

Value and exchange in economic theorizing: The contribution of the Freiburg School

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Abstract The purpose of this contribution is to point out the main characteristics of the research program of the German economist Walter Eucken, the head of the Freiburg or ORDO-school. An exposé of his thoughts will be given on (a) the relation between theory and history, (b) the foundations of economic science (c) his contributions to economic theory, and (d) his contributions to the theory of economic policy. Moreover the relevance of the contribution of the Freiburg School (Eucken) to the theme of this symposium on value and exchange in economic theorizing will get attention.

Keywords Value · Exchange · Eucken · Freiburg School · Theory and history

JEL codes B31 · B4 · B5

1 Value and exchange in economic theorizing: the contribution of the Freiburg School

The German economist Walter Eucken (1891–1950)¹ wrote important contributions to economic science, especially in the field of the theory of economic order, economic theory, and the theory of economic policy. From 1927–1950, he was professor of economics at the University of Freiburg. There in the thirties of the twentieth century, the Freiburg School formed itself around Eucken. In the following sections, the thoughts of Eucken as head and prominent member of this School are treated. First attention is paid to the relation between theory and historical reality in Eucken's system of thoughts. Next, his contributions to the theory of economic order, economic theory, and the theory of economic policy are exposed. Finally, these thoughts are discussed in relation to the subject of the symposium.

¹On Life and Work of Eucken: Bilger (1964), Meijer (1987a,b), Gerken (2000), Meijer (1994, 2004)

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1.1 Theory and history

Originally, Eucken was an adherent to the German Historical School. He was influenced as a student by the economist Herrmann Schumacher, a leading figure of the then reigning Historical School, who was his teacher at the University of Bonn. He followed Schumacher as scientific assistant to the University of Berlin. The early publications of Eucken (1914, 1921) are, to an important extent, characterized by this influence and this school.

The historical school defended the inductive method and fought against the exclusive use of the deductive method in economic science. By using the deductive method, it is tried to deduce economic laws by reasoning starting from axioms. In case of induction, it is tried to formulate economic laws starting from observed facts.

New problems came to the fore between the two world wars, especially in the field of national and international money, the market forms and price theory, and the centrally administered economy. This concerns among others the hyperinflation, cartel and trust formation, and the application of the centrally administered economy, more particularly in Germany and the Soviet Union. To explain these problems, new theorizing was necessary. The theoretical insights of economic science at that time were insufficient for explanation, and the approach of the reigning Historical School too one-sided.

After the First World War, the theoretical (deductive) element in his work increased. This is already expressed in his work on monetary theory in the twenties of the former century. In 1923, he published, at the time of hyperinflation in Germany, a book on monetary policy (Eucken 1923). In his book on capital theory (capital formation and interest), first edition published in 1934, the theoretical (deductive) element is predominant (Eucken 1934).

In Eucken's work, the correct insight of the Historical School, namely, that economic reality has to be explained and has to be taken as point of departure, is combined with new theoretical explanations. This connection between history and economics, we find again and again. In the thirties, he elaborates this synthesis between history and economics. His book of 1934 (Eucken 1934) and his articles on *Staatliche Strukturwandlungen und die Krisis des Kapitalismus* (Eucken 1932), *Die Überwindung des Historismus* (Eucken 1938a), and *Wissenschaft im Stile Schmollers* (Eucken 1940a) are preliminary steps. The last mentioned article is a critical review of the contributions to the book edited by Spiethoff (1938). This book was published on the occasion of the commemoration of the fact that Schmoller (1838–1917) was born a hundred years before. According to Eucken neither Menger (founder of the Austrian School and defender of the deductive method) nor Schmoller (head of the younger historical school and defender of the inductive method), and even less their adepts, do justice to reality. Both are wrong, and the truth also does not lay midway. Eucken combined the inductive and deductive method and settled the *Methodenstreit*. This made it possible for him to make significant and stimulating contributions to economic science.

He objects to the a priori construction of models in the field of price theory and the theory of market forms in the thirties. In this connection, he criticizes E.H. Chamberlin (1933), Joan Robinson (1933), and H. von Stackelberg (1934). He insists on the analysis of the reality of the centrally administered economy. The aprioristic theoretical constructions of, e.g., Lange (1938), and Schumpeter (1942 [1961]) have no connection to historical reality. They cannot explain the working of the centrally administered economies as they exist in historical reality.

In his book *The Foundations of Economics, (Die Grundlagen der Nationalökonomie, 1940b, 1959, 1990)*, published first in 1940, he develops these ideas. He applies them to the exchange economy, the centrally directed economy, and the market forms and monetary systems that have existed in historical reality. Later on, he applies them in his theory of the

centrally administered economy, more in particular as practiced in Hitler-Germany and the Soviet Union (1948, 1952 [1990], 1954).

In the thirties, the Freiburg School formed itself around Eucken and Böhm. The Freiburg School is characterized by the cooperation of economists and lawyers. This integration of the sciences of law and economics was after the opinion of the “members” necessary to give the economic process the desired legal form (constitution) (Böhm 1957). In the thirties, Eucken was the editor of a series of books under the title: *Probleme der theoretischen Nationalökonomie*. With the lawyers Franz Böhm and Herrmann Groszmann-Doerth, he edited also a series with the title *Die Ordnung der Wirtschaft*. The purpose (the research program) of the Freiburg School was formulated by Eucken, Böhm, and Groszmann-Doerth in the preface of *Ordnung der Wirtschaft als geschichtliche Aufgabe und rechtsschöpferische Leistung* (economic order as a historical task and law-creating performance) (Böhm 1937). The contributions of the Freiburg School concern all aspects of economic theory and economic policy.

After the Second World War, the thoughts of the Freiburg School are elaborated in *Ordo-Jahrbuch für Ordnung von Wirtschaft und Gesellschaft*. ORDO was published for the first time in 1948 and was founded by Eucken and Böhm. That is why this school also is labelled ORDO-school. The economic policy of Germany since 1948 was in a large measure inspired by Eucken and his school.

After the decease of Eucken in 1954, the *Walter Eucken Institut* was founded in Freiburg. This independent scientific institute publishes a series *Wirtschaftswissenschaftliche und wirtschaftsrechtliche Untersuchungen*. Later, the title of the series was changed in *Untersuchungen zur Ordnungstheorie und Ordnungspolitik*. This can be seen as a continuation of both series edited before the war.

1.2 Eucken on foundations of economics

In the first chapter of Part 1 (pp. 1–23) [*Das eine Hauptproblem* The first fundamental problem)] of his book on foundations of economics (1959 [1940, 1990]; 1938b [1947, 1961]), he raises the question: What is the objective of economics? The answer is to understand everyday economic experience (*Alltagserfahrung*). He describes what he means by pointing out that an economic subject influences the economic process by his actions and raises the question how the economic process is directed. This he calls the first fundamental problem of economics (*Das erste Hauptproblem*). This problem has five aspects: how, for whom, when, where, and what.

In the second chapter, he writes first on the method of economics. In this respect, he treats what he calls the great antinomy (*Die grosse Antinomie*). The problem is historical-individual but also theoretical-general. To give a solution to the great antinomy, he calls the second fundamental problem of economics (*Das zweite Hauptproblem*). All human action is history. However, to understand everyday experience of the on division of labor and exchange-based economy in its interconnectedness and complexity is not possible without theory. The problem is how to combine these two approaches, that is, how to solve this antinomy.

In the second part (pp. 24–68), Eucken criticizes economics from the viewpoint of whether the second fundamental problem has been solved. In the first chapter, he points out that in his opinion, the classical school did not succeed. They studied only part of reality, in particular, complete competition. They neglected analysis of other market forms, e.g., monopolies and oligopolies and centrally directed economies, although these existed in their time and also before. They were looking after the natural order of economic life and

found it in the exchange economy, the market order based on complete competition. They did not see clearly the antinomy.

The reaction on this was that it was tried to find a way out of this doctrinarism and to explain not only part but the whole of historical reality. Eucken discusses three ways in which it was tried to find a solution. All these solutions in his opinion failed. The first was to start with definitions of what is meant by trade, money, etc., and then to go to historical reality. These economists did not see the antinomy. They failed in studying historical reality and also in theorizing about it. The second solution made a distinction between historical economics and theoretical economics, i.e., dualism. This is the solution, which was defended by Carl Menger. In this distinction, the antinomy is not solved. The historical economists with their historical method fail because they do not have a theory. The economic theorists loose contact with historical reality.

Schmoller criticized the dualism of Menger. He wants one economics. However, the way he wants to reach this also is not a solution of the problem. He distinguishes a descriptive science, which serves as a foundation for theory. This empiricism, however, cannot lead to theory.

In the next chapter, Eucken treats approaches that see the antinomy. They try to distinguish and find phases, stadiums, periods, styles in history and try to provide a theoretical explanation for each of them. However, it is, according to Eucken, not possible in this way to come to a solution. They use not ideal types but real types. These real types are, however, not descriptions of historical reality. In the third part (pp. 69–242) of the book, Eucken shows the way in which he thinks the science of economics can explain everyday economic experience. Therefore, not abstraction but penetration of historical reality is necessary. By isolating abstraction (*pointierend-hervorhebende Abstraktion*), ideal-typical economic systems can be determined.

He distinguishes two constitutive forms (*Grundformen*): the centrally directed economy and the exchange economy. The centrally directed economy can have a simple form. In this simple directed economy (household economy, *Eigenwirtschaft*) the central plan can be based on exact economic calculation in natura because the economy is small and can be overseen. Serious problems, however, arise in the centrally administered economy because it is large and needs a central administration. Eucken distinguishes three variants of the centrally administered economy: the totally central administered economy, without any form of exchange; the central administered economy with free exchange in consumer goods, and the centrally administered economy with free consumer choice. In the exchange economy, there arises the problem of the coordination of the plans of the households and the firms, or perhaps better, the coordination of the economic activities. The working of the exchange economy differs according to the realized market forms and money systems. The related problems are the subject of the next section.

In the third chapter, he starts the analysis of the economic system. This, he first demonstrates for the simple form of the centrally directed economy. The leader of this economy makes his plan taking into account the data for his plan. There are six: wants, labor, nature, capital, technical knowledge, and juridical and social organization.

Furthermore, there are rules of experience (*Erfahrungsregeln*) which have to be taken into account: the first law of Gossen, the law of diminishing returns, and the greater productivity of roundabout methods of production. On the basis of plan data and rules of experience, the plan is built. The planner has to estimate the significance of the individual goods for the several ways in which they can be used. This means that the centrally directed economy is a world of values. In practice, it often turns out that there is a difference between the plan data and the factual data because there is no complete foresight. This

means that plans have to be changed. However, it is also possible to take this risk of difference between factual and plan data into account when the plan is drawn up.

In the exchange economy, there are several individual plans which have to be coordinated. Whereas in the centrally directed economy the problem of scarcity has to be solved, in the exchange economy, also the problem of coordination of the plans and activities has to be solved. This coordination is in the money exchange economy performed by the pricing process. This has to be explained by economic science. For this, micro- and macro-analysis is necessary. The plans of the firms and households have to be analyzed. In these plans, only a small part of the economic process takes place. They are incomplete. They take into account the data and rules of experience, but they are also surrounded by prices for their inputs and outputs. The difference between factual and plan data concerns, here, moreover the prices. This price risk also has to be taken into account in the analysis of the households and firms.

Next, the prices have to be explained. This means analysis of markets and money systems and their role in pricing. Besides analyzing the pricing in the different market forms, also the time element (short run, long run) has to be considered. The interdependence of the markets in different market forms and money systems and, therefore, of prices has to be explained. In the exchange economy there are microeconomic plan data and microeconomic factual data; also, there are factual macro-data. However there are not macro-plan data. They only exist in the centrally directed economy.

When the six macro-data do not change, the economic process will not change, but rotate in the same way. The economy can be designed as static. This theoretical device shows the interdependence of the economy and the direction it moves in case of given macro-data. Moreover, it can be used to show changes in the developments in the economy when one of the data changes (variations method). However, often, the device is only used to describe a given static situation. Then, the problems that exist in everyday experience are neglected, e.g., with regard to the time and place aspect of economic life. Moreover, one has to be aware of the existence of two forms of the stationary economy.

The first is the general equilibrium in the sense of the Lausanne School: all available means of production and labor are optimally used. Eucken calls this kind of static economy: general optimum equilibrium (*allgemeines vollkommenes Gleichgewicht*). This may happen when there is complete competition on all markets. The static economy is not the same as this concept. There is also the possibility of a static economy, in which the means of production and labor are not optimally used. He calls this the static economy in which general equilibrium is absent (*mangelndes allgemeines Gleichgewicht*). In this case, there is unemployment. With both mistakes combined, this theoretical device must be unfit for the solution of concrete economic problems.

Eucken also is of the opinion that the analysis of the simple economy of Robinson Crusoe and the exchange economy *in natura* (*Naturaltauschwirtschaft*) are of great importance to get insights in the economic process: the first, because it shows clearly the fundamental economic problems that exist in every economic order; the second, because after studying the exchange economy *in natura*, the characteristics of the money exchange economy can be better recognized. This bears fruits for the theory of money, interest, and capital (investment and saving).

In the fourth chapter, Eucken shows how the application of his theory of economic order and his economic theory approach can be used to understand the economic order and the economic process in all times and all places. In the first place, the concrete economic order (of a country), as a whole, has to be determined by generalizing abstraction (*genera-*

lisierende Abstraktion). In this respect, the cooperation of economic history and economics is necessary. After this question has been answered, it has to be decided which theory has to be used. In this connection, Eucken introduces the concepts of actuality and truth. Theories are true when they have been arrived at in a correct way. They are actual when at a certain time and place the conditions are present, within which they are true.

Special attention is paid by Eucken to economic development. Economic change can take two forms. The economic order can change, and as a consequence, the economic process. It may take the form of expansion, but also of contraction. With regard to the business cycle, Eucken is of the opinion that there is not a normal business cycle. In this connection, he refers to W.C. Mitchell.

1.3 Contribution to economic theory²

Eucken makes a distinction between the economic order and the economic process. With regard to the economic order, he distinguishes between the centrally administered economy and the free exchange economy. Within both there may exist different market forms and monetary systems. The economic process differs according to the economic order. We will make a few short remarks on these subjects as far as it seems useful in relation to the topic of this symposium.

This concerns first the contributions of Eucken and Hensel (who was long time his assistant) on the theory of the centrally administered economy. Next, the main characteristics of the contributions by Eucken on the theory of market forms will be described. The same will be done with regard to his contribution to the theory of monetary systems.

1.3.1 Contributions to the theory of the centrally administered economy

The theory of Eucken The theory of Eucken (1948, 1952) is mainly concerned with the experiment of the centrally administered economy in Germany that started in 1936, under national socialist rule and continued until the economic reform in 1948. During this experiment, de jure private property was maintained. As time moved on, the centrally administered economy became more and more the dominant structural form of the economic order.

The procedure followed in Germany went through four stages. The first phase consisted of the collection of statistical data. These data served as a base of the real planning, which comprised the planning of the wants, the available means, and the balancing of the wants and means. Those concerned were consulted. Data from previous periods were used, and the wants were radically standardized. The central authority formulated a list of priorities of wants. This procedure also involved negotiation with the parties concerned (the so-called *Fachabteilungen*). When no agreement was reached, a higher authority made the decision. Consequently, in the third phase, production instructions were announced. In the last phase, the realization was controlled on the basis of periodical reports, with the aid of *Soll-Ist* (plan and realization) comparisons. In both these phases, the parties concerned were consulted, and conflicts of interest arose.

The procedure here described has two characteristics. The first is that valuation on the basis of the material balances is not a calculation per unit (individual calculation or marginal cost calculation), but a global calculation. The relative significance of the different objectives was estimated. The schedule of priorities was—also because of standardization—rather crude and did not sufficiently take into account the phenomenon of complementarity. One tried to balance these tentative valuations by negotiation. The applied comparisons between plan and

² See for a more comprehensive treatment Meijer (1987a, 1988)

realization (*Soll-Ist Vergleiche*) are no standard to determine economic action. The optimum equilibrium as indicated in the Second Law of Gossen was not achieved.

The second characteristic is that this kind of economic calculation does not have decisive character. In the free exchange, economy prices (at least in the case of complete competition) function as a measure of scarcity and as a controlling device. When a firm is not profitable, it will, in the long run, have to stop production. In the centrally administered economy, the determination of wants and the management of the direction of production are in the same hand. For that reason, the calculation has no decisive character. This has advantages and disadvantages. The maximizing of wants suffers, but full employment can be realized rather easily. Political desiderata are rather easily accomplished. Production can be continued and extended in directions, which would not be profitable in the case of calculation by pricing. There exist disproportionalities in the productive equipment: this harms productivity and is expressed in a low consumption level. This consumption level can, of course, also be low, because the central authority gives priority to investment over consumption.

Full employment can be realized rather easily in the centrally administered economy. In the first place because the investments made are higher than the savings and are financed by money creation. The central administration will repress the resulting inflation by price controls. In this way, open inflation is transformed into repressed inflation. In the second, place economic calculation is global and is not decisive in character. It is not possible to determine exactly whether or not an employee can be maintained. Even if this becomes apparent by global valuation, the centrally administered economy is not obliged to fire the employee.

Prices were used, but these were accounting prices. They did not indicate scarcity, because since 1936 a "price stop" existed. The accounting prices were refined by calculation prescriptions, but were no guarantee for reaching the optimum. In this manner, one did try to approach the optimum. The fixing of new prices, which would indicate scarcity, was not possible. Global valuations do not form a basis for this. Total or partial release of the prices would have brought about conflicts between the central authority and the householders. Moreover, there were monetary policy objections in connection with existing repressed inflation.

Economic equilibrium is not brought about through negotiation. In the free exchange economy, in the first place, we know the equilibrium of households. This is not an objective of the centrally administered economy and is not brought about. Also, general equilibrium is not reached, especially not with investments.

The great art in this procedure is to recognize bottlenecks and take measures in time. As far as this was not successful, the black market had a useful mitigating function. In as far as households had the freedom to follow the Second Law of Gossen, optimum equilibrium was approached. Exact economic calculation was, however, not possible. More or less, arbitrary decisions were taken in the areas of investments, international trade, and the distribution of the national product.

Eucken thinks Mises is right in the case of the totally central administered economy in which there is no exchange, and therefore, no pricing process. Exact calculation is not possible in this constellation.

The theory of Hensel In his theory of the centrally administered economy, Hensel (1954 [1959]) distinguishes between economic calculation during planning and economic calculation during execution of the plan. The economic calculation during planning comprises six points:

- (1) The registration of the available goods; here, the central authority has to use estimates concerning the goods that are in the hands of private citizens. These estimates can be a source of wrong decisions.
- (2) The determination of the wants; this can be done sufficiently exactly.

- (3) The conversion of goods of the first order into goods of higher order. This may take place on the basis of existing and expected technical coefficients. In these calculations one has to use averages, but this is, according to Hensel, not a real disadvantage.
- (4) The framing of material balances for all goods separately; this can be determined exactly. The balances of those material balances indicate the degree of scarcity of several goods.
- (5) The conversion of that scarcity of goods of higher order into those of first order; this can be done sufficiently exact by making use of the technical coefficients mentioned in (3).
- (6) The coordination of production-possibilities and wants by the planning mechanism so that an exact valuation of all goods is possible on the basis of scarcity. The Second Law of Gossen is satisfied. This planning may take place in natura. The objectives are not those of the individuals but of the central authority.

With regard to economic calculation during the execution of the plan, the problem of subordination comes to the fore. All participants of the economic process have to be induced to defer to the plan. The planners and the executors are on different levels. The planning is done centrally, the execution in the individual households. In a centrally administered economy, there is no closed internal accounting even if calculation in money, with the aid of accounting prices, which are the expression of scarcities indicated by material balances, is introduced. In the case of collective property, this calculation cannot be executed as good as in the case of private property. The economic freedom of the management of the firm is confined to the problem of performance. The control has a bureaucratic character. The operation of economic calculation is not always warranted and fails seriously compared to the free exchange economy as far as the possibility of exact economic calculation is concerned.

Hensel's point of view involves the rejection of the theory of Von Mises. A general unit of accounting is not necessary and calculation in natura is sufficient when drawing up the plan. The pricing process is not necessary; it is displaced by the planning procedure. Pricing, that is in the form of accounting prices, is only useful during execution of the plan.

The findings of Hensel at some points are not in accordance with those of Eucken. They agree on the analysis of the German reality. Hensel attributed the deviations for a large part to the differences between that reality and the hypotheses he uses himself. By contrast Hensel attaches more significance to the material balances. From these originates the mechanism of the plan. Scarcity is indicated by the remainders of the material balances. On that basis, marginal calculation is possible, and optimum equilibrium can be realized. The crude priority of wants is at first used to set up the system and can be refined after the scarcity on the material balances becomes apparent so that the Second Law of Gossen and the provision of complementary goods are shown to their full advantage. The prices are only used for the realization of the plan. When Eucken argues that exact calculation is absent in the centrally administered economy, Hensel thinks he still follows too much the way of thinking associated with the free exchange economy. Global calculation does not necessarily have to be second to marginal calculation. Eucken's conclusions that the Second Law of Gossen is not fulfilled and that no justice is done to the phenomenon of complementary, so that no optimum equilibrium is accomplished, are untenable according to Hensel.

The thinking about the problem of economic calculation in the centrally administered economy has strongly influenced the ideas of Eucken and Hensel about economic order. They are of the opinion that in the centrally administered economy, economic calculation and the decision making based upon it, cannot, or not as well, take place as in the case of the free exchange economy. For that reason, from an economic point of view, they prefer the free exchange economy in which economic calculation takes place with prices.

1.3.2 Contributions to the theory of market forms

Eucken (1959, pp. 88–112) uses the plans of the economic subjects as a base for his theory of market forms. These are based on certain facts that are seen as given by the economic subjects, the so-called planning data. Regarding market behavior, they can accept, respectively: the price; the expected behavior of demand and supply; or the expected behavior of the demand and supply and the behavior of a few competitors, as given.

At the demand side and at the supply side, the following cases may occur: competition, partial oligopoly, oligopoly, partial monopoly, collective monopoly, and monopoly. By combination of the demand and supply side, he obtains 25 forms. These market forms can be open at both sides, closed at both sides or, open or closed at one side. The distinction between open and closed market forms extends the number of market forms to a hundred.

The market form complete competition is characterized by competition at the supply and demand side and can occur in four forms, namely, open at both sides, closed at both sides, open or closed at one side, or open or closed at the other side. Openness is not a criterion for the existence of complete competition. The distinction open – closed is related to the question whether or not free entry to and exit from the market exists, in other words, whether or not artificial barriers are present. These barriers may be created by the participants themselves or by government. Free entry is very significant because, otherwise, potential competition would not exist.

Eucken exclusively uses as criterion for complete competition (*vollständige Konkurrenz*) the question whether or not all market participants treat the price as given in their plans. He rejects as criteria for the existence of competition and therefore a fortiori for the existence of complete competition:

- (1) That the price, in fact, is not influenced by supply and demand. It is only of importance that the economic subjects do not take this influence into account.
- (2) That the elasticity of supply and demand is infinite.
- (3) The number of market participants.
- (4) Whether or not homogeneity of goods exists.
- (5) Whether or not the firms have about the same size.
- (6) That the market has to be transparent.

Eucken's objection against the authors using one or more of these criteria is that they do not base their theory on reality but on a priori determined criteria. If homogeneity of product (or homogeneity of firm size) is used as criterion for competition, one says implicitly that competition hardly exists in reality. This has been obtained by definition and does not say anything about reality. In reality, every producer has a different product. This criticism is directed more in particular to Chamberlin (1933), Robinson (1933), von Stackelberg (1934, 1943, 1948), and L. Miksch (1937, 1947). Then, one is not able to characterize competition as it exists in reality.

Eucken distinguishes the market forms with respect to the planning data that are used by economic subjects in their plans. According to these criteria, one is also able to distinguish the market forms in reality. They are not mixed forms. The market structures are clearly distinguishable. He rejects the idea that complete competition and monopoly in reality hardly can be found because they are not realistic borderline cases and that only mixed forms occur in reality. This idea can only occur to authors who use homogeneity of goods or homogeneity of firm size, in the sense of Von Stackelberg, as criterion for their classification of market forms. Homogeneity hardly ever does exist. All suppliers are monopolists, if one poses homogeneity as a requirement. Thus, one arrives at the concept of monopolistic

competition, in which many suppliers offer a heterogeneous product. However, what is decisive is which planning data these suppliers use in drawing up of their plans.

The contribution to the theory of market forms, discussed above, forms the basis for the study of the economic processes within these market forms. In this way, conclusions can be drawn about the working of the pricing processes in the different market forms. His ideas on competition policy are linked up with these analyses of the market forms and of the economic (pricing) processes in the different market forms. Eucken's criterion for competition policy is complete competition. Where it does not exist or cannot be realized, complete competition has to be the yardstick of competition policy. Only when complete competition exists can a general optimum equilibrium be realized. All other market structures have, in this respect, shortcomings compared with complete competition.

1.3.3 Contributions to the theory of monetary systems

With regard to the money economy, Eucken (1959, pp. 112–123) points out that in history, two main ideal types can be observed by isolating abstraction: one form in which money, as means of exchange, also is used as unit of calculation (*Recheneinheit*); the other in which money as means of exchange and unit of calculation are separated.

Eucken distinguishes three pure monetary systems. In the first, money originates when a good becomes money. In the second system, money originates in exchange with goods and services. In the third system, money originates through credit. The influence of money on the economic process differs in the case of different monetary systems. Eucken's theory of money, and its consequences for monetary policy, will not be treated here. An extensive study on this point is made by Folz (1970).

1.4 Eucken's theory of economic policy

Also in the field of the theory of economic policy, Eucken elaborates the synthesis between theory and history. The results of this, also based on research of his pupils and colleagues (supporters) who belong to the Freiburg School, we find in his posthumous book *Grundsätze der Wirtschaftspolitik (Principles of Economic Policy, 1990)*.

The second part of this book contains extensive reflections on types of economic policies executed in the past and present. The title is *Erfahrung und Kritik (Experience and Critique)*. He discusses there the economic policy of laissez faire, the policy of experiments, the policy of the centrally administered economy, and finally, the middle of the road policies. The full employment policy and the policy of public industrial organization are examples of the latter. These contemplations are followed by reflections on freedom and order. In this part, *Freiheit und Ordnung (Freedom and Order)*, he argues against the myth of the inevitability of historical evolution and the theory of concentration, both those of Marxist and non-Marxist origin, e.g., Schumpeter (1961) and Schmalenbach (1949). There do not exist inevitable historical developments. It is possible to order in freedom. At last, he gives an exposition of the policy of the on competition-based economic order (*Wettbewerbsordnung*) and how to realize this economic order. Much attention he gives to the question how this policy can be executed in the given historical economic and political circumstances: *Prinzip und Moment (Principle and Moment)*. He also points explicitly to the importance of the state, science, and the churches as constitutive forces of the economic, political, and social order.

Eucken developed a program of economic policy based on his analysis of the economic order and the economic process.³ The basic principle of economic policy is to let the pricing process work as well as possible. This is, in his opinion, the case with complete competition. The policy has to refrain from all measures that conflict with the basic principle. Such measures have to be taken so that the market form complete competition will be developed. In this context, Eucken distinguishes measures that are *system conform* and *system nonconform*.

The economic order based on complete competition (competitive order, *Wettbewerbsordnung*), is founded on six constitutive principles:

- (1) stability of the monetary system;
- (2) open market, i.e. free entry;
- (3) private property, also of the means of production;
- (4) freedom of contract, however, not to interfere with the basic principle;
- (5) complete liability for economic actions; and
- (6) constancy of the policy.

These six constitutive principles have to be realized simultaneously.

Apart from these constitutive principles, Eucken distinguishes the regulating principles that are directed towards keeping the economic order based on complete competition intact. There are four of these principles:

- (1) a policy to attack monopolies (*anti-monopol-politik*);
- (2) a policy aimed at changing the distribution of incomes;
- (3) the fixing of minimum wages; and
- (4) a policy to equalize individual and social costs.

The business cycle problem is, according to him, solved if the constitutive and regulative principles are fulfilled. The monetary side of the economic order has for that reason to be changed in such a fashion, that the business cycle is eliminated. He propagated the introduction of a commodity reserve standard and 100% money. For that reason, the business cycle policy is not mentioned among the regulative principles.

Besides the constitutive and regulative principles, he formulates three principles of state policy:

- (1) The state has to limit the power of interest groups.
- (2) All state intervention has to be policy of the economic order, not of the economic process.
- (3) Economic and social policy has to be systematic and not ad hoc.

Moreover, Eucken stresses the interdependence of economic, political, juridical, social order (*Die Interdependenz der Ordnungen*). In his theory of economic policy, he stresses the relations between the economic order, the instruments of economic policy used, and the economic and noneconomic aspects of the societal order.

Economic policy has always to take in account that these interdependencies exist. For every measure, it has to be considered what the effect is for the economic process, as a whole, and the economic order and the noneconomic order. All instruments have to be complementary to one another and not to conflict. An eye has to be kept on the whole economic process.

³ See for a more comprehensive treatment: Grosseckttler (1994), Meijer (1988, 2004)

2 Relevance for the discussion on value and exchange in theorizing

In his scientific approach, Eucken makes use of both the theory of value and the exchange theory. He criticizes the methodological approach of Menger, which he designates as “dualism”. Also, Walras is criticized by him because he abstracts from reality. In the system of Walras, not all integrated aspects of the economic process are analyzed. Especially, this is not the case with the aspects of time and space. Therefore, Eucken (1934 [1954]) himself elaborated on the theory of capital; an excellent summary is given by Yeager (1994). Furthermore, the Lausanne School (Walras, Pareto) is criticized for concentrating on perfect competition static general equilibrium.

He stresses the interconnectedness of the economic process, which is relevant for theory and policy. Also, he stresses the interdependence of orders. In this respect, he is working in the tradition of the German State Sciences.⁴

With regard to economic systems, he makes a distinction between the order based on market and exchange in which the plans of the subjects are coordinated by prices and the centrally directed economy in which the economic process is guided by subordination of all economic activities to a central plan. With regard to the centrally directed economy, he makes the important distinction between simple directed economy (*Eigenwirtschaft, einfache zentralgeleitete Wirtschaft*) and the centrally administered economy (*Zentralverwaltungswirtschaft*). In these types of economic systems, there is no exchange. On the basis of the data and rules of experience, the plans are made by the leader(s) with their valuations, from these follow their actions, and in this way, the economic process and its problems can be explained. Theorizing on these economic systems is possible and necessary, although they are not based on exchange. They can and have to be studied by using value theory. We have seen (Contributions to the theory of the centrally administered economy) in which way the Freiburg School has contributed to this subject.

It may give rise to confusion to confront value and exchange as alternative approaches of theorizing in economics, as Kohn (2004) does. Value and exchange have always been core concepts in economic theorizing. Already, Aristotle in politics, at the early beginnings of thinking about economics, made the distinction between *oikos* and exchange. The *oikonomia* studies the rules of the household economy; the rules of exchange are studied by chrematistics. He distinguishes value of use and value of exchange (Schumpeter 1954). Later, important contributions were made by the School of Salamanca (Grice-Hutchinson, 1978), and the marginalist schools, foremost the Austrian School of Menger, Mises, Hayek, and Kirzner. The core concept in this last stream of thought is subjectivism (Kirzner 1995).

Exchange as a concept is ambivalent. It has a different significance in different market forms and monetary systems. Also, the legal order of exchange, e.g., with regard to property, contract, and accountability, is of influence. Lindblom (1977) mentions, in his discussion of the term exchange, yet another use of the term by Homans. He refers to the article of Homans (1958) on “Social Behavior as Exchange”. Here Homans uses exchange to include all human interaction. Buchanan (1964) uses the concept in a similar way, when he writes that he prefers the use of the term “symbiotics” above catallactics instead of economics. This maybe one of the reasons why Robbins’ position is misunderstood and misrepresented by Buchanan.

The work of Robbins (1935) is rooted very firm in Austrian value theory. He stresses that economics studies the economic aspect of all economic activity, not only the exchange economy. For Robbins, economics is, in the first place, based on the Austrian value theory,

⁴ Backhaus (2006)

the theory of choice. In his preface to the first edition, he writes: “I should like, however, once more to acknowledge my special indebtedness to the works of Professor Ludwig von Mises...”. Moreover, he points out that economics is more than the theory of exchange. He writes: “But it is one thing to contend that economic analysis has most interest and utility in an exchange economy. It is another to contend that its subject matter is limited to such phenomena. The generalizations of the theory of value are as applicable to the behavior of isolated man or the executive authority of a communist society, as to the behavior of man in an exchange economy — even if they are not as illuminating in such contexts. The exchange relationship is a technical incident, a technical incident indeed which gives rise to nearly all the interesting complications, but still for all that, subsidiary to the main fact of scarcity.”

At last, some remarks on the two first points of the New Research Program, proposed by Kohn, are made in the lights of the exposition of Eucken’s ideas:

1. Good science is primarily good observation and suggests a renewed interest in economic history of all times and all places. It has to include all economic activities, including economic policy, in all economic systems. The way in which this has to be done is, however, important. In this respect, Eucken would be a good and indispensable guide.
2. With respect to the qualitative vs quantitative aspects of economics, Eucken’s position is that both have to be considered by economists. In case of the economic order, economic science has to theorize about qualitative aspects.

In this connection, there is also a broad field of interdisciplinary research. With regard to theorizing on the economic process, quantitative aspects come to the fore. To stress the need for research on the qualitative aspects, with the argument that in the recent past, this has been relatively neglected and that after a time of disintegration of economic science, it is fruitful to integrate the results of different approaches, is one thing. To leave the quantitative aspects to applied econometrics, however, means to resign on theorizing about the economic process.

The theory of economic order (*Ordnungstheorie*) is interdisciplinary (Herrmann-Pillath 1991, 1994). All kinds of modern directions in economics, which develop separately, can be integrated in Eucken’s approach. He mentions, as examples, property rights theory, evolutionary economics, and new institutional economics. The same is the case with constitutional economics (Vanberg 1988), Economic History (North), Law and Economics, Economics of the Family (Becker), Economics of Culture (Klamer 2006), Cultural Economics (Goldschmidt 2002), the study of economic systems, institutional change, economic development, and modern Austrian Economics.⁵ In fact, all these approaches can be found in the publications of the Freiburg School from the beginning in the thirties of the 20th century. These are all approaches that are part and parcel in Eucken’s work.

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⁵ On the relationship between the Freiburg School and the Austrian School see Meijer (2005)

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