-free civil law society (Böhm 1980: 164). In no lesser clarity than modern public choice contributions on the problem of rent-seeking, the Freiburg ordoliberals described the fatal political dynamics that inevitably unfolds where governments and legislators are empowered to grant privileges and where, in consequence, special interest groups seek to obtain such privileges. As Böhm (1989: 66; 1980: 166) phrased it, the government "is constantly faced with a considerable temptation to meet the contradictory demands of many pressure groups. ... The fact that this tendency is, as it were, in the nature of things makes it a weakness of the system which must be taken seriously."<sup>31</sup>

What the ordoliberals made clear with their *constitutional approach* to market competition was that the competitive order must be considered a *public good*, and that – as in all public good cases – it is important to clearly distinguish between a person's interest in enjoying the benefits of a public good and her interest in contributing to its production. Applied to the *competitive order* as a public good, it is important to distinguish between, on the one side, the issue of whether a person has an interest in enjoying the benefits that a competitive market environment has to offer and, on the other side, the issue of whether it is in the person's interest willingly to submit to the constitutional constraints of a competitive market order (Böhm 1960: 165). As Böhm (1989: 63f.; 1980: 158) notes, it surely is in the common interest of all citizens that legislator and government act in accordance with their "constitutionally determined mandate ... to create, preserve and manage that regulative framework which guarantees the functioning of the free market." Such common interest does not prevent, however, that "it is possible for any participant and for any group of participants to obtain benefits by violating the rules, .... at the expense of other participants or groups of participants" (Böhm 1989: 64; 1980: 158), be it by explicit rule-violations such as the forming of cartels, be it by lobbying for special privileges. The latter strategy is, as Böhm (1980: 158f.) pointed out, particularly attractive because "in this case, the individual does not expose himself to the odium of cheating but demands are made of the legislator or the government to elevate cheating to a ... governmental programme ... Protective duties, tax privileges, direct subsidies, price supports, initial support for establishing monopoly or 'orderly markets' can be

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<sup>31</sup> Böhm (1973: 41) also clearly described the asymmetry in the political dynamics that makes it easy for politicians to grant privileges, but very difficult to take them away:

demanded. ... It is the state itself which is to be enjoined to override the rules of the prevailing order in favor of one group and at the expense of other groups or citizens."

Even if they did not use the term "public good," nor the concepts of game theory, the ordoliberals most clearly recognised that the "*game of competition*" represents a prisoners' dilemma, in the sense that, while all players are better off living under a competitive regime compared to potential alternative regimes, everybody has an interest in being exempt from the constraints that competition imposes. Yet, if everybody successfully seeks protection from competition for himself, all will end up in a through and through protectionist regime that is desirable for nobody, and that nobody would choose over the competitive alternative if the choice were between the two. It is in order to escape from this dilemma that all can benefit from committing to a competitive economic constitution, if that commitment is made credible by the presence of a government that effectively enforces the rules of the game of competition. And it is a violation of such commitment, a violation of the rules of the game, if players seek to escape the discipline of competition through private contrivances or by the means of politics (Böhm 1937: 126). This is the logic behind the ordoliberals' diagnosis that the competitive market order is not self-generating and self-maintaining but needs the assistance of *Ordnungspolitik*. In the language of game theory one might say that to them the principal task of *Ordnungspolitik* is to allow the economic players to escape from prisoners' dilemmata.

In assigning to the state the task of acting as "guardian of the competitive order," as "Hüter der Wettbewerbsordnung" (Eucken 1990: 327), the Freiburg ordoliberals found themselves facing a fundamental dilemma. The logic of their argument implied that the solution to the problem of guarding the competitive order had to come from an agency, the government, that they recognised, at the same time, to be a major source of the defects that it was supposed to cure. They did by no means naively expect an unqualified 'state' to act in the common interest but, instead, explicitly criticised the illusionary belief that government can be trusted to act as a benign and omniscient agent of the common good (Eucken 1932: 323; 1990: 331). Yet, they also insisted that the political order as it exists must not be taken as an unalterable fate, but should be regarded as something that can be and must be reformed (Eucken 1990: 338). And they were full aware of the fact that the real challenge is, in the political realm no less than in the economy, to establish a framework that induces ordinary, self-interested people to do, in pursuit of their own interest, what is in the common interest of all (Eucken 1940: 490f.). In other words, they recognised, much in line with modern Constitutional Economics, that the solution to the problem of rent-seeking must ultimately be

found in the political constitution (Eucken 1990: 327, 331f.). They saw that, before the state can be trusted to be a reliable guardian of the competitive economic constitution, the constitutional order of 'the state,' or the rules of the game of politics, are in need of reform (ibid.: 334). And they were aware, of course, of the fact that such reform can, again, only be achieved through the political process, and that, therefore, there can be no guarantees that a solution to the twofold constitutional problem will be achieved. But to them this was not an acceptable excuse for not making an effort to address this problem.

That the noted dilemma exists is not the fault of the Freiburg research program, it lies in the nature of things. And it speaks to the intellectual honesty of the founders of this program that they did not pretend to be able to offer an easy answer. A phrase that they used, and that has often been misunderstood, is the argument that a 'strong state' is needed to fend off interest group pressures. This was not meant as an argument in favour of an authoritarian state with large discretionary power. To the contrary, the Freiburg ordoliberalists expressly noted that it is the modern growth of the state's apparatus and activities, that have made it "a plaything in the hands of interest groups" (Eucken 1990: 326; Böhm 1980: 258 ).<sup>32</sup> The formula 'strong state' was meant by them as a shorthand for a state that is constrained by a political constitution that prevents government from becoming the target of special interest rent-seeking.<sup>33</sup> What such a constitution was to entail, i.e. how constitutional safeguards may be installed that effectively prevent the dynamics of privilege-seeking and privilege-granting, they did not discuss in detail. But they would have certainly subscribed to the general recommendation that the authority and the power to discriminate among citizens by granting privileges must be taken away from governments and legislators.

Eucken, in particular, emphasised the importance of extending the logic of *Ordnungspolitik* from the realm of the economic constitution to that of the political constitution. He explicitly stated that, just as *Ordnungspolitik* is needed in order to establish and to maintain an appropriate economic constitution, *Ordnungspolitik* is also needed at the

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<sup>32</sup> Eucken (1932: 307): "Die Umwandlung des liberalen Staates zum Wirtschaftsstaat bedeut für das staatliche, wie für das wirtschaftliche Leben sehr viel. Daß mit diesem Prozeß die Größe des Staatsapparates außerordentlich wächst, daß sein Etat mächtig anschwillt, daß er mit seinen Subventionen, Zöllen, Einfuhrverboten, Kontingenten, Moratorien usw. ... viel tiefer als früher in die Einkommensgestaltung des einzelnen eingreift, daß sich also eine entschiedene Expansion der Staatstätigkeiten vollzieht, ist oft geschildert worden. Solche Tatsachen dürfen aber nicht eine andere Seite der Sache übersehen lassen; diese Expansion nämlich ... bedeutet nicht etwa eine Stärkung, sondern ganz im Gegenteil eine Schwächung des Staates."

<sup>33</sup> As a "strong state" in this sense a state would qualify that meets Böhm's (1989: 61; 1980: 148) description: "The situation in a private law society, which is combined with a democratically structured constitutional state favours the realisation of a social structure which makes the attempt by social groups to exploit other social groups a more and more hopeless undertaking."

level of politics in order to establish and to maintain an appropriate political constitution.<sup>34</sup> His early death prevented Eucken from working out his thoughts on the notion of Ordnungspolitik for the political realm. But the paradigm that he and Böhm have launched clearly invites such an extension of its logic from the market arena to the political arena, and it is not least in this regard that the research program of constitutional political economy can be considered a natural complement of the Freiburg tradition.

The significant contribution that both these research programs, the ordo-liberalism of the Freiburg School and Buchanan's constitutional economics, have made to the classical liberal tradition is that they have sharpened our awareness of the *constitutional dimension of the liberal paradigm*, an awareness that is conspicuously absent in much of the libertarian doctrine with its emphasis on the 'unhampered market.' The research program of the Freiburg School has drawn attention to the fact that the liberal ideal of a free society and market competition is a *constitutional* ideal, that it has to be specified in constitutional terms, i.e. in terms of the specific rules of the game that it advocates, and that it has to be argued for in terms of its attractiveness as a constitutional regime. This insight implies that, in advancing his proposals for the constitutional order of a free society, the liberal must ultimately appeal to people's constitutional interests, and his arguments for a 'liberal order' amount, in the final analysis, to nothing other than the claim that people's common constitutional interests are better served by such an order than by feasible alternative regimes.

The particular significance of Buchanan's constitutional liberalism must be seen in the special emphasis that it adds to the constitutional theme, namely its insistence that a consistent liberalism cannot confine its normative principles of individual freedom of choice and voluntary contract to the sub-constitutional level of market transactions, but must extend them to the level of constitutional choice and constitutional contracting as well.<sup>35</sup> It is Buchanan's singular merit to have generalized the liberal ideal of voluntary cooperation from market choices to constitutional choices, from exchange contracts to social contracts, and to have shown thereby how the classical liberal paradigm can be generalized from its traditional emphasis on voluntary exchange and freedom of choice in markets to the level of constitutional

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<sup>34</sup> Eucken (1990: 331f.): "Die Ordnung des Staates ist ebenso eine Aufgabe wie die Ordnung der Wirtschaft. ... Denn es ist auch die ordnungspolitische Frage zu stellen: Wie kann ein leistungsfähiger Rechtsstaat aufgebaut werden? ... Und so bedarf der Aufbau des Staates abermals von Grund auf ordnungspolitischer Durchdenkung." – See also Eucken (ibid.: 338): "Die Interdependenz von Staatsordnung und Wirtschaftsordnung zwingt dazu, den Ordnungsaufbau von beiden in einem Zuge in Angriff zu nehmen."

<sup>35</sup> For further discussion see Vanberg 2001.

choices, thus supplementing in an important respect the earlier arguments of the Freiburg School.

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