

Manfred E. Streit
Michael Wohlgemuth*

The Market Economy and the State
Hayekian and ordoliberal conceptions
Diskussionsbeitrag 06-97*

Prof. Dr. Manfred E. Streit
Dipl.-Volksw. Michael Wohlgemuth
Max-Planck-Institut zur Erforschung von Wirtschaftssystemen
Abteilung Systemwandel und Wirtschaftspolitik
Kahlaische Straße 10, D 07745 Jena
Tel. (49) 3641 68 66 01
Fax: (49) 3641 68 66 10
e-mail: streit@mpiew-jena.mpg.de
wohlgemuth@mpiew-jena.mpg.de

* Paper prepared for the Fifth Annual SEEP-Conference on Economic Ethics and Philosophy, Section I, Marienrode 29 October - 1 November 1997.
We wish to thank Thoralf Erb, Jochen Jahraus, Uwe Mummert, Axel Schulz, Stefan Voigt and Tobias Winkler for valuable criticism and suggestions.

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I. Introduction

There is not and has never been *one* liberal conception of the market economy and the state. In fact, the term „liberal“ has received connotations that, especially in the United States but also, for example, in France, still support the old dictum of Schumpeter (1954/82: 394): „as a supreme, if unintended, compliment, the enemies of the system of private enterprise have thought it wise to appropriate its label.“

We shun the discussing of labels. We will simply identify one particular liberal position with the rich body of social philosophy of Friedrich A. Hayek which one may call „retro-liberal“, since basically it represents a rediscovery and reformulation of classical liberalism. Hayek’s conception of the market economy and the state will be compared with what is commonly called „ordoliberalism“. The term „ordoliberal“ already implies some specification since it represents a specific German tradition of this century. Still, there is not *one* ordoliberal conception of the market economy and its politics. For example, there are good reasons to distinguish between a Freiburg and a Cologne mode of (ordo-) liberal thought (e.g. Sally 1996: 248f; Vanberg 1988: 20ff). Even if both „schools“ have mostly unofficial and overlapping memberships, the former can be said to be more sceptical towards attempts to combine individual freedom on markets and social balance through government intervention, as highlighted in the politically effective term of a „social market economy“ (see Müller-Armack 1956/89). At any rate it would be wrong to equate any ordoliberal conception with the *practice* of the so-called „social market economy“ - which gradually developed into its actual dismal state (see, e.g. Streit 1998a). We will concentrate our analysis of ordoliberalism on Walter Eucken and Franz Böhm, two founding fathers of the „Freiburg School of Law and Economics“ (Streit 1994; 1992a). As will be shown, the work of these eminent ordoliberals is mostly complementary and can thus be combined to allow a comparison with Hayek’s elaborate system of social philosophy.

Our paper is organised as follows: First, we assess the mutual intellectual influence between Hayek and scholars of the Freiburg School, giving a short account of the respective historical and intellectual backgrounds (II). Next, we present the ordoliberal conception of the state and the market economy. As a main common theme of Eucken and Böhm we identify the problem of social power. This theme underlies the analytic and normative conception of the competitive order („Wettbewerbsordnung“) in the economic context and the rule of law („Rechtsstaat“) in the political context (III). Hayek’s views of the market and the state also have one dominant, common theme: the problem of individuals’ lack of knowledge. Obviously, this problem dominates Hayek’s view of the market as a spontaneous order of actions, or „catallaxy“. But also his social philosophy of the law and the state, his theory of the spontaneous order of rules, and his political ideal of „nomocracy“ is intrinsically related to the knowledge problem (IV). Having thus established a somewhat parallel plot of our presentation, we next try to establish common grounds and fundamental differences between both conceptions. The points of departure are located mainly in three areas: the appropriate meaning and politics of competition, the emergence and political shapeability of social institutions, and the meaning of the „social question“ (V). Finally, the lasting relevance of both liberal conceptions is briefly discussed from the perspective of Constitutional Economics. It is asked if the legacy of Eucken, Böhm, or Hayek contains not only basic insights into the malaise of modern welfare states, but also proposals for feasible

constitutional reforms (VI).

II. Hayek and the Freiburg School: Some historical notes

The relation between Hayek and the first generation of the Freiburg group around Eucken and Böhm¹ seems to be one of mutual benign neglect. At least, there is a distinct lack of *explicit* references to their respective works. This is surprising because Hayek and the ordoliberalists started with a common basic value judgement (individual liberty), focused on similar subject matters (like competition and the social order) and, in principle, arrived at similar policy implications (like limited government). Let us briefly review the literature in question and look for first explanations in the respective intellectual and historical backgrounds.

At least in his most prominent works, Hayek hardly makes any explicit reference to German ordoliberalism. This holds even for the growing body of his work written after he first met Eucken (around 1947) or came to live and work at Freiburg (in 1961)². On the other side, on ceremonial occasions he openly declared his „friendship of many years’ standing, based on the closest agreement on scientific as well as on political questions, with the unforgettable Walter Eucken“ (Hayek 1962/67: 252).³ Still, this agreement left virtually no explicit and concrete trace in Hayek’s work.

But the reverse is also true. Böhm and Eucken hardly ever explicitly referred to those works of Hayek which early enough became academically challenging (e.g. Hayek 1937/48 and 1945), widely discussed (e.g. Hayek 1935a, 1935b and 1940/94) and even notoriously famous (Hayek 1944). Perhaps most surprisingly, Hayek’s contributions to the calculation debate went totally unnoticed.⁴ As we will see, this observation might be telling, since it corresponds to theoretical shortcomings of Eucken’s analysis. The problem of dispersed knowledge which cannot be acquired by a central authority, the role of incentives for speculative and innovative entrepreneurship and hence the fundamental importance of capital markets for

¹ Hans Grossmann-Doerth, a professor of law was third among those who composed the „ordo manifesto of 1936“ (Böhm et. al 1936/89). He died in the war. For the authors’ assessments of the Freiburg School, see Streit (1992a, 1994), Kasper/Streit (1993) or Wohlgemuth (1996). See also Sally (1996), Peacock/Willgerodt (eds., 1989), Grosseckler (1989), Hutchison (1979) or Oliver (1960).

² In the trilogy on Law, Legislation and Liberty (Hayek 1973; 1976; 1979) Eucken is not mentioned. Böhm is given only one small note referring to his notion of „private law society“. In the „Constitution of Liberty“ (1960) only two articles of Böhm are mentioned in footnotes.

³ Eucken was the only German to come to the first international conference of liberals that Hayek called to the Swiss Mont Pèlerin in 1947 (see Hayek 1983/92: 191f.). Hayek also invited him to give a series of lectures at the London School of Economics in 1950 (see Eucken 1951/52), during which Eucken unexpectedly died. Hayek (1951/67: 199) stated that this „sudden death ... robbed the liberal revival of one of its really great men“; later he (1983/92: 189) even calls Eucken „probably the most serious thinker in the realm of social philosophy produced by Germany in the last hundred years“.

⁴ The debate on the feasibility of socialist calculation and of central emulations of market processes is referred to in only one longer footnote in Eucken (1940/92: 333f) - even though he devotes half of the book to a comparison of centrally administered and exchange economies. Later, Eucken (1952/90: 76f; 99ff, 136ff) fills several pages discussing the ideas of Lange and Barone without mentioning Hayek’s contribution. Even Mises is mentioned only once in an editor’s note to the posthumously published book. Some negligence may be due to the fact that foreign literature was just not available during the Nazi reign and in the difficult after-war-period (Hayek’s „Road to Serfdom“ remained censored even in the American Sector). However, Hayek’s early contributions to the calculation debate (1935a; 1935b) are part of a collection of essays (edited by Hayek) which Eucken himself refers to - dealing, however, only with the contributions of Barone.

evolutionary market processes remain mostly unnoticed. While these arguments acted as catalysts for a second generation of Austrian economics (see Vaughn 1994, ch.3, Wohlgenuth 1997), they did not reach the Freiburg School as early. On the other side, Hayek's early work on the „Decline of the Rule of Law“ (Hayek 1953) is very friendly received and extensively used by Böhm.⁵ And indeed, we will see that the legal and political philosophy of Hayek is very similar to that of Böhm. In some cases the work of Böhm can serve as a bridge connecting to Hayek's conceptions of the institutional order, where Eucken's views seem to be somewhat incomplete or inconsistent.

Hayek's comparative disregard of the literature by German ordoliberalism also might not be totally accidental. As it were, his intellectual background seems always to have been predominantly British, Austrian and, to a lesser degree, American. This is not only reflected in his selection of ideas, but also in his choice of empirical background and subject-matters. For example, Hayek's treating of institutional questions - especially his theory of the spontaneous order of the law - is intrinsically linked to the English system of common law. The intellectual Austrian background includes the first generation of Austrian economists (Menger, Böhm-Bawerk) and later Ludwig von Mises as his most important mentor. The influence of the Scottish moral philosophers (Hume, Smith, Ferguson), but also Mill, Mandeville, Locke and Dicey or Lord Acton is visible in all his social philosophy. Even politically, Hayek positioned himself within the history of the British party system, calling himself „an old Whig“.⁶ The fact that Hayek's ideas were deeply rooted in classical liberalism and its conception of a spontaneous development (evolution) of civilisation is essential in understanding his social philosophy. As we will see, this also helps to explain why Hayek on one occasion arrived at the judgement that „the Ordo circle ... was, shall we say, a restrained liberalism.“ (Hayek 1983/92: 190).

Concerning the Freiburg School, it can be argued, as Hayek (1951/67: 199) once did, that it differed from other schools of liberal thinking „in that its origin cannot be traced back directly to any great figure of the preceding generation.“ Its philosophical origin perhaps is most aptly described as Kantian⁷. As far as economics is concerned, the works of Eucken and Böhm can hardly be understood without accounting for the intellectual and political climate in Germany. Intellectually, especially Eucken was struggling to find an acceptable position overcoming the „great antinomy“ between the „individual-historical approach“ of the Historical School and the „general-theoretical“ approach of the Marginalist School (e.g. Eucken 1940/92: 34ff.) that found its expression in the acrimonious „*Methodenstreit*“ between Carl Menger and Gustav Schmoller. Eucken's solution led to his method of „isolating abstraction“ (ibid.: 107), borrowing from the phenomenologist philosophy of Husserl and others⁸. The ordoliberal conception of Eucken and Böhm is also

⁵ See Böhm (1953/60: 99 [fn.2]). Böhm (1957/60: 174) even explicitly names Hayek's work on the rule of law as an example of the general interdisciplinary character of the Freiburg School.

⁶ Hayek, in his biographical sketch, notes that „the real root“ of his ideas lays „with Ferguson and these peoples“ (1994: 140). Concerning his political affinities, he reports a meeting with the British Prime Minister: „The last time I met her she used the phrase, ‘I know you want me to become a Whig; no, I am a Tory’. So she has felt this very clearly.“ (ibid.: 141).

⁷ See also Möschel (1989: 149); Albert (1985: 54), Sally (1996: 238). References to Kantian conceptions of liberty and the law can be found in Eucken (e.g. 1952/90: 52, 126, 176).

⁸ Husserl developed the principle of „phenomenological reduction“ which influenced Eucken's „abstraction of significant salient features“ (1940/92: 332, note 28). Instead of „generalising abstraction“ which seeks to identify common traits of different phenomena, Eucken was convinced

marked by idiosyncrasies of German history. The traumatic experience with both interventionism and collectivism motivated the ordoliberalists' declared programmatic interest in active economic policy. The task to reorganise the institutional structure and relationship of state and society - the mutual interpenetration of which has been a recurrent cause of German „roads to serfdom“ - was deeply felt by German ordoliberalists. As we will see, this experience might help to explain the scepticism towards invisible-hand-explanations of institutional change as they were to be taken up by Hayek.

III. The ordoliberal conception of the state and the market economy

the two-sided problem of power

The theoretical and political programme of the Freiburg School can be described in the words of Böhm (1957/60: 162) as follows:

„The question that preoccupied us all, was ... the question of private power in a free society. This leads by necessity to the further question of what an order of a free economy is made of. From there one arrives at the question, what kinds and possibilities of an economic order are at all feasible, what role is played by power in each, in fact the power of government as well as the power of private persons and groups, and what obstructions of order arise if a distribution of power emerges within state and society which differs from that which conforms to the respective economic system.“

Note that these questions referring to „power“ and „order“ as the key-notions of ordoliberalism differ from typical economic concepts as well as typical legal concepts. For the Freiburg School, they define the fields of common theoretical interest and political concern which centres around the basic concept of the competitive order („Wettbewerbsordnung“). The central and defining concern of ordoliberalism was to establish „order“ as a set of legal rules for a society of essentially self-reliant decision makers whose actions are controlled and co-ordinated by market competition. „The lawyer knows what private law is. The economist knows what the market economy is“ (Böhm 1966/89: 46). In order to know what the competitive order is and how it can be achieved in practice, the knowledge of the lawyer and of the economist must be brought together. They combine in a characteristic ordo-view of the economic and political problem of power. It is a key message of the Freiburg tradition that private (market-) power not only reduces the freedom of the many in favour of the domination by the few in the economic system, but that it also penetrates and impairs the political system. We now turn to the first, and, according to ordoliberalism, original, aspect of the problem of social power.

power and the market: the ordoliberal conception of the „Wettbewerbsordnung“

The above question of „how an order of a free economy is constituted“ was understood by Böhm as a problem of an adequate legal order. Free market exchange above all requires a system of rules, defining a protected domain (property rights) and allowing co-operation of equals (private contracts) where they seek it and

that it should be possible to identify certain recurrent elementary forms in economic life. This is how he went to isolate the centrally directed and the exchange economy as conceptual answers to the following question: „Does one central authority direct everyday life, or do countless single individuals make their own decisions?“ (ibid.: 81).

settlement of conflicts (arbitration) where they need it. A society that builds on these principles is justly called a private law society („Privatrechtsgesellschaft“, see Böhm 1966/89). However, the basic provisions of private law still provide no complete answer to the question of private power. This was a central lesson drawn from German economic and legal history: Private attempts to close markets (e.g. by formation of cartels) were considered legitimate uses of the freedom of contract, and boycotts or collective discrimination applied against outsiders received support from the courts. Hence, the freedom to compete of third parties was reduced to the effect that economic power became vested in the formalism of private law. Therefore, ordoliberals insisted in supplementing the private law society with an institutional guarantee of open markets in order to ensure that market competition can display its central function as „the most genial instrument of emasculating power“ (Böhm 1961: 22).

This is the most important and original contribution of the Freiburg School to a political economy of the market: competition is not only (and not even primarily) regarded as a means to achieve „economic“ goals like growth and efficiency. It is mainly advocated as a procedure to curb the power of economic agents and organisations. Economic power, in turn, is regarded as evil not only because it cripples the price mechanism and its allocative potential, but also, and primarily, because it allows infringements on the liberty of others which is regarded the fundamental precondition of moral behaviour⁹. In accordance with this broader view of competition, ordoliberals developed a broader and more articulate assessment of the preconditions of competition than the neoclassical marginalists. Whereas the latter employed simple „rules“ of decision logic to deduce abstract results, ordoliberals emphasised legal rules and principles that structure real market processes.¹⁰

The institutional framework of the competitive order is most prominently described by the famous „principles“ laid down by Eucken (1952/90: 254ff). As „fundamental principle“ the creation of a workable price system is postulated. As „constituent principles“, conducive to a well-functioning price system, he enumerates the stability of the monetary system, open markets, private property, freedom to contract, liability for one’s commitments and actions, and steadiness of economic policy. Necessities for political interventions that might still arise should be accounted for along „regulating principles“ like monopoly control, income policies and the correction of technological external effects (ibid.: 291ff). These principles, of course, have no other addressee than government. Now arises another central and, as we will see, somewhat distinguishing trait of ordoliberalism. It is based on the view that „a private law society cannot function without authority ... it requires a support, which it cannot produce from within its own resources, in order to function at all.“ (Böhm 1966/89: 51). By conferring such an authority to the state and hence to politicians, a second problem of power necessarily emerges: political power.

power and the state: the ordoliberal conception of „Rechtsstaat“

⁹ See e.g. Eucken (1952/90: 126) referring to Kant’s fundamental moral principle that individuals must be regarded ends in and of themselves, not means towards the achievement of others’ ends. Böhm’s conception of private autonomy (e.g. 1980: 202f) is an expression of the same principle.

¹⁰ Regarding the economic properties of his ideal type of „complete competition“ Eucken (much more than Böhm) at least terminologically remained in the vicinity of the neoclassical paradigm as he found it. As we will discuss later, the main thrust of the Hayek-critique remained unrecognised.

As we have seen, ordoliberals assigned to competition a rôle which went beyond its economic importance. Because of its capacity to curb economic as well as ensuing political power it deserved protection by the law. Competition policy was considered a genuine task of the state. This implied also that the state had to refrain from any activities which could restrain competition. Considered from this point of view, it seems rather straightforward that ordoliberals advocate a strong but limited government. It must be strong in order to be able to hold out against monopolies and pressure groups, thus safeguarding the „economic constitution“¹¹. At the same time, it must be limited to pursue only this genuine task and use only liberty- and market compatible means. Hence, it was required that activities of the state should conform to the functioning of the markets. Seen from the point of view of the economic constitution, it was the task of the state to protect the private autonomy of the individual agents against infringements due to restraints of competition resulting in economic power. At the same time this would prevent that private power could impair the political decision making process. This process was supposed to be structured by a political constitution which displayed features corresponding to the economic constitution: It had the double task (1) to grant independence those who are entrusted and legitimised to make laws and to govern, thus allowing for political neutrality or „strength“ against economic power groups and (2) to provide a sophisticated combination of checks and balances, thus preventing and limiting an arbitrary use of political coercive power. Such a structure displays the salient features of the ordoliberal conception of the rule of law.

It should be evident that this conception of the „*Rechtsstaat*“ is a far cry from an image of the „benevolent dictator“ that still looms large in welfare economics.¹² Eucken (1952/90: 338) made this unmistakably clear: „It is wrong to see the existing state as an all-knowing, all-powerful guardian of all economic activity. But it is also incorrect to accept the existing state which is corrupted by interest groups as irreversibly given and consequently to despair of mastering the problem of building a proper political-economic order.“ Eucken and no less Böhm evidently opposed unlimited government; they clearly exposed the institutional framework of what later became known as the „rent-seeking society“ (see Tollison 1982); and they proposed institutional precautions to prevent the „wild refeudalisation of society“ (Böhm 1958/80: 258) they have witnessed in German history (see already Eucken 1932 and Böhm 1933).¹³ At best, therefore, they can be „criticised“ for not having produced an „economic theory of politics“ which was only later to become a theory of public choice (see section VI).

That a strong and limited state is no contradiction in terms, that political authority, and constitutional limitations actually complement each other, became a central tenet

¹¹ A modern interpretation and application of the conception of „economic constitution“ is provided by Streit/Mussler (1994: 319ff). It has been developed mainly by one of Böhm's collaborators, Ernst-Joachim Mestmäcker (e.g. 1973/74; 1996).

¹² It reveals a biased and very selective reading, when Kirchgässner (1988) claims that (a) ordoliberals restricted their analysis to the realm of production and consumption of goods and services (ibid.: 55), when he insinuates that (b) they did not perceive the problem of political power exercised by economic power groups (ibid.: 57) and when, finally, he is led to argue that (c) ordoliberals „take the image of the benevolent dictator for granted, whose action contradicts the social welfare only if he is either uninformed or malicious.“ (ibid.: 60).

¹³ We do, however, agree with Kirchgässner (1988: 67) that Eucken's (1952/90: 334) principle that politics ought to be „directed at the dissolution of economic power groups or limit their functions“ is rather crude and difficult to reconcile with liberal rights to association (see below, VI).

of ordoliberalism. That an unlimited state is always in danger of being weakened and corrupted by economic power groups was a central conclusion that ordoliberals drew from German history, especially from the period of „experimental economic policies“. Eucken (1932: 307) observed that the „expansion of government activities ... not at all meant a strengthening, but to the contrary, a weakening of the state“. ¹⁴ The corruption of the political order and unreliability of economic institutions combined with politicians' subsequent dependence upon economic power groups is a prominent example of the general idea of an „interdependence“ of the legal, political, and economic order (e.g. Eucken 1952/90: 332ff). The analysis of the collusion of public and private power in cartel-like, corporativistic arrangements, or the „capturing“ of the state by vested interests (Böhm 1950: xxxvi) can still serve as very apt descriptions of the weakness of modern welfare states. We will come back to this part of the ordoliberal analysis.

IV. The Hayekian conception of the state and the market economy

the two-sided problem of knowledge

Like the ordoliberals, Hayek developed and sharpened his conception of the market and the proper role of the state through the confrontation with practical and theoretical attempts of central planning during the 1930s. However, the perception and reaction to this challenge differ. Eucken and Böhm looked upon Germany's history of political experiments including the later command economy and upon the theory of economic systems focusing on economic and political power. Hayek, in turn, discussed the unfeasibility of socialist planning and the major merits of capitalism focusing on the ability to make use of subjective, non-centralisable knowledge and skills. This is how he discovered the „division of knowledge“ which he regarded „the really central problem of economics as a social science“ (1937/48: 50). ¹⁵ The problem of the division of knowledge and its underlying fact of a constitutional lack of knowledge was to become the starting point of almost all of Hayek's ensuing work, as he repeatedly emphasised:

„The fundamental condition from which any intelligent discussion of the order of all social activities should start is the constitutional and irremediable ignorance both of the acting persons and of the scientist observing this order, of the multiplicity of particular, concrete facts which enter this order of human activities because they are known by *some* of its members.“ (1967/78: 71).

This view underlies Hayek's approach to the spontaneous order of economic actions, the „catallaxy“, as well as to the rule of law, the „nomocracy“.

¹⁴ This is exactly what Hayek (1979: 99) pointed out, namely that „democratic government, if nominally omnipotent, becomes as a result of unlimited powers exceedingly weak, the playball of all the separate interests it has to satisfy to secure majority support.“

¹⁵ Hayek's basic ideas on the „use of knowledge in society“ (Hayek 1945) have much of their „micro-foundation“ in his early studies in cognitive psychology. There he analyses the mental process by which sensory experience of an individual is structured, leading to subjective images of the world as patterns of perception or cognition. Links between the „Sensory Order“ (published in 1952 - some 30 years after Hayek wrote the book) and Hayek's later views on the spontaneous order of interactions and social rules are shown by Streit (1993).

knowledge and the market: Hayek's conception of „catallaxy“

The problem of the division of knowledge concerns the following questions which need to be answered in every economic order (Streit 1998b: 40): (a) How are individuals induced to procure knowledge that may turn out to be useful for their own purposes? (b) How is subjective knowledge about economic circumstances disseminated, which may also be useful to others for their own dispositions? (c) How is the utilisation of knowledge controlled in order to reveal possible errors? (d) How are errors counteracted and thus limited in their overall economic consequences? Hayek's (1968/78) answer was: through „competition as a discovery procedure“ and as the driving force of a system of voluntary exchange that he called „catallaxy“ (e.g. 1967/78: 90ff). In a catallaxy, every individual is free to use his or her unique knowledge of particular opportunities and possibilities for his or her own purposes. In addition, competitive market processes provide incentives to procure knowledge and use personal skills as means of economic survival. Unfettered markets also convey information to others through changes in the structure of prices, if only „in a coded form“ (1976: 117). Prices induce promising transactions on the part of those actors who incur (transaction-) costs and command enough skill and good luck in interpreting the signals in view of their personal economic circumstances. Such transactions can counteract errors of others, who in turn are exposed to price effects which provide pressures to adjust. In this way the system allows to discover and use the dispersed knowledge and skills which as a whole are not accessible to anyone¹⁶. In addition, it tends to be restabilised in the sense that cumulative errors are made unlikely.

Like the price mechanism, abstract rules of just conduct allow individuals to adjust to events and circumstances which are not known to anyone in their entirety. In the market as well as in other complex and anonymous interactions, actors who try to coordinate their behaviour would be lost if they could not perceive and rely on regularities in the conduct of others, which enable them to form corresponding expectations. In order to act as mutual stabilisers of expectations, or as „successful adaptations to the irremediable limitations of our knowledge“ (Hayek 1967/78: 72), the rules of conduct (institutions) have to conform to certain principles, most notably to the principle of universalisability. This principle is at the heart of Hayek's notion of the rule of law which will now be considered.

knowledge and the state: Hayek's conception of „nomocracy“

Eucken (1940/92: 81) once asked: „If many individual economic units, though they make their plans independently, are dependent on and exchange with one another, ..., then the question arises to the form of the system of exchange relationships. What are the rules of the game?“. Hayek's answer was that these rules of the game must (a) allow individuals to pursue their own objectives by making use of their own knowledge and skills, and (b) enable them to form reliable expectations about the conduct of others. Such rules would have to (c) define a protected sphere of

¹⁶ This property has far-reaching consequences. It means no less than a renunciation of conventional price theory. Thus, it is no longer appropriate to assume „given“ and „homogenous“ goods, because „which goods are scarce goods, and how scarce or valuable they are - these are precisely the things which competition has to discover.“ (Hayek 1968/78: 181). But also the benchmark of traditional economics - efficiency - becomes irrelevant if applied beyond a pure individual logic of choice: „If we do not know the facts we hope to discover by means of competition, we can never ascertain how effective it has been in discovering those facts that might be discovered“ (ibid.: 180).

individuals' autonomy to act, thus preventing interpersonal conflicts while (d) at the same time keeping the system open for the discovery and realisation of actions that have not been thought of before.

Hayek (e.g. 1967/78: 77) identifies such rules as „nomos“, that is abstract or universal „rules of just conduct“. ¹⁷ Such rules can be found within the formal body of private law, but also as customs and conventions which may even be more important in daily economic affairs (e.g. Hayek 1970/78, 8f). They conform to the meaning of universalisability in the tradition of Hume or Kant, requiring that the rules be (a) general, i.e. „applicable to an unknown and indeterminable number of persons and instances“ (Hayek 1973: 50), (b) open, i.e. they merely describe those actions which are not allowed and thus leave it to the individuals to discover innovative modes of action (e.g. Hayek 1976: 36ff) and (c) certain and distinct, i.e. they can be relied upon, allowing actors to identify in practice those actions which are not allowed (Hayek 1960: 208f). ¹⁸

These abstract rules of just conduct not only contribute to a spontaneous order of co-ordination and control of interactions. For Hayek, most of them are themselves the result of spontaneous development (evolution). Hence, most abstract rules of just conduct are described by Hayek as purpose-free not only in terms of their content but also in view of their creation. Since they have to be appropriate to purposes and circumstances which no one can know in their entirety, the rules can not have been designed to bring about concrete pre-known results. Rather, in a process of learning to cope with many exigencies they were discovered as behavioural guides which proved to be also valuable in unforeseen circumstances. Hayek argues in the tradition of Scottish moral philosophy that civilisations in which freedom-oriented abstract rules could prevail prospered because they favoured the „process of adaptation and learning“ (Hayek 1960: 40) that is necessary for cultural evolution. ¹⁹

Hayek's concept of the Rule of Law is foremost the reformulation of the above-described notion of „nomos“ as a political principle. In opposition to a „teleocracy“ where citizens' actions are deliberately directed towards particular political ends, Hayek's political ideal of the rule of law is that of a „nomocracy“ - the „empire of laws and not of men“ (Hayek 1967/78: 98). Here „the 'public good' or 'general welfare' consists solely in the preservation of that abstract and end-independent order which is secured by obedience to abstract rules of just conduct“ (ibid.). This means in view of the necessary and legitimate task of the state, that it should conform to

¹⁷ See e.g. Hayek (1976: 31), explicitly pointing at the complementary conceptions of Böhm (and Popper) when he states that the rules of just conduct „are the *nomos* which is at the basis of a 'private law society' and makes an Open Society possible.“

¹⁸ As a main indicator of the „certainty of the law“ Hayek (ibid.) names the amount of „disputes which do not lead to litigation because the outcome is practically certain as soon as the legal position is examined.“ In line with the tradition of the common law, he insists that the rules need not be explicitly known or written down. It is rather an implicit „sense of justice“ that in the end guides the judges' application of the rules of just conduct and that, if traditionally transmitted and shared within a community, determines the certainty of the law (e.g. Hayek 1973: 155ff.).

¹⁹ Hayek's theory of cultural evolution (see 1988: ch.1 and 8 or 1979: 153ff), based on the principle of group selection in an environment of unconscious learning and adaptation of rules by group members cannot be discussed here in detail. His idea that groups which found and followed certain abstract rules could outgrow the organisational limitations of small groups and reach prosperity in the extended order of catallaxy may be a telling „conjectural history“. Its applicability to institutional change of modern legal rules and constitutions is rather dubious, however. Many critics have identified similar weaknesses in Hayek's reasoning (e.g. Vanberg 1986, Witt 1994).

„the basic principle of the limitation of the coercive powers of government to the enforcement of general rules of just conduct“ (Hayek 1978a: 132). As we will see in part VI, this view of the rule of law as „nomocracy“ lead Hayek to develop a particular proposal on how the separation of powers in a democracy should be (re-) organised in order to keep the legislative body within the limits of „real“ legislation (the setting or „finding“ of *nomos*) and separate it from the administration of government which should be controlled through another representative body.

V. Common grounds and major differences

common grounds

Even if Eucken, Böhm, and Hayek, as we have shown, started from different traditions and chose different approaches, in many respects they met on common grounds. What they basically share is, first of all, a normative position in favour of individual liberty, which created an equally deep interest in problems of the economic and political order, the analysis of which followed a common, basic *Leitmotiv* that „institutions matter“. To the question „What matters *most* about institutions?“ answers may differ - not in substance, but in emphasis. Hayek would stress the co-ordination properties of institutions regarding the knowledge problem; Eucken or Böhm would stress the controlling properties regarding the problem of power. Neither, however, would have denied or even belittled the importance of *both* fundamental functions of social institutions. Ordoliberals and Hayek evidently share the general position that individual freedom and social order are no opposites and that the observance of social rules of conduct and hence general restraints on behaviour are prerequisite for the attainment of an economic and political order of a free people.²⁰ They also agree on the principle that public policies should not only be committed to the task of maintaining the legal order, but also more (Hayek) or less (Eucken) strictly limited to do just that. Both are equally strict in rejecting political activism in pursuit of specific market outcomes which they regard as arbitrary (and hence a threat to individual liberty), disorienting and destabilising.²¹ Within these common grounds one also finds some rather similar methodological roots. Two aspects may shortly be mentioned:

(1) Ordoliberals and Hayek not only shared normative basic positions. They also held similar views as to how to deal with values independent of their own normative position. Eucken and Hayek explicitly rejected the common misinterpretation of Weber's dictum on inadmissible value judgements in the social sciences.²² Hayek

²⁰ One must bear in mind, however, that the different perspectives also produced different meanings of „order“. For Eucken, „order“ has two possible meanings: that of any realised form of a social system within which the ordinary economic process occurs or the normative ideal type of *Ordo*, the order that „corresponds to reason or the nature of men“ (Eucken 1952/90: 372). Regarding the first meaning, conditions for the emergence of order and for distinguishing order from disorder play no role, regarding the second they remain dubious and rather close to naturalistic fallacies (see Streit 1992a: 681). Hayek uses a theoretically more meaningful individualistic definition of „order“ which directly relates to the problem of the division of knowledge: „The achievement of human purposes is possible only because we recognise the world we live in as orderly. This order manifests itself in our ability to learn, from the (spatial or temporal) parts of the world we know, rules which enable us to form expectations about other parts.“ (Hayek 1967/78: 72).

²¹ Consequently, Hayek and the ordoliberals rejected Keynesianism both as a theoretical system and as a political tool-kit. Hayek already during the 1930s was regarded the principal rival of (his personal friend) Keynes in the field of monetary and business cycles theory (see, e.g., Hicks 1967). He repeatedly blamed himself for not returning to the attack when Keynes published his „General Theory“ (e.g. Hayek 1966/78: 284). Later, he could only deplore the Keynesian legacy of inflationary politics (e.g. Hayek 1972). Eucken (e.g. 1948/89: 44) early pointed at disrupting effects of demand manipulations on the „scarcity gauge“ of relative prices.

²² See Albert (1967/72) for a comprehensive recapitulation of Weber's position and its misapprehensions within the social sciences. Here, it is also outlined in more detail that one has to distinguish between (a) unavoidable basic value judgements in the process of identifying problems and selecting subject matters, (b) values that prevail within the social and institutional objects under observation and (c) value judgements that express an opinion based on a normative principle and aimed at prescribing a certain behaviour of the addressees. A „Werturteilsproblem“ is only implied in

(1962/67: 253) argues that this „unfortunately has often produced a fear of expressing any value judgement and even an avoidance of the most important problems which the economist ought frankly to face in his teaching.“ His own work shows that since the object of analysis, the spontaneous order, is the result of complying with rules of just conduct, it would be an inappropriate abstraction to refrain from dealing with norms. These formal and informal rules also reflect and are supported by a basic value, namely individual liberty. Eucken (1952/90: 340ff) explicitly goes even one step further, claiming it a duty for social scientists to propose what they regard the right and just social order. One has to accept that basic value judgements guiding the interpretation and selection of problems for examination are unavoidable, as e.g. Böhm (1957/60: 159) stated. More importantly, values and norms are an essential part of the institutional structure and hence of the subject matter under analysis.²³ To be sure, ordoliberalism and Hayek also did not shun outright value-judgements in politics and morals. However, these were not hidden (or: „crypto-normative“) but clearly identifiable.²⁴ At any rate, both strands of liberalism obviously shared the view that social sciences cannot usefully be separated from moral philosophy.

(2) Ordoliberalism and Hayek also shared a common uneasiness with the dominant mainstream of economic modelling. While this is most obvious in the case of Hayek, in the case of Eucken the distance to contemporary neoclassical modes of thought is, as we will see, less evident. Still, we may note that Eucken (1948/65: 197) cites approvingly the following dictum of Lord Robbins: „in the excitement of perfecting our instruments of analysis, we have tended to neglect a study of the framework which they assume.“ The basic message of „Ordnungstheorie“, that depending on the institutional order economic processes have different meanings and take different developments (e.g. Eucken 1952/90: 24), has only recently been rediscovered by more than just a few economists. At least, this holds true for the „New Institutional Economics“, beginning with studies on the effects of different arrangements of property rights (e.g. Furubotn/Pejovich 1972) and continuing, among others, in the field of economic history and the theory of growth (e.g. North 1990).²⁵

major differences

The different approaches - Hayek's predominant view based on the problem of the division of knowledge and the ordoliberalism's preoccupation with the problem of private economic power - led to major differences in the theory and politics of (1) competition, (2) institutional change and (3) social justice.

(1) Hayek's view of competition as a „discovery procedure“ forced him to abandon

the latter case. Here, it becomes imperative to make the personal value basis transparent.

²³ On the „ethics of rules“ or the normativity of market institutions, see Streit (1992/95: 147ff).

²⁴ See Kirchgässner (1988: 62ff) who blames a „crypto-normative content“ in ordoliberal and Hayekian statements. What seems to make it worse - according to an implicit value judgement of Kirchgässner - is that some ordoliberal opinions are not in line with what he believes to be a majority opinion. From that it is inferred that such ideas are not „democratic“ (ibid.: 65ff). We will have to come back to this latter allegation.

²⁵ See Schmidtchen (1984) or Tietzel (1991) for a detailed discussion of relations between ordoliberal conceptions and parts of the New Institutional Economics. Relations to Constitutional Economics will be shortly discussed in section VI.

conventional equilibrium theory²⁶, whereas the ordo-conception of competition as an „emasculating instrument“ might have allowed to stick to an ideal type not unlike, for that matter, perfect competition. These differences have consequences in competition policy.

(2) Hayek's concept of institutions as „an adaptation to our ignorance“ (1976: 39) led most naturally to an evolutionary concept of social institutions and scepticism regarding conscious institutional changes, whereas the ordo-view of institutions as instruments to reduce private power produced the task of „fashioning the legal instruments for an economic constitution“, which has to be „understood as a general political decision as to how the economic life of the nation is to be structured.“ (Böhm et al. 1936/89: 24).

(3) Hayek's concept of catallaxy leaves no room in a meaningful way to pose „the social question“ aiming at distributive justice; his concept of „nomocracy“ precludes political attempts to answer this question by employing any discriminatory means. Ordoliberal, in turn, cannot simply discard the social question once they define economic power also in material terms requiring to pass judgements on market results and take a comparatively instrumentalist approach towards the economic constitution.

All three differences could be stylised to create an outright opposition between Hayekian and ordoliberal views. A more cautious and sympathetic reading of textual and historical contexts, however, should help to explain and qualify some of the differences. It will sometimes even allow for an integrative perspective.

the meaning of competition: Austrian and Freiburgian views

Eucken's lifetime struggle with the „great antinomy“ led him to produce compromises some of which today appear rather outdated. This particularly holds for his attempt to distance himself from the Historical School by adopting, at least to some extent, concepts of contemporary neoclassical economics. It has often been noted that Eucken's concept of „complete competition“ („vollständiger Wettbewerb“, e.g. 1952/90: 244ff) resembles the static concept of „perfect competition“ which, as Hayek (1937/48, 1945) was amongst the first to show, is totally inappropriate to account for the primary functions and achievements of competitive processes. Taking an equilibrium state of an economy at rest, deduced from assumptions of perfect information and foresight, as an objective for political action not only amounts to a conceptually dubious „Nirvana approach“ (see Demsetz 1969). It also means taking a constructivist view on the market economy which is treated like a purposeful organisation or „teleocracy“ (see Streit 1993: 237).

At least in Eucken's writings the presence of both, „Nirvana“- and constructivist fallacies cannot be totally denied.²⁷ However, it should be remembered that his ideal

²⁶ There is a discussion on whether Hayek has completely abandoned the concept of equilibrium. For example, some of his presentations of market processes seem to imply the idea of a „tendency towards equilibrium“ not unlike the one used, e.g. by Kirzner (1973). For an analysis of these questions, see Loy (1988).

²⁷ To be sure, deviations from the model of perfect competition can be found. Eucken (1952/90: 24) rejected the condition of „perfect competition“ that goods be homogenous, as unrealistic. Hayek did so too, but his objection was more substantial: „because of the ever changing character of our needs and our knowledge, or the infinite variety of human skills and capacities, the ideal state cannot be one requiring an identical character of large numbers of products and services.“ (1946/48: 104).

type of „complete“ competition was not in the first instance used as an indicator of efficiency. It was rather circumscribing the ideal of a consumer-oriented economy in which the social and political problem of economic power is solved. Still, the old *ordo*- view of competition was far from integrating entrepreneurship and innovation in a theory of market processes - processes which necessarily disturb equilibria and create instability (not absence) of economic power. Schumpeter's (1912/34 and 1942/87) early attempts in the field of economic development and entrepreneurship were noticed by Eucken - which is about all one can say.²⁸ Hayek's (1937 and 1945) fundamental critique of any theory of market competition that presupposes given or complete information, went totally unnoticed - so one must say.

The consequences of taking either the knowledge problem or the power problem as basic points of departure become most clear in the field of competition policy. The emerging difference is most striking when it comes to the question of monopoly regulation. For Hayek (e.g. 1979: 70f) any attempt to make a firm act „as if“ competition existed is simply absurd, since a discovery procedure's results cannot be anticipated and hence not dictated. In addition, „discretionary power given to authorities for the purpose of merely preventing 'abuses'“ would rather lead to the agency protecting the monopoly against newcomers (ibid.: 86). Thus Hayek's views have led to the political concept of „freedom to compete“²⁹, which centres around the strict application of „*nomos*“ and can be expressed with a single legal principle: „to declare invalid and legally unenforceable all agreement in restraint of trade, without any exceptions, and to prevent all attempts to enforce them ...by aimed discrimination or the like by giving those upon whom such pressures were brought a claim for multiple damages“ (ibid.). Eucken, in turn, did neither seem to be aware of the knowledge problems nor of the risks of „captured“ agencies when he explicitly declares an aim of a governmental monopoly agency to urge monopolists to act „as if there was complete competition“ (Eucken 1952/90: 295 or 1949: 68).³⁰ He goes on to state that „the price has to be fixed such that supply and demand reach their equilibrium and at the same time equals marginal costs“ (Eucken 1952/90: 297; 1949: 69). This is exactly the view that Hayek (1940/94) challenged in another context, namely when he assessed Lange's proposal of market socialism, attacking „an excessive preoccupation with problems of the pure theory of stationary equilibrium.“ (ibid.: 240).

Considering Hayek's view of competition and taking into account new insights of property rights analysis and transaction cost economics, the following central tenets of a modern „neo-ordoliberal“ concept of market competition can be formulated: Competition is a process during which (1) knowledge about possibilities of substitution (i.e. opportunity costs) is discovered and disseminated, (2) control of the use of property rights is exerted through actual and potential substitution of partners to (and objects of) transaction and (3) incentives to reassess the individual portfolio

²⁸ Eucken (1940/92) deals with Schumpeter in some footnotes; but there he is mainly concerned with attaching labels like „positivist“ or „relativist“ on Schumpeter and his social philosophy.

²⁹ This concept was established primarily by Erich Hoppmann (e.g. 1988, part II), successor of Hayek at Freiburg. It is mainly inspired by Hayekian competition theory. But also the fundamental principles of Böhm's elaborate ideas on competition policy are mostly in line with the concept of „Wettbewerbsfreiheit“ or „freedom to compete“. Eucken's concept, in turn, bears much more resemblance to the „structure-conduct-performance“ paradigm of the Harvard School, in opposition to which Hoppmann developed his concept of a purpose-free order of free competition.

³⁰ Eucken seems to have come under the influence of his disciple Leonhard Miksch (e.g. 1949) when he adopted the idea of regulation according to preconceptions of an „as-if competition“.

of property rights are provided through the price effects of transactions. For competitive processes to sufficiently fulfil these functions, it is necessary that individuals incur transaction costs, the level of which, in turn, depends on the quality of the institutional order that underlies market co-ordination and competitive control. Given this, the intensity of competition is related to the propensity of market participants to incur transaction costs (Streit/Wegner 1992). Along these lines, and setting aside the differences in conceptualising competition and competition policy, the Hayekian knowledge problem and the ordoliberal occupation with the competitive order of rules can be brought together to form one integrated body of thinking in terms of the market-process and the market order.³¹

the emergence of institutions: spontaneous order and intentional rule-setting

As we have once again seen in the above context, Hayek emphasised the threat to the free market system emanating above all from the state's attempt to steer a purpose-free, self-organising, and complex order of actions, or from politicians' „presumption of knowledge“, whereas ordoliberals stressed that the economic freedom is mainly endangered from within, by economic power groups facing a „weak“ state that is unable to maintain the competitive order. This difference in emphasis is also reflected in the respective positive and normative theories of institutional change.

Eucken and, to a lesser degree, Böhm³² criticised the idea that the rules for a free, competitive order would ever emerge and be maintained spontaneously. For them, „it is not enough to realise certain principles of law and for the rest leave the development of the economic order to itself ... “ (Eucken 1952/90: 373). This, at first glance, seems to be in open opposition to (the later) Hayek³³. And indeed, on a continuum of positions between purely „evolutionist“ and purely „constructivist“, while none covers the extreme positions, Hayek is closer to the evolutionist position, while the ordoliberals are somewhere in the middle, but tending to the constructivist stance if the institutional framework of the competitive order is concerned.

Concerning the economic order of actions, ordoliberals and Hayek similarly describe and propagate the image of market co-ordination as spontaneous interactions within rules. Both deplore the effects of the state's intervening in the precarious price-signalling and controlling mechanisms of competitive market processes. When it comes to the institutional order, however, ordoliberals attempt to make a sharp distinction: while the day-to-day economic processes - the market „game“ - are not to

³¹ The work of Möschel, Mestmäcker and Hoppmann stands for this integration of Hayekian insights into a new ordoliberal assessment; see also the contributions of Streit (1992a: 685; 1992b).

³² Böhm's account of the origins of the private law society is quite in line with Hayek's philosophy of the law; see e.g. Böhm (1966/89: 46). Böhm (1957/60: 97) also joins Hayek when he argues that at least the elementary principles of the law are not „made“, but „found“. Hence it is justified to argue that Böhm „strikes a different, evolutionary note“ (Sally 1996: 243).

³³ In his „Free Enterprise and Competitive Order“ Hayek (1948) still argued very similar to the ordoliberals' critique of classical liberalism, and proposed a „policy which deliberately adopts competition, the market, and prices as its ordering principle and uses the legal framework enforced by the state in order to make competition as effective and beneficial as possible - and to supplement it where, and only where, it cannot be effective“ (ibid.: 110). He goes on to discuss unemployment insurance, town planning, patents, trade-marks, cartel building contracts, limited liability corporations and what today are called „incomplete contracts“ opting for special legal provisions. Further indications of a somewhat „constructivist“ Hayek are found by Vanberg (1986). The fact that Hayek constructed a model constitution is discussed in part VI.

be planned, the economic constitution should not be left to a similar kind of spontaneity. The adequate rules of the „game“ are assumed to be clearly established, they must only be set up and maintained with the help of one organisation - the state³⁴. „Laissez-faire“ towards the order of rules, ordoliberalism argues, cannot work, it would lead to a „fettering of the state by private interests“ (Eucken 1932: 307) which means that the rules' consistency and neutrality would have to give way to political activism and favouritism and that monopolies would soon reign over both the market and the legal order of society.

The ordoliberals developed this view not only in contrast with what they regarded as „laissez-faire“ liberalism, but also in opposition to a then dominant stream of historic determinism. It must be remembered that during the 30s and 40s, historicism was at its height. Not only orthodox Marxists, but also most economists of the German Historical School and even Schumpeter (1942/87) adopted the idea that economic power in the end necessarily determined political actions and that the monopolisation of the industry was just as unavoidable as the ensuing breakdown of capitalism and advent of socialism. Considering this intellectual background, it is quite understandable that Eucken (1951/52: ch.II) devotes one of his five London lectures to fight the thesis of the „inevitability of development“ arguing that „an intelligent co-ordination of all economic and legal policy“ could solve the problem of economic power (ibid.: 54). In addition, the historical situation in Germany after 1945 has to be taken into account. The need to create a new political, but also economic order of rules was just given. To be sure, liberal ideas were not prevalent within the German democratic parties which after the war all favoured different forms of a socialist organisation of the economy. Ordoliberals, however, took advantage of several unique historical opportunities, thus justifying the importance of what Eucken (e.g. 1952/90) labelled the „historical moment with its particular power-constellations and imponderabilia“. Among these constellations one certainly cannot dismiss the courageous rôle that Ludwig Erhard played as a political entrepreneur or the strategic interests of the western allies that supported the introduction of a capitalist order in Germany (see, e.g. Grosseckler 1989: 67ff)³⁵.

Hayek (e.g. 1952/79, ch.7) condemned historicism as fiercely as Eucken or Böhm. However, the opponent intellectual mood that provoked his evolutionism is not historical fatalism, but rather what he called „rationalistic constructivism“. The idea „that man 'created' his civilisation and its institutions“ and that, therefore „he must also be able to alter them at will so as to satisfy his desires or wishes“ (Hayek 1970/78: 3), which was held by proponents of the French or Continental tradition of liberalism, to Hayek was an expression of a most dangerous hubris and an „abuse of reason“ (e.g. 1952/79). In the British tradition of evolutionary liberalism, he took the opposite view that modern civilisation with its fine-structured layers of customs, conventions and legal principles can only have grown as the unplanned result of

³⁴ In a peculiar way Eucken occasionally seems to regard the state as necessary and active and at the same time uncreatively obedient to some laws of nature. Thus, he (1952/90: 374) argues that „the state does not dictate an economic order, it merely brings to bear what otherwise would be driven back by other tendencies.“ Such statements indeed remind one of a benevolent dictator- view of the state.

³⁵ Hayek (1983/92: 193f) states that he early became an admirer of Erhard who „deserves far greater credit for the restoration of a free society in Germany than he is given for either inside or outside Germany.“ He adds: „Erhard could never have accomplished what he did under bureaucratic or democratic constraints. It was a lucky moment when the right person in the right spot was free to do what he thought right, although he could never have convinced anybody else that it was the right thing.“

human action and not of human design or political will. For Hayek, the extended order has not been created „at will“, and it can only be destroyed by attempts to redesign it with holistic blueprints.

Even if he did not explicitly comment on the matter, we believe that Hayek would not have strictly opposed the ordoliberal attempt to provide guiding principles of an economic constitution for the German institutional reconstruction after the war (also: Vanberg 1989: 179). However, a Hayekian evolutionist must frown at parts of the underlying ordoliberal *Weltanschauung*, with its amount of faith in human intelligence and knowledge to design a new order. At any rate, he would protest a constructivistic and naturalistic creed which took an extreme expression in one statement of Eucken (1948/89: 34), according to which „economic policy ought to bring about the free, natural order that God intended.“ This really is asking too much of politics.

The lasting relevance of these diverging views is illustrated by current debates on the ongoing Eastern European economies in transition (see Streit 1998b: 49ff). In some societies (like the Czech or Polish) a „constructivist“ switch of the basic rules of the game was at least partly possible, provoking a comparatively prompt and successful „game of catallaxy“ (Hayek 1976: 115) to have its way. This was mainly due to the fact that in those cases the state was at least comparatively strong and its population in principle willing to accomplish such a switch. In addition, the Czech and Polish were able to pick up the threads of a longer tradition of and experience with a private law system. In other societies, like especially the Russian, exactly these preconditions which can not be created by fiat were not given. Here, even presidential decrees which would entail Eucken’s principles in their purest form can not be expected to bring the country nearer to a competitive order. Here, the market economy will probably have to grow much more from „below“, as the result of practices within subgroups of merchants and on grey or black markets with their rules based on custom and private conventions much more than on a private law society in its legalistic western form.³⁶

the „social question“: Hayekian and ordoliberal views

Böhm (1957/60: 160) once described the major pre-scientific interest and *raison d’être* of the Freiburg School to be a „political concern“, which led „all scientific works and aspirations ...“ be „... dedicated to the attempt to remove the social question from the dogma of Karl Marx and his historical-dialectic philosophy.“ In so doing, ordoliberals attempted to integrate the question of social justice into their own concept of the competitive order. To them, the „social question“ was not, as Marx and most members of the historical school believed, the result of excessive but rather of insufficient competition, reflecting the failure of the state to set and preserve the framework of a competitive order. For this failure, in turn, ordoliberals more or less openly blamed the ideas of classical, or, as they preferred to call them, „laissez-faire“ liberals. Adherents of „laissez-faire“ are accused for ignoring that - in a monopolistic setting - private citizens exercise power over other private citizens and that - in a corporativistic setting - the state can be „captured“ by those who wield economic power (e.g. Böhm 1950: lii; Eucken 1952/90: 358f). Eucken (1951/52: 56) claimed

³⁶ A stimulating exchange of views on whether to impose a market economy as a strong state’s design „from above“ or to rely on the unplanned emergence of market economies as a result of human action „from below“ took place between Gray (1994) and de Jasay (1994). See also Voigt (1994).

that „social security and social justice are the great questions of the hour“. For him, the „dependence of income levels on market conditions can ... lead to grave injustice and certainly poses a considerable problem“ (ibid: 63). Not so for Hayek.

Hayek, in his later social philosophical works, comes to the conclusion that „the social question“ cannot meaningfully be asked at all since it has no responsible addressee and that „social justice“ as such is an almost empty word which definitely loses meaning if applied to the results of the unplanned and purpose-free order of „catallaxy“ (e.g. Hayek 1976, chs. 9-11). Hayek’s strictly monistic reference to individual liberty as the sole foundation of justice and hence the rules of just conduct does not mean that he ignored the *analytical question* of social justice. Especially in his later work, he wants to identify the origins of what he calls the „atavism of social justice“ (e.g. Hayek 1978b). He tries to explain individuals’ instinctive demand for social cohesion and warmth that can no longer be satisfied by the abstract „extended order“ itself (e.g. 1988, ch. 4), which rather creates what already Popper (1945/50: 172) described as the „strain of civilisation“. The extended order is different from the household economy or tribal society exactly in that it makes no use of purposeful „income distribution“. Unequal positions of wealth are the unplanned and temporary results of individual skill and luck in using one’s personal knowledge and abilities. Such results can neither be considered just nor unjust according to recognised general principles. Only the rules of the game can be found to be just (fair) or unjust (unfair), which again would depend on the „test of universalizability“ (Hayek 1976: 27ff) and thus be a question of procedural justice and not one of material justice (Hayek 1976: 28f). Consequently, the „struggle for formal equality, i.e. against all discrimination based on social origin, nationality, race, creed, sex, etc.“ finds full support by Hayek (1978a: 142) - as long as it aims at general, abstract rules of conduct (and not their „affirmative“ manipulation). In addition - and with a deplorable amount of *ad hoc* reasoning - Hayek granted that there may be reasons to assure „outside of and supplementary to the market“ a protection against severe deprivation in the form of guaranteed minimum income to all (e.g. 1976: 87).³⁷

The latter policy objective is shared by ordoliberals. Most of them, however, would also include progressive taxation and other variants of Eucken’s regulatory principle of „income policy“ (1952/90: 300f), which is aimed at correcting the spontaneous income distribution and covering „urgent needs“ (ibid.) of the population. But these normative conclusions, again, reflect only differences in degree and not in substance. The difference in substance is at the theoretical stage. Hayek did not follow the enchanting ordoliberal slogan that a well-functioning competitive market order would in itself be the most eminent „social“ device or even a major precondition for the solution of the „social question“ (ibid.: 314).³⁸ He would certainly not follow Eucken in arguing that „the realisation of social justice ... depends on the realisation of the general principle of a competitive economy“ (ibid.: 315) if this implied a concept of material justice. In this case Hayek would argue that the realisation of

³⁷ Hayek fails to give the necessary clarifications on the modalities of such a protection and, especially, on how to prevent social insurance schemes from exceeding limits of reasonable „minimalness“, as historically they did soon after their introduction in all major welfare states.

³⁸ Hayek’s rejection of the German term and concept of „social market economy“ as „most confusing and harmful“ (Hayek 1965/67: 83) or as „a real danger“ and „camouflage for aspirations that certainly have nothing to do with the common interest“ (Hayek 1957/67: 238f) is probably intended to be a critique of German politics rather than of ordoliberal concepts. Still, even if only in a more modest form, the critique also applies to the latter.

social justice required „a kind of order of society altogether different from that spontaneous order which will form itself if individuals are restrained only by general rules of just conduct.“ (Hayek 1978a: 140).

VI. The political economy of liberalism: A constitutional economics perspective

a note on political economy and economics of politics

In terms of pre-scientific interests (basic value judgements) and normative conclusions, the ordoliberal concept of an economic constitution and Hayek's „constitution of liberty“ (1960) do not differ dramatically from modern constitutional economics as represented, especially, by James M. Buchanan.³⁹ However, in terms of the analytical structure or „economics“ employed, the approaches differ considerably. Obviously, neither Eucken and Böhm nor Hayek would claim „rational choice“ or stylised maximising behaviour as used within mainstream economics (including most of constitutional economics) as belonging to the „hard core“ of their research programmes.⁴⁰ Also „contractarianism“ or the „exchange paradigm“ are not part of their view of politics and the state. In short, ordoliberals and Hayek are political economists in a traditional sense; they command no „economics of politics“ or economic theory of the state if economics is defined by the above elements.⁴¹

Regarding the research programme of the ordoliberals and their principles of public policy, the lack of a (positive) theory of politics may pose a serious problem of theoretical incompleteness.⁴² Since ordoliberals strictly rely on the state, and hence on elected politicians, to enact the very comprehensive institutional reforms advocated by them, the incentive structures of politicians, voters, and interest groups do become empirically important and theoretically worthy of the most sober analysis. To be sure, Eucken and Böhm were not blind optimists who disregarded the workings of the real political processes. As we have seen, their historical observations and political demands were rich in considerations of vested interests, of their institutionally determined influence on the political process and of the ensuing effects on the economic order. Thus, Eucken and Böhm to some degree anticipated the „rent-seeking“ insight that was later to emerge within the Public Choice movement (e.g. Krueger 1974, Olson 1982). However, they kept on regarding politicians mainly as addressees of programmatic demands rather than as objects for a behavioural analysis.

Hayek's approach to politics can be similarly qualified. Especially his trilogy on Law, Legislation and Liberty is full of accounts of the unromantic side of legislation

³⁹ For a programmatic overview and delimitation of the domain of constitutional economics, see Buchanan (1990); for an instructive survey, see Voigt (1997). The relation between ordoliberalism and constitutional economics is discussed e.g. by Vanberg (1988) and Leipold (1990). The relation between Hayek and constitutional economics is analysed e.g. by Vanberg (1983 and 1989) or Buchanan (1989) and - in an interesting attempt to build a synthesis - by Leschke (1993).

⁴⁰ See, e.g. Buchanan (1990: 12ff). A vigorous defence of homo oeconomicus can also be found in Brennan/Buchanan (1985, ch. 4).

⁴¹ See Tietzel (1991) for a critique from the perspective of mainstream economics of politics.

⁴² This is one of Kirchgässner's (1988: 55ff) more convincing points of critique. In fact, Eucken (1940/92: 213ff) states that the emergence and changes (but not the effects) of „the social and legal organization“ and hence politics themselves ought to be treated as „data“ to the analysis. It is here that he proposed that „the theoretical explanation has to break off“ (ibid.).

within the prevailing form of democracy. But the contemporary Public Choice literature is ignored - with the sole exception of Olson (1965). Hayek's political economy hence basically remains tied to political philosophy in the tradition of the Scottish classics; it does not become an economics of politics or of the constitution in the modern meaning. Hayek's remaining a traditional political economist without turning into a protagonist of the economics of politics is certainly not accidental. The kind of market analogy used predominantly within much of Public Choice reflects exactly those elements of neoclassical reasoning that Hayek rejected already for economic theory (see Wohlgemuth 1995a). Hayek reserves the concept of „catallaxy“ for the spontaneous order of the market, with its private law institutions and price signals. Politics, according to Hayek, is mainly part of a fundamentally different kind of order, namely that of an organisation or „teleocracy“ (e.g. Hayek 1967/78: 89). Concerning the relationship between the two kinds of order, the basic relation between politicians and citizens, there certainly is no „exchange paradigm“ (e.g. Buchanan 1990: 9) in the political theory of Hayek. This does not mean that Hayek's analysis becomes in any way inconsistent. He does not use different „models of man“ for politicians and for ordinary market actors. Both are assumed to be pursuing their own ends, to be exposed to the constitutional lack of knowledge, and to have to rely on rules of conduct. The rules, however, differ. And it is from here that Hayek's political philosophy starts.

We have seen that ordoliberals and Hayek, even if they tend to disagree on the conceptual role of social justice within a constitution of liberty, have provided similar insights into the political economy of the welfare state, its mutually reinforcing disruptive effects on the economic and the political constitution. For them, the welfare state is „captured“ by economic interest groups and forced to supersede the autonomy of the individual and the rule of private law by corporativism and the rule of public law.⁴³ This process, in ordoliberal terms, leads to the destruction of the competitive order as a means to emasculate economic power, in Hayekian terms it means the abandonment of equality before the rules of just conduct as a precondition of a spontaneous order of free actions. Let us now see what ordoliberals and Hayek have to offer in terms of political reforms or „institutional choice“.

constitutional reforms

As Vanberg (1988: 24) observed, ordoliberals have „devoted astoundingly little explicit argument to the issue of what constitutional provisions might be required to make the ‘strong government’ perform its proper task and not to use its power in an undesired way“. Because they believed the main disturbance of the competitive order to originate from *private* agglomerations of power, the economic constitution with its aim of taming economic power seems to prevail over (at least: conceptual work on) the political constitution's traditional task of „taming Leviathan“. Hence the ordoliberals' understanding of the rule of law as an institutional arrangement that protects the state from being captured by private power groups. Beyond stating general principles, however, the Freiburg School has little advice to offer by ways of practical antidotes. If it comes to concrete reforms of political institutions, only the following „political principle“ („*staatspolitischer Grundsatz*“) is provided by Eucken (1952/90: 334): „The policy of the state should be directed at the dissolution of

⁴³ An elaborate and very Hayekian critique of the social welfare state is provided by Böhm (1953/60).

economic power groups or limit their functions.“ The particular elements of a corresponding feasible political reform remain rather obscure and dubious. Efforts to make the activities of interest groups more transparent, to set public hearings or the advice of experts against their pressure, and to reveal their financial support for politicians and parties would be hardly more than cosmetic operations on the body politic. Stronger measures, like provisions of public law in order to restrict their activities would soon violate the civil liberties of expression, association and assembly besides suppressing useful functions which some interest groups might actually serve. The involved conflict between political equality on the one hand, which becomes distorted because not all interests of the electorate have equal access to the legislature, and the aforementioned civil liberties on the other hand has to be solved in a different way. One way would be to bind the legislature.

Two types of constitutional constraints on parliament are mainly discussed (Streit 1987: 12ff): (1) to reduce the authority of parliament or render its use more difficult, (2) to break up the legislative authority by ways of a strict separation of powers.

The first types are in the tradition of Knut Wicksell (1896/1988, part 2: „A new principle of just taxation“) who proposed highly qualified majorities for parliament’s fiscal decisions. Building on this tradition, constitutional economics later developed „unanimity- rules“ as political translations of the Pareto-principle to serve as ultimate normative benchmarks for the appraisal of collective action (e.g. Buchanan/Tullock 1962). Mainly by using contractarian and hence unanimity- based thought-experiments, they also proposed constitutional constraints on taxation (e.g. Brennan/Buchanan 1980) and on deficit spending (e.g. Buchanan/ Wagner 1977: 180f). Within the context of basic political decision rules and procedures, direct democracy is also proposed as a means for the taming of Leviathan (e.g. Frey 1994). These proposals cannot be discussed here. They are advocated neither by early ordoliberal nor by Hayek.⁴⁴

The second type of reform is in the tradition of John Stuart Mill (1861/1993, ch. 13 „Of a second chamber“), who, however, was rather sceptical regarding the countervailing power of such a chamber. Hayek reintroduced the basic concept in the form of „a model constitution“ (esp. 1979, ch. 17).⁴⁵ He (ibid.: 3) identified the fact

⁴⁴ This is not to mean that they would be contradictory to the ordoliberal or Hayekian views. For example, the use of referenda and, especially, of popular initiatives can in principle be recommended on Hayekian grounds. As e.g. Bohnet/Frey (1994) have shown, such procedures are apt at lowering entry barriers in politics, breaking protective belts of the „classe politique“ and fostering political discussion and communication. They can thus bring the political competition of ideas at least somewhat closer to an economic discovery procedure (Wohlgemuth 1995a: 83ff). More discursive methods of political decision making can be compatible with the „central belief from which all liberal postulates may be said to spring ... that more successful solutions of the problems of society are to be expected if we do not rely on the application of anyone’s given knowledge, but encourage the interpersonal process of the exchange of opinion from which better knowledge can be expected to emerge.“ (Hayek 1978a: 148). However, the rules of direct democratic legislation would have to be equally strict as those Hayek proposes for representative democracies. Above all, the „universalisability test“ would have to be applied.

⁴⁵ We cannot here go into the details of the model. A thorough analysis has been provided by Nienhaus (1982). A remarkable evaluation from the point of view of German constitutional law can be found in Rupp (1979). Critical remarks are added by Barry (1979: 190ff) and Voigt (1992). The fact that Hayek proposed a „model constitution“ has often been observed to be in contradiction with his evolutionary bias in favour of spontaneously grown orders of rules. Hayek (1979: 107f) of course remarked this possible inconsistency. He makes clear: „I certainly do not wish to suggest that any

that parliament is „not only highest but also an unlimited authority“ as „the fatal defect of the prevailing form of democracy“. He argued that „the possession of unlimited power makes it impossible for a representative body to make the general principles prevail on which it agrees, because under such a system the majority of the representative assembly, in order to remain a majority, must do what it can to buy the support of the several interests by granting them special benefits“ (ibid.). In order to save the rule of *nomos* (nomocracy), political decision makers must be put in the position to be able to point at democratically legitimised rules and procedures which simply would not allow themselves to give way to the pressures of special interest groups (ibid.: 15ff). Hayek claims that this can only be accomplished if the task to lay down abstract rules of just conduct and the task to govern by ways of regulations and public law are organisationally separated. He proposes to establish two representative bodies with distinct functions and - correspondingly - distinct democratic procedures to recruit their members. As a third institution, the constitutional court would have the task to control that each chamber acts within the boundaries of its authority (ibid.: 120ff). The separation of powers would hence be such that the first chamber (the „legislative assembly“, ibid.: 112ff) would be limited to the „production“, or better: „finding“ and careful adaptation of the abstract rules which are needed to form and preserve the order of society. A second chamber (or „governmental assembly“, ibid.: 119f) would be in the position to control government and decide upon the legislation which is still needed for the provision of public services. The latter chamber, however, would itself be controlled by the former; it would be strictly bound by the *nomos* laid down by the legislative assembly. In this way, Hayek hoped to safeguard his political ideal of nomocracy from the onslaught of politicians and interest groups. Thus, he also wanted to save democracy from deteriorating into a „bargaining democracy“ which is unable to reflect common opinion on what is just and fair but would become the „playball of group interests“, a pure reflection of the power of organisations⁴⁶

Still, propositions which aim at a change in the institutional structure of prevailing democracies hardly have a fair chance to be realised under normal political conditions. Eucken's demand to displace vested interests, the various contractarian attempts to tame Leviathan and also Hayek's „model constitution“ would require a binding decision of self-restraint by those who neither have a vested interest nor are very likely to face a massive electoral pressure to do so.⁴⁷ As has often been noted (e.g. Streit 1987: 4ff), political reforms in this direction, but also most framework activities of „Ordnungspolitik“ or „nomocracy“ are rather unattractive under the

country with a firmly established constitutional tradition should replace its constitution by a new one drawn up on the lines suggested.“ His purpose in presenting his constitutional „sketch“ was (a) to illustrate the general principles of nomocracy, (b) to advise countries that have no tradition of the rule of law and wish to introduce democratic bodies and (c) to propose organisational rules for supra-national governments.

⁴⁶ Kirchgässner's (1988: 66) verdict that Hayek „wants to abolish democracy“ is thus totally mistaken. It simply fails to grasp the main idea that to put democratic government under the law means not to abolish, but to strengthen democracy as a method of legitimising collective action and expressing public opinion.

⁴⁷ On the manifold theoretical and practical problems of self-restraint in the sense of „constitutional commitments“ there has grown a respectable body of literature from which we recommend Kliemt (1993). In the tradition of Hume (and much like Hayek), Kliemt (ibid.: 146) comes to the conclusion that „the model of opportunistically rational behavior will not work as a *universal* basis of economic or jurisprudential constitutional theory.“ A comprehensive account of precommitment devices used in history is given by Elster (1984).

prevailing forms of democracy. For political entrepreneurs trying to attract and preserve particular groups of clients (supporters and voters), the political value of the constitution and legislation depends upon the extent to which they promise to provide economic results to particular individuals and groups. The competitive order and nomocracy exactly preclude to assign specific results to anybody. Therefore, reforms in their direction would under every-day political conditions be politically hazardous. They would mean to take away group-specific privileges, thus creating identifiable (private) losses on the one hand and widely dispersed and hardly identifiable (public) gains on the other. Because of this perception problem political entrepreneurs can hardly expect to win the support of the beneficiaries - even if these build a very qualified majority. However, even if the prospects for political self-treatment according to ordoliberal or Hayekian blueprints must be sceptically considered, one must not despair. There still are (and become more and more vigorous) spontaneous market forces at work which can make themselves felt also in the realm of politics, breaking social and political rigidities for themselves or acting as additional pressures for politicians to adjust the institutional structures. This leads to a second way of coping with Leviathan.

spontaneous correcting forces

Among those spontaneous correcting forces which may at least signal, but perhaps also help to overcome the economic and political malaise of welfare states, the shadow economy and interjurisdictional factor movements (or: „globalised markets“) have received special attention. Let us close with a brief assessment of the latter from the perspective of ordoliberal and Hayekian conceptions⁴⁸.

While neither Hayek nor the ordoliberals have done much work on the meaning of open markets between jurisdictions and the potential repercussions of spontaneous processes of exit on incentives within the political process, this general idea of institutional competition can be very well analysed using both Hayekian and ordoliberal *Leitmotive*. In principle these are the same as in our above presentation of the respective ideas on economic competition: the problem of knowledge and the problem of power. As we have shown in more detail elsewhere (e.g. Wohlgemuth 1995b and Streit 1996), institutional competition can be regarded a partial solution to the political knowledge problem, being a political „discovery procedure“ in Hayekian terms. This means that „exit“ of mobile resources (be it the shifting of financial portfolios, foreign direct investment or outright migration of citizens) allows citizens an individual „choice of rules“, testing the expediency of available institutional arrangements. At the same time it induces political agents to adapt to signalled preferences about existing alternatives, but also to develop innovative policies in the sense of potentially new institutional solutions to societal problems. Consequently, a competitive order of spontaneous „exit“ can serve as a procedure for the discovery of such institutional infrastructure „as, without resort to it, would not be known to anyone, or at least would not be utilised.“ (Hayek 1968/78: 179).

⁴⁸ An analysis of the shadow economy at large - comprising not only black or grey market activities, but also basically marketable household production and voluntary non-profit social services - and its relation to the welfare state is provided by Streit (1984). There, it is argued that the growth of the shadow economy signals the shadow price of maintaining inefficient welfare-state arrangements and that it might ultimately act as a brake upon the process of institutional sclerosis.

Furthermore, institutional competition can serve as a non-constructivistic answer to the ordoliberal problem of power. Here, of course, competition in the first instance would act as a device of „taming Leviathan“, that is, reducing the power of politics over citizens. Institutional competition, however, does not necessarily lead to what ordoliberals would have to suspect as a „weak“ state, as many reports on the alleged consequences of „globalisation“ seem to suggest. We would not so much expect the single states in an increasingly common world market to lose the authority and ability to perform their proper functions. We would rather expect institutional competition to force more and more governments to return to and concentrate on exactly these proper functions which lie mainly within the realm of the „protective state“ in the sense of Buchanan (1975: 68ff) or of its proper „coercive function“ in the sense of Hayek (1979: 135), referring to „the enforcement of general rules of conduct equally applicable to all.“⁴⁹ However, we have to admit that institutional competition has to be tolerated if not supported by rules to which political actors have to subscribe. Hence the problem of self-restraint comes up again. But it may well be that - on a world-wide scale - political actors are not likely to form a lasting cartel which would make institutional competition ineffective.

VII. Conclusion

Summarising our main findings, we can state that Hayek, Eucken and Böhm developed conceptions of the market economy and of the state that have much more in common than may be indicated by the amount of explicit references. Although they started from different angles and with different intellectual backgrounds, we found our protagonists very often to meet on common grounds and to arrive at rather similar policy conclusions.

To be sure, we also found some plain differences - most of which we attribute to the ordoliberals' predominant occupation with the problem of private (economic) power and Hayek's preoccupation with the problem of private (subjective) knowledge. While concerning the problem of power, the differences are rather of emphasis than of substance, it is concerning the knowledge problem that a fundamental difference can be identified. Whereas for Hayek the problem of the division of knowledge permeates all his theory of the spontaneous order, it remains largely neglected by the early ordoliberals. Even if Hayek could subscribe to most of the liberal principles defining the „*Wettbewerbsordnung*“, his conception of „catallaxy“ has much more to offer. It yields a theory of market processes that the early ordoliberals had to do without. Nevertheless, the ordoliberal programme still contains insights and warnings that deserve being rediscovered and refurbished - the problem of power within interventionist and corporatist welfare states is far from being solved.

To close with a personal value judgement we hold that the Hayekian legacy remains more demanding and more promising to exploit and develop. At any rate, there is not and will never be one liberal conception of the market economy and the state.

⁴⁹ To be sure, one cannot expect institutional competition to bring about a total erosion of discriminatory welfare state arrangements. This is clearly prevented when taking into account exogenous limits, representing the rules of interjurisdictional competition (like, e.g. many provisions of the EU- treaties), but also endogenous limits which can be traced to the competitive process itself (like limits on the actors' knowledge and mobility, on the institutions' flexibility and changeability), see Streit 1996: 241ff.

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