„The end of *laissez-faire*" – Keynes and the Freiburg School

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Keynes proclaimed the "end of *laissez-faire*" in lectures held in Oxford (1924) and in Berlin (1926), published as pamphlet almost simultaneously in English and in German in that same year. Some ten years later, German economists who became known as Freiburg School of *Ordo*-liberalism after World War II began to write about the "failure of *laissez-faire"*(*"Scheitern des laissez-faire"*). Both, Keynes in the UK, and Walter Eucken, et al., for post-war Germany, called for a fundamental re-orientation of economic policy. They shared the preference for individualism, political liberalism, and the market economy, rejecting central planning and socialism as an alternative to crisis-ridden capitalism. But the conclusions about what kind of changes were needed are quite different. In the following, the paper will first introduce the arguments of Keynes and Eucken. A further investigation of the reasons which underlie these differences will show differences between Great Britain and Germany with respect to historical contexts as well as to the fundamental theoretical approaches of Keynes and the Freiburg School.

1 Keynes and the "end of *laissez-faire"*

Keynes took great care in elaborating origins and meaning of the principle of laissez-faire in social philosophy and economics. In regard of the former, the principle rests on two pillars: the individual's innate right to pursue its own happiness, which was the contribution of philosophers of enlightenment; and, that through 'the natural effort of every individual to better his own condition' a harmony between private advantage and public good could be achieved – this was the contribution of the economists, of Adam Smith in particular. Since the equal right to pursue one's own happiness contains a strong egalitarian element, the merging of the two pillars are a "miraculous union" of different currents of thought. "It harmonised the conservative individualism of Locke, Hume, Johnson and Burke with the socialism and democratic egalitarianism of Rousseau, Paley, Bentham, and Godwin." (Keynes 1926/1972, p. 274f) Later, the principle of laissez-faire came to be understood in the context of Darwin's theory of evolution. If "free competition had built man", the idea of "survival of the fittest could be regarded as a vast generalisation of Ricardian economics." (ibidem, p. 276)

Keynes also elaborates extensively on how practical-historical experience contributed to the triumph of the laissez-faire principle (p. 278ff). The phrase was first used by a businessman who objected to the regulations of the comprehensive mercantilist system which had been established in 17th century France by Colbert. Later, the decline of French manufactures was attributed to the protection granted by statutory monopolies. If Adam Smith, who did not use the phrase, had identified monopolies established by the "commercial system" as the principal obstacle to economic growth, "his attitude towards the Navigation Acts and the usury laws shows that he was not dogmatic" (p. 279). The "poor quality of the opponent proposals" protectionism and Marxist socialism also contributed to the plausibility of the laissez-faire doctrine.

Paradoxically, "no such doctrine is really to be found in the writings of the greatest authorities" among the economists. Rather, it was "the language of economists [that] lent itself to the laissez-faire interpretation", and thereby prepared the ground for "utterances of secondary economic authorities" and tracts of non-economists which "fixed laissez-faire in the popular kind as the practical conclusion of orthodox political economy." (p. 277f)[1] This popular orthodoxy has two essential elements: "that individuals who move in the right direction will destroy by competition those who move in the wrong direction" (p. 282); and "the love of money, acting through the pursuit of profit, as an adjutant of natural selection, to bring about the production on the greatest possible scale of what is most strongly desired as measured exchange value." (p. 284)

Keynes traces critical thoughts that free competition without government interference would produce a social optimum from J.St. Mill[2] to Alfred Marshall before he states his six points in which he summarizes his objections to the laissez-faire doctrine from a technical-economic point of view:

> "[E]conomists generally reserve for a later stage of their argument the complications which arise – (1) when the efficient units of production are large relatively to the units of consumption, (2) when overhead costs or joint costs are present, (3) when international economies tend to the aggregation of production, (4) when the time required for adjustment is long, (5) when ignorance prevails over knowledge, and (6) when monopolies and combinations interfere with inequality of bargaining." (p. 284f)

The whole essay does not directly answer the question what concrete changes have made laissez-faire obsolete. One can even get the impression that, as a general principle, it was wrong from the beginning. Although five of the six "complications which economists reserve for a later stage of their argument" are related to problems arising from economic concentration, Keynes paid little attention to structures of competition among firms and their changes over time in his later writings.

Keynes also gives only few general indications what the remedies would be. His most general conclusion is that the institutions of society must accept responsibility for such processes of coordination where such coordination cannot be expected from independent individual actions. The state or other collective entities must fulfil "the functions which fall outside of the sphere of the individual, ... which are made by no one if the State does not make them." (p. 291) More specifically, he draws several conclusions with respect to economic policy. In order to avoid the shortcomings of centralized decision making at the highest level of government, he suggests "that progress lies in the growth and recognition of semi-autonomous bodies within the State - bodies whose criterion of action ... is solely the public good ..., and from whose deliberations motives of private advantage are excluded." These bodies are "mainly autonomous within their prescribed limitations, but are subject in the last resort to the sovereignty of the democracy expressed through Parliament." (p. 288f) As models of such bodies Keynes mentions the Bank of England and the Port of London Authority. In this context, he points to the "trend of joint stock institutions, when they have reached a certain age and size, to approximate the status of public corporations rather than that of individualistic private enterprise." Thus, big enterprise has a tendency to "socialise itself". More specifically, Keynes recommends "the deliberate control of the currency and of

[1] In this context, Keynes points to a „pessimistic version" of laissez-faire derived from Malthus' theory of population, in contrast to the optimistic version that dominated economic policy in the 19th century. It should be remarked that Keynes nowhere in his essay mentions J.B. Say whose "law" was and still is one of the central arguments in favour of a laissez-faire approach.

[2] „To escape error, we ought, in applying the conclusions of political economy to actual affairs of life, to consider not only what will happen supposing the maximum of competition, but how far the result will be affected if competition falls short of the maximum." (Mill 1871/1909, p. 248)

credit by a central institution"; "the collection and dissemination on great scale of data relation to the business situation"; more coordination of saving and investment and of the distribution of investment between the domestic and the foreign sphere; influence on the development of the population. (p. 292)

In the last section of the essay, which he had not included in its original publication, Keynes emphasizes that his reflections aim at "possible improvement in the technique of modern capitalism by the agency of collective action", while at the same time "money making and money-loving instincts of individuals" are still "the main motive force of the economic machine." (p. 292f)

2 *Das Scheitern des laissez-faire* (failure of laissez-faire)

The case for state intervention made by the Freiburg School of Ordo-liberalism, as a consequence of the failure of laissez-faire, was significantly different from Keynes'. The name of the Freiburg School derives from the discussion group formed under the leadership of Walter Eucken at the University of Freiburg in the 1930's. (Rieter/Schmolz 1993, p. 247f) Wilhelm Röpke and Alexander Rüstow, who had been forced to leave Germany by the Nazi government because of their political convictions, shared essential concepts of Eucken and made important contributions to the dissemination of the school's ideas, especially after 1945. In a still wider sense, the concept of Social Market Economy as developed by Alfred Müller-Armack after World War II, which was the theoretical concept on which Ludwig Erhard based his economic policies for Western Germany from 1948 to the 1960's, is an intellectual offspring of the Freiburg School, although these policies did significantly deviate from the doctrines of Ordo-liberalism.

At the heart of the problem, Eucken (1959, p. 119, at this point referring to a dictum by E. Heckscher) sees a basic internal conflict in liberalism between "free competition *à tout prix* and freedom of contract *à tout prix"*. In the era of laissez-faire, preference had been given to freedom of contract, based on the belief that "a workable economic order would emerge spontaneously from the forces of society based on [individual] freedom and the rule of law." (ibidem, p. 34) This implied the assumption that freedom of contract would generally result in perfect competition[3] which guarantees optimal satisfaction of consumers' wants. "However, it turned out that frequently other market structures [*Marktformen*] were realized, because this policy granted the freedom of forming combinations which eliminated competition." (p. 37) Eucken closely associates instability and social evils of capitalism which produced the Great Depression of the 1930's with the tendency of competition to produce monopolies and cartels under laissez-faire conditions.

In his effort to develop a general theory of economic order Eucken distinguished between the "exchange economy" *(Verkehrswirtschaft*) with decentralized plans of economic units and decisions linked by the market process, and the "centrally administered economy" (*Zentralverwaltungswirtschaft*). Private property, although fundamental for preserving freedom of the individual, is not the decisive criterion, because in itself it does not guarantee optimal economic performance. The propensity of the unregulated market to restrict or eliminate competition is the cause of an increasing overall instability of the system, since imperfect competition does not display a tendency towards equilibrium. State interventions

[3] By perfect competition Eucken and his followers do not mean competition inm the sense of mathematical general equilibrium system, but rather in the Austrian School's understanding of competition as a dynamic process among market competitors who make their plans by taking current prices from the market which coordinates all their further actions (Eucken 1959, p. 156)

into the functioning of the system, as practised in Germany during the "age of experiments" after 1900, have not been able to provide satisfactory cures of the system's flaws. On the contrary, as ad hoc-designed "interim provisions" (*Zwischenlösungen*) they have pushed the economy more and more towards the centrally administered type (especially under National-socialist government) which has further aggravated its malfunctioning.

As a consequence of the failure of laissez-faire in its traditional meaning Eucken concludes that an economic order which is stable and efficient must be established by a conscious act of the state. Moreover, sustainability of this order requires continuous efforts by the state to ensure that conditions of perfect competition are preserved, and tendencies to create monopolies suppressed in all markets, or at least to the greatest possible extent.

Competition policy is therefore the central core of the ordo-liberal concept of economic policy. Eucken criticizes that technical reasons have much too easily been accepted as inevitable drivers of monopolization and industrial concentration. Instead, Eucken argues that to an overwhelming extent these tendencies originate from institutional arrangements which implicitly or explicitly promote the restriction of competition. A comprehensive competition policy must not content itself with forbidding all forms of abuse of market power against competitors. In its preventive arm, it must include a general prohibition of cartels and a strict control of mergers. Company law, laws of taxation, laws regulating credit and banking, insolvency law, patent law, proprietory rights, etc. have to give utmost priority to the goal of promoting full competition. To ensure open access to markets, the reduction of tariffs with the aim to establish free trade for all goods is of paramount importance. In the few cases where technical or natural monopolies persist, they must be subject to strict regulation.

Eucken accepts that the market economy needs a social dimension in the form of adequate systems of social insurance, and also through redistribution of income by a tax system which avoids poverty and reduces excessive wealth. He does not, however, use the term "*Soziale Marktwirtschaft*" which, under the influence of Müller-Armack and Ludwig Erhard, became the central political concept of the economic policy of the Christian-democratic government of Western Germany in the 1950's and 1960's.

In Eucken's view, the competitive market system not only ensures efficient allocation of resources and a maximum of consumer satisfaction, but also a high degree of overall economic stability, provided that the economic order ensures further general conditions among which Eucken mentions: "neutral money" through stable currency which does not become a source of inflation; private property, freedom of contract within the framework of competition policy, constancy and consistency of economic policy (p. 160ff). If the maintaining of an appropriate economic order cannot be achieved by a single constitutional act, but requires constant political efforts in legislation, administration and jurisdiction, it remains an essential characteristic of Eucken's Ordo-liberalism that economic policy should not interfere with the economic process itself[4] (*Eingriffe in den Ablauf)*. Hence, he was generally sceptical of anti-cyclical fiscal and monetary policies. In particular, he objected to full employment as a goal.

Alexander Rüstow, who held an economic chair at the University of Heidelberg in 1949 after his return from exile in Istanbul, had formulated a fundamental critique of the "deficits of liberalism" along lines similar to Eucken. In order to ensure a satisfactory functioning of the market mechanism Manchester-type laissez-faire would have to be replaced by a "liberal

[4] Eucken admitted such interventions only in cases of emergency. E.g., he thinks that an implementation of the Lauterbach-Plan in 1931 could have prevented the Nazi's coming to power (Eucken 1950/2012, p. 40)

interventionism" consisting of interventions whose effects would be "in the direction of the laws of the market process" ("market-conformity"). (Rüstow 1949/2009, p. 51) Rüstow went beyond Eucken when he advocated sharp restrictions for advertising, nationalization in cases where monopolies have technical or natural causes. The transfer of wealth through inheritance should not be allowed to exceed the value of an average farm holding. He propagated an ideal of a society based on small proprietorship not only in agriculture but also in industry where he thought that most workers could be equipped with a machine in their home, with the additional benefit of less mobility. (ibidem, p. 73) Rüstow was aware that his program would "not be less utopian then the program of communism 100 years ago." (p. 95) His visions of an ideal society became more realistic in his later publications. Rüstow supported Müller-Armack's concept of Social Market Economy, but sharply disagreed with the soft stance of the legal regulation of restrictive business practices (*Gesetz gegen Wettbewerbsbeschränkungen*) which was finally enacted in 1957.

Rüstow was aware that, pursued in isolation, the ideal of "small is beautiful" would be detrimental for the country's economy as long as other states continued to create favourable conditions for their national champions. Rüstow and Wilhelm Röpke therefore proposed a framework for international coordination "within which each state would direct its energies towards maintaining the internal conditions favourable to this international scenario: States would develop 'fresh non proletarian types of industry ... forms adapted to peasants and craftsmen'. The state would break up the big cities and industrial districts', and move toward properly directed country planning'." (Rahtz 2014, p. 11, quoting Röpke 1944) Eucken, whose recommendations to establish perfect competition wherever possible and by all available means, were almost as radical as Rüstow's and Röpke's, did not address the problems a country would encounter if it implemented such a policy in isolation.

3 The economic realities in Great Britain and in Germany in the interwar period

Keynes published his pamphlet on the end of laissez-faire in 1926, his *General Theory* (to which I will refer in the following sections) appeared in 1936. The publications of Eucken and his circle began to appear in the late 1930's and had their greatest impact during the years after World War II in which the foundations for Western Germany's economic policy were laid (1945-1950). There are enormous differences in the economic development of the two countries which are reflected in what the authors mean when they proclaim the end of laissez-faire.

Whereas the German economy fell into chaos during the years of hyperinflation from which it emerged only in 1924, there is comparative continuity from war to peace in Great Britain's economy, so that the latter country's effort to return to the pre-war "normal conditions" could become the principal orientation of its economic policy. However, this required a deflationary monetary and fiscal policy which put the country on a path of near-stagnation during most of the 1920's. The dominant orthodoxy argued that return to the gold standard at pre-war parities would be the essential measure to set things right. Keynes sharply criticized this policy which would not deliver the promised results. As an alternative he proposed a policy of managed currency which avoided deflation[5], and a program of public investment deliberately aimed at the reduction of the unemployment rate[6] which remained above 10 percent until 1929.

In his *General Theory* Keynes supplied the theoretical underpinnings for his position when the Great Depression had made the failure of laissez-faire even more evident.

[5] In his *Tract on Monetary Reform* (1923), excerpts in: Keynes (1972), p. 164ff.

[6] *„Can Lloyd George Do It?"* (jointly with Hubert Henderson, 1929), in: Keynes (1972), p. 86ff.

The main problem of German economic policy was the financing of reparation payments to which the country was obliged by the Versailles peace treaty. After the catastrophic events of 1923 Germany returned to fixed parity of the *Reichsmark*, which initiated a period of rapid economic expansion until 1929. During the Great Depression the decline of GDP was much more severe than in Great Britain. Whereas for Keynes the main cause of the Great Depression was the system's macroeconomic instability, in particular lack of an automatic mechanism to establish equilibrium between savings and investment, as had been maintained by advocates of laissez-faire, for Eucken it was the monopolistic structure which had come to displace perfect competition in an ever increasing number of markets. Relying on Stackelberg's (1934) analysis which had demonstrated that monopolistic or oligopolistic markets were devoid of the automatic adjustment mechanism of perfect competition and, therefore, lacked an inherent tendency towards equilibrium, Eucken attributed the failure of the system to stop its contraction to the erosion of the competitive structure of the German economy which had started already in the last decades of the 19th century.

Among European nations, Germany was the country with the most vigorous movement towards the formation of cartels. It had supported the process of cartelization by special legal provisions. The economists of the German Historical School had put forward a theory which idealized the "organized economy" as a higher stage of economic development[7]. In the spirit of the German *Sonderweg,* organized capitalism was considered ethically and politically superior to Western style capitalism. After the Nazi takeover the existing cartel organizations were merged into an apparatus of national planning whose main aim was to prepare for war. When full employment was achieved by the end of the 1930's and various shortages appeared due to lack of foreign currency, inflation was suppressed by controls of prices and wages. After the World War II, cartels were dissolved by the occupation powers, but war-time rationing was maintained for several years to ensure the provision of basic goods for all. In Eucken's view, lack of competition was not only the cause of the depression of the early 1930's, but also of the tendency towards ever more state control and central planning of the economy. In post-war Western Germany political demands to maintain certain degree of planning under a democratic system appealed to major parts of the population, until they gradually bated after the successful currency reform of 1948.

In contrast to Germany, the cartelization movement did not reach Great Britain before the 1930's[8]. Until then the country had abstained follow the protectionist tendency on which many countries had embarked in their trade policy. Under the impact of the Great Depression Britain abandoned its free trade orientation by creating a protective tariff structure in order to promote industrial production for domestic consumption. Thereby, it initiated a process of import substitution which was widely held responsible for the improvement in economic performance during the 1930's. This development is hardly reflected in Keynes' *General Theory*.

4 Price and wage flexibility

In Eucken's view, the protracted downward movement of production during the Great Depression was due to lack of competition resulting in price (and wage) rigidities which prevented the necessary downward adjustments. As a consequence, prices of raw materials, other production goods and wages were too high for profitable investments (Eucken 1959, p. 175). The downward movement was accelerated by the contraction of credit which was due to the instability of a monetary system based on the creation of money by banks. With a properly

[7] On this point see Chaloupek 2015.
[8] On the cartelization movement in Great Britain see Pribram (1935), p. 267ff.

functioning price mechanism, the recession of 1929 would not have developed into a deep depression (ibidem, p. 49).

Keynes' argument in the *General Theory* was just the opposite. He denied that a system of flexible prices and wages would function as a brake to the downward movement of the economy. To the contrary, a reduction of money wages due to a fall of employment would not reduce real wages, it might even "have the effect of increasing them through its adverse influence on the volume of output." The chief result would be a great instability of prices which would make rational business calculations impossible. "To suppose that a flexible wage policy is a right and proper adjunct of a system which is on the whole one of *laissez-faire*, is the opposite of the truth." (p. 269) Therefore, a stable wage level functions as a brake in a downward movement, "provided that the equilibrium with the rest of the world can be secured by means of fluctuating exchanges." (p. 270)

If the decline of production after 1929 was less severe in Great Britain than in Germany, in Keynes' view this could not be attributed to more intensive competition in Great Britain, but rather to the rigidity of its wage system.

5 Investment and the scarcity of capital

Keynes introduced the concept of marginal efficiency of capital to emphasize that "capital is not a self-subsistent entity" but is affected by the propensity to consume (Keynes 1936, p. 106). In a typical course of the trade cycle, a collapse of the marginal efficiency marks the beginning of the downswing. (p. 315)

More important in the present context is Keynes' thesis of a long run tendency of declining marginal efficiency of capital. It is the decreasing scarcity of capital which renders laissez-faire capitalism obsolete in the 20th century – an explanation which is missing in the essay of 1925.

> "The post-war experiences of Great Britain and the United States are, indeed, actual examples of how an accumulation of wealth, so large that its marginal efficiency has fallen more rapidly than the rate of interest can fall in the face of the prevailing institutional and psychological factors, can interfere, in conditions mainly of *laissez-faire*, with a reasonable level of employment and with the standard of life which the technical conditions are capable of furnishing." (p. 219)

It is beyond the reach of monetary policy to bring the rate of interest down to rate of marginal efficiency of capital prevailing at this point. The rate of interest does not function as adjustment mechanism which establishes equality between desired savings and investment. Instead, income and employment decline until savings are sufficiently reduced – if "the propensity to consume and the rate of investment are not deliberately controlled in the social interest but are mainly left to the influences of *laissez faire*." (ibidem)

Eucken denied, in the first place, that possibilities for profitable investment were declining in the long run. "We are not in a world that is economically satiated. There are possibilities for investment as long as the scarcity of goods is felt as a constraint. Investments can be made until all needs of men are satisfied by production. To this point, the distance is still immeasurable." (Eucken 1959, p. 175)

In Eucken's view, what is at issue is something different: "Why was the propensity to invest so low during the last decades, although the real opportunities for investment were great?" (ibidem) Here Eucken refers to a situation which resembles the fall of the marginal efficiency of capital as described by Keynes in the chapter on the trade cycle. Eucken explains the reluctance of entrepreneurs to invest both to lack of flexibility and lack of constancy. On the one hand, a reduction of wages and prices of production goods would be necessary to restore profitability of investments. On the other hand, a higher degree of “constancy of data (*Konstanz der Daten*) was required to induce entrepreneurs to embark on greater investment projects.”

6 Demand management and allocation of resources

Keynes cast his argument in macroeconomic terms. He put great emphasis on the separation of state control of demand as a whole and allocation of resources for production of individual goods.

> “[I]f our central controls succeed in establishing an aggregate volume of output corresponding to full employment as nearly as practicable, the classical theory comes into its own again from this point onwards. ...private self interest will determine what in particular is produced ... Thus, apart from the necessity of central controls to bring about an adjustment of the propensity to consume and the inducement to invest, there is no more reason to socialise economic life than there was before.” (p. 379)

Eucken refused to accept the Keynesian dichotomy between macro- and microeconomic thinking, and thereby rejected the macroeconomic approach to economic policy. “This kind of global thinking which prevails in the economic policy in most countries does not do justice to economic realities. We know that it is decisive that the correct proportions of economic quantities are found.” Full employment must be achieved through correct allocation of resources by the process of perfect competition, which brings forward the sufficient volume of investment. A full employment policy through expansion of credit “destroys the allocation mechanism of prices, which are either kept fixed or allowed to rise. As a consequence, the allocation of production goods is distorted, and the supply of consumption goods suffers.” (Eucken 1959, p. 101f)

7 Stability of monetary system

In Keynes’ polemic against laissez-faire, the return to the gold standard at pre-war parities was the main target in his publications of the 1920’s. Instead of a declining price level which was brought about by a deflationary policy which devoted all its efforts first to establish, and thereafter to defend the pre-war parity, Keynes argued that the price level should be kept stable, which would permit a less restrictive discount policy of the Bank of England, and also result in greater stability of interest rates. After Britain had gone off the gold standard in 1931, Keynes supported a policy to bring the prices back to the level of 1929. In the depression, he advocated to keep interest rates low but cautioned against expectations that monetary policy alone could bring about recovery. (Peden 2006, p. 102f)

Whereas deflation was the main problem of monetary policy from a British perspective in the interwar period, from a German perspective stability was threatened from inflation. For Eucken, the principal flaw of the monetary system was the power of banks to create money through expansion of credit – another consequence of a laissez-faire policy. (Eucken 1959, p. 161f) Similar to monopolized markets, such a monetary system has no mechanism to establish equilibrium, and therefore eventually “leads to cumulative depression and mass unemployment.” (Eucken 1950/2012, p. 48) Eucken shared Keynes’ preference for price stability, but generally distrusted manipulative money regimes to achieve this goal, as recommended by Keynes. Eucken held automatisms essential to secure exchange rate stability in a post-World War II international currency system, without, however, advocating a return to the gold standard. (1959, p. 118)

8 Big business and corporatism

Keynes took the "degree of competition" as given in the short run. As regards the long run, he was aware of the growth of "efficient units of production" and the growing importance of "monopolies and combinations". There is a spurious remark in the *General Theory* that he has "no objections to be raised against classical theory as to the degree of consilience between private and public advantage in conditions of perfect and imperfect competition." (p. 397) However, from the perspective of the British experience of the interwar years, it does not come as a surprise that Keynes weighed the dynamic gains from the tendency towards big business higher than the static welfare losses of monopoly. His attitude foreshadows Schumpeter's defence of monopoly in the latter's *Capitalism, Socialism and Democracy* (1942, p. 81ff). Keynes "was a corporatist", because corporatist structures provided a better institutional basis for the policy he recommended for the post laissez-faire-age. Keynes "was a strong advocate of public corporations and large private concerns that were ready to do deals with the government and look beyond shareholder value. From the 1920s to the 1940s, he frequently referred approvingly to the two-thirds or three-quarters of fixed investment which he regarded as already effectively under public control and influence." (Brittan 2006, p.185)

In contrast, it was the perspective of the German experience of the interwar period which induced Eucken and his followers to attribute the fundamental deficiencies of the economy to Germany's corporatist structures of cartels and monopolies. Eucken directly criticized Keynes' preference for "semi-autonomous bodies within the State" (see above section 1) of which "we have long known from science that they prevent the economy from achieving a stable equilibrium." (Eucken 1959, p. 154) Moreover, Eucken did not believe in the effectiveness of state control over such bodies, nor did he share Keynes' firm belief in parliamentary democracy. Rather, he "stressed the importance of a strong state, which could stand above social conflicts, for the creation and preservation of the competitive order." (Rieter/Schmolz 2014/1993, p. 261)

In an essay published in 1942 Eucken wrote that the abolition of the controls of the war economy would not be sufficient to establish a durable economic order after the end of the war. All concentrations of private economic power should be dissolved to create a fully competitive economy. After 1945, Eucken wrote several memoranda addressed to the sectoral occupation governments in which he tried to convince them to implement the uncompromising competition policy as remedies for the failures of laissez-faire. (Eucken 1999, 2012) The members of the Freiburg School observed the compromising attitude of the West-German government with respect to competition policy with growing disappointment. Eucken's follower Hans-Otto Lenel wrote a long article against the inevitability of big corporate enterprise as late as 1962.

9 Post-laissez-faire economic order

Keynes and Eucken approached the problems resulting from laissez-faire under general aspects which are very different. Keynes criticized the malfunctions of the economy by analyzing its dynamic processes which did not produce a satisfactory equilibrium and therefore failed to make full use of available resources. Eucken's ambition was to develop a general theory of economic order with legal and institutional structures as basic elements[9]. He defined a variety of different possible orders by different combinations of these elements, and thereby tried to explain the differences in performance of economies under criteria similar to Keynes'. With regard to dynamics, Eucken has only little to offer beyond referring to basics of price theory and classical allocation theory. Keynes used the terms capitalism and socialism, but he was not interested in a general theory of economic order or economic system which, except for few exceptions[10], became a subject of economic research only in the second half of the 20th century.

Central to Eucken's theory of economic order was the dichotomy between perfect competition and centrally administered economy (*Zentralverwaltungswirtschaft*). With laissez-faire, perfect competition is bound to transform into cartelization and monopolization. Eventually, a framework of central administration is superimposed upon the monopolistic economy. Interim forms (*Zwischenlösungen*) of economic order between perfect competition and central administration (in modern terms: a "mixed economy") are unstable by their very nature, and therefore not durable (Eucken 1959, p. 132).

Keynes had argued just the opposite way. He proposed an interim form as a means to save the "bourgeois" capitalist system from the failures of the laissez-faire economy: state control of big macroeconomic aggregates through fiscal and monetary policy. But "apart from the necessity to bring about an adjustment between the propensity to consume and the inducement to invest, there is no more reason to socialise economic life than there was before." (1936, p. 379) Keynes did not see such controls as a step towards state socialism. His self-understanding was that of a "progressive Liberal" who "can work out his policies without having to pay lip-service to trade-unionist tyrannies, to the beauties of class war, or to doctrinaire State Socialism." (1972, p. 309f)[11] In the same vein, Keynes rejected the dichotomy which is central to Eucken's concept of economic order: "I think that it would be for the health of the [Liberal] party if all those who believe ... that the coming political struggle is best described as capitalism versus socialism and, thinking in these terms, mean to die in the last ditch for capitalism, were to leave us." (p. 310)

In Eucken's analysis, contradictions between occasional (*punktuell)* interventions by which the state reacts to the abuses of laissez-faire capitalism result in growing inconsistency of economic policy, which inevitably leads to a centrally administered economy. Yet Keynes provides a solution to this problem by his new macroeconomic paradigm. The circular flow-approach of the national accounts system provides a basis to ensure consistency of the measures to influence broad macroeconomic aggregates.

10 The end of laissez-faire in the Golden Age of post-war capitalism

[9] According to Kleinewefers (1988) Eucken deserves credit for his pioneering effort to develop a general approach for comparative analysis of economic orders built up from basic forms of planning and decision making competence under the restriction of exogenously given data. However, the economic policy concept which he proposes in his book *Grundsätze der Wirtschaftspolitik* cannot be deduced from his conceptual framework without further assumptions for which he gives only insufficient reasons, or which he makes implicitly without argumentative evidence. I think that Kleinewefers' conclusion that in economics there have been no significant advances towards a general theory of economic order is still valid today.

[10] Most notably Sombart (1925).

[11] All the more Keynes rejected the idea of a soviet type centrally planned economy: "on the economic side I cannot perceive that Russian Communism has made any contribution to our economic problems of intellectual interest or scientific value." (1972, p. 267)

Whereas for Eucken and the economists of the Freiburg School the development towards "organized capitalism" through progressive elimination of competition causes the end of laissez-faire, Keynes' 1926 essay remains rather vague in this respect. In his other writings, three long-term developments or events appear to render the 19th century capitalist order obsolete:

(i) For several reasons the gold standard "with its dependence on pure chance, its faith in 'automatic adjustments', and its general regardlessness of social detail ... an essential emblem and idol of those who sit at the top tier of the machine" (1972, p. 224), had become untenable. The main reasons were "an immense burden of bonded debt, both national and international", which had been contracted since 1914 (p. 128); "the interposition of [a] veil of money between the real asset and the wealth owner" (p. 151); and "most important of all, in the modern world of paper currency and bank credit there is no escape from the managed currency, either we wish or not" (p. 178).

(ii) The laissez-faire view, "the theory of the economic juggernaut ... that wages should be settled by economic pressure" did not do justice to the changing theory of economic society "that wages should be fixed by reference to what is 'fair' and 'reasonable' as between classes" (p. 223). Social costs of deflation had increased tremendously since "the trade unions have become strong enough to interfere with the free play of forces of supply and demand." (p. 305)[12]

(iii) The main argument put forward in the *General Theory* is the vanishing scarcity of capital which has pushed down the marginal efficiency of capital below what is an acceptable rate of interest for rentiers (see above, section 5).

In the light of these arguments, I conclude that laissez-faire has largely lost its relevance for economic policy in the post-World War II era. In the Bretton Woods system of international currency gold was replaced by the US$ as a reserve currency. In case of imbalances, the system provided for discretionary adjustments instead of the previous automatic correction mechanism. As regards national monetary and fiscal policies of Western countries, it is a matter of controversial discussion to what extent these policies have succeeded "in establishing an aggregate volume of output corresponding to full employment as nearly as practicable" through central controls. But Keynesianism was more than that: an equally important aspect of fundamental change in economic thinking is the break-through of macroeconomic analysis brought about by the *General Theory*, i.e. the comprehensive look at the total economy in terms of big aggregates GDP, private and public consumption, investment, total income consisting of wages and profits, and current statistical observation of these magnitudes. The OECD served as a platform to introduce this conceptual framework in all Western countries. Macroeconomic thinking in terms of the circular flow became the standard of economic policies, which were shaped according to the different circumstances in member states. There is a general consensus that economic policy should avoid deflation, and that collective bargaining is the proper method of wage formation.

With respect to (iii), Keynes' assessment was not confirmed by the post-war development. During the Golden Age of post-war capitalism (1950-1975), and even for several decades thereafter, there is no evidence for the vanishing of opportunities for profitable investment. Whether that has changed after the turn of the century, is still an open question.

[12] However, in the *General Theory* Keynes' argument is somewhat different – see section 4.

Laissez-faire has also come to an end with respect to competition policy, but in a way rather different from that envisaged by Eucken and the Freiburg School. On the one hand, the freedom of business enterprises to combine and to form alliances became subjected to increasingly severe restrictions. On the other hand, the tendency towards monopolization or oligopolization of markets has progressed, as individual countries have promoted and not impeded the growth of corporate enterprise ("national champions"). Whether the opening of national markets to international competition and the prohibition of abusive practices are sufficient to counter the concentration of economic power is increasingly put into question.

For most Western European countries the years between 1950 and 1975 deserve to be seen as a Golden Age, to whatever extent this period of exceptional prosperity may be attributed to favourable circumstances or to Keynesian macro-policies. There were few countries, most notably Great Britain, where recurrent deficits of external accounts made it increasingly difficult to implement such policies. (Robinson 1965) But the Golden Age came to an end when more countries lost control over inflation and public deficits in the second half of the 1970's.

Since then, crisis management and ad hoc-reactions rather than planned control of broad economic aggregates have characterized national economic policies. And yet, this is not a return of laissez-faire. The recourse to floating exchange rates after the breakdown of the Bretton Woods system marks another fundamental change in the post-World War II economy, but it cannot be seen as a return to laissez-faire either.

From the 1990's onwards, laissez-faire has returned in the garb of the so-called "efficient market hypothesis", which served as theoretical basis for the deregulation of financial markets. The inherent instability of financial markets, which increasingly dominated the development of the real economy, became evident once more in the worldwide crash of 2008/09. The consequences for future development are still uncertain.

When Germany adopted the concept of *Soziale Marktwirtschaft* after the monetary reform of 1948, British left-wing Keynesians predicted that it would be doomed to failure (Hutchison 1981, p. 155ff). It soon turned out that their assessment had been severely distorted by ideological prejudices. But if, during the 1950's, Western Germany had budget surpluses, this does not mean that its policy was anti-Keynesian, as the ideologues of the Social Market Economy suggested. With an average rate of GDP growth of almost 7 percent, a balanced budget or a surplus were appropriate in fiscal policy. Nonetheless, there was heavy intervention in order to promote investment in certain industries and transport through the *Investitionshilfegesetz* (Investment Support Act), through massive subsidization of housing construction, and a variety of other schemes. (Zinn 1992, p. 59ff) When recession hit in 1966/67, Germany adopted an explicitly Keynesian approach. In the concept of Karl Schiller (Minister of economy) which supplemented macroeconomic policies with *Ordnungspolitik, "*Keynesian economic policies took on a specifically German tinge." However, "with mounting inflationary pressures and a strong increase of unemployment in 1974-75 following the first oil price shock, Keynesian ideas lost ground against the rising new monetarism lauched by Milton Friedman." (Hagemann 2013, p. 48)

Together with Minister of economy Ludwig Erhard, Alfred Müller-Armack was the chief theoretician of German economic policy. Unlike Eucken, he saw market competition as an instrument, not as a goal. If the cartels had been dissolved by decree of the allied powers, no attempts were made to establish perfect competition by subordinating all legal instruments to that goal, as suggested by Eucken. The Competition Act of 1957 permitted cartels under certain conditions. Competition policy in Germany followed the model of US anti-trust law

(Herdzina 1991). Despite Germany had developed a distinct model of a Mixed Economy, which contradicted the thesis of "instability of the interim form", Eucken's dichotomy between perfect competition and centrally administered economy continuously occupied a prominent place in Germany's economic policy discourse – for ideological reasons. (Kleinewefers 1988, p. 67) Taken into consideration this gap between ideology and reality, it is not correct to invoke Eucken as "father of the Social Market Economy". Nonetheless, he deserves credit and memory for having provided an intellectual basis for the creation of a new economic order after Germany's catastrophic defeat in World War II (Janssen 2009, p. 202; Rieter/Schmolz 1993/2014).

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