

Universität - Gesamthochschule - Siegen

JAMES M. BUCHANAN

Nobel Laureate 1986

PROSPECTS FOR ECONOMIC THEORY IN THE 1990s  
AND BEYOND

and Contributions by

RICHARD BRINKMAN

BODO B. GEMPER

RÜDIGER PETHIG

Edited by

BODO B. GEMPER

Siegen 1993

Universität - Gesamthochschule - Siegen

JAMES M. BUCHANAN  
Nobel Laureate 1986

PROSPECTS FOR ECONOMIC THEORY IN THE 1990s  
AND BEYOND

and Contributions by

RICHARD BRINKMAN  
BODO B. GEMPER  
RÜDIGER PETHIG

Edited by

BODO B. GEMPER

EDITION

ENSIS

NETPHEN



Published in 1993 by Edition Ensis  
University of Siegen Printing Office  
Hölderlinstr. 3, 5900 Siegen, Germany

© 1993 by EDITION ENSIS  
Bodo B. Gemper, 57250 Netphen 3, Germany

All rights reserved  
Printed in Germany

Typeset by Marianne Kerkfeld, Siegen  
Editorial Assistant Dieter Stolz, Siegen

## Contents

Editor's Foreword ----- p. 1

Rector's Address ----- p. 4

**James M. Buchanan**

George Mason University, Center for Study of Public Choice

*Prospects for Economic Theory in the 1990s and Beyond* ----- p. 6

**Rüdiger Pethig**

University of Siegen, Department of Economics

*Catallaxy contra Management-directed Economic Theory* -- p. 25

**Richard Brinkman**

Portland State University, Department of Economics

*Public Choice: Toward a New Paradigm for Economics ?* -- p. 33

**Bodo B. Gemper**

University of Siegen, Department of Economics

*The Jena Pioneers of the Freiburg School* ----- p. 47



## Editor's Foreword

It was indeed a privilege to welcome Professor James Buchanan to the University of Siegen for our "Colloquium on Economics" and we felt very much honoured having this Nobel Laureate as our guest speaker.

James Buchanan's theory of decision-making in the public sector is known to most economists under the name "Public Choice". This comprehensive theoretical conception lies on the border-line between economics and political science.

Constitutional economics and Ordnungspolitik are closely related intellectually. Conceptually they are so near to each other and yet they are so far away from each other, both in geographical distance and in the deferment in time. Despite this there is a congeniality of thinking in the sphere of forming economic and social orders in a free society.

Karl-Ernst Schenk and Victor Vanberg, for example, examined the German tradition of Ordnungstheorie from the perspective of modern constitutional economics, the research programme that is notably associated with the name of James Buchanan. Schenk's inquiry<sup>1</sup> into the nature and concept of "Institutional Choice" forms the background of the analysis of "Ordnungstheorie" and its position vis-a-vis the "Institutional Choice" - approach. Vanberg discussed the fundamental correspondence as well as the specific differences between the two approaches in his paper

---

<sup>1</sup>"'Institutional Choice' und 'Ordnungstheorie'", Walter-Eucken-Institut, Vorträge und Aufsätze, 82, Tübingen 1982.



"Ordnungstheorie' as Constitutional Economics - the German Conception of a 'Social Market Economy'"<sup>2</sup>

Professor Buchanan feels very much at home in Europe. He has good European contacts, he has had many European experiences and his research work has been received very well, especially in the German speaking part of Europe. He has enjoyed a very wide exposure to a large number of European academics and academic communities. As an adherent of the Freiburg School of economic thinking I do feel very much attracted to James Buchanan's concept and the definition of his position. I like in particular how he himself made his point of view clear to us when he said: "I very easily put myself in a category of being an individualist, a contractarian and a constitutionalist".

Professor Richard Brinkman from the United States acted as the lead- in discussant after Professor Buchanan's lecture to remove any initial bashfulness and to invite criticism from the audience.

I would like to thank both, Richard Brinkman and the co-ordinator of the "Colloquia on Economics", Professor Rüdiger Pethig, for their loyal and co-operative support in making Professor Buchanan's guest lecture an unforgettable academic and amiable event.

I am very much indebted to Professor Buchanan for his visit to the Siegerland and that he accepted my invitation to the University of Siegen. Furthermore, he visited Wilnsdorf, a community which has carried out vast structural change with positive results with regard to the level of employment. I would like to express my sincere thanks to the Mayor, Mr. Elmar Schneider, and the

<sup>2</sup> Cf. ORDO, Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft, Vol. 39, Stuttgart & New York 1988, pp. 17-31.

Director of Administration of Wilnsdorf, Mr. Karl Schmidt, for receiving this distinguished guest from the United States together with the accompanying group from the University of Siegen. This again was evidence of the vital and fruitful links between this university and its neighbouring local communities.

Siegen, North-Rhine-Westphalia,  
January 1993

Bodo B. Gemper



**Prof. Dr. Klaus Sturm, Rector Magnificus,  
University of Siegen**

Address delivered at the Economics Department of the University of Siegen, on the occasion of the lecture of Prof. Dr. Dr. h. c. mult. James M. Buchanan, Nobel-Laureate 1986

---

Ladies and Gentlemen,

it is a privilege and honour for me to welcome you, Prof. Buchanan, to the University of Siegen. It is a wonderful opportunity for the faculty and the students to have this distinguished internationally well-known Nobel-Laureate in Economics with us. I hope that you will find a creative atmosphere and enjoy inspiring discussions with the members of this colloquium.

The University of Siegen is a new university, based on the concept of the comprehensive university founded in 1972. The comprehensive universities in the state of North Rhine Westphalia have been established in order to combine the tasks of research and teaching by universities, teacher's training colleges and technical colleges into an integrated type of university. To this end, interrelated courses of study are offered which lead to two types of degrees after three or four years, respectively.

Without doubt this fresh type of establishment of higher education represents a species of university in Germany, especially in North Rhine Westphalia, conceived and planned for the development of a forward looking research and teaching system.

At the German Rector's Conference last week, we discussed the future conception for German universities. There will be manifold different profiles. But all the universities will become more similar to the type of Siegen University, due to the more complex and differentiated demands of the highly developed western societies. During the last ten years there has already been a development towards this innovative and flexible type of universities.

In this respect I hope that we have good conditions to prepare the reforms, which are necessary in the post-revolutionary time in all fields of society, and in the self-organisation of universities as well.

One of the aims of our university is to improve interdisciplinary teaching and research by opening up and strengthening further links with allied disciplines.

Prof. Buchanan's lecture in the Department of Economics is evidence of its multinational openness and successful international cooperation for which I would like to thank the organizer of this lecture today, Prof. Bodo Gemper, and the spiritus rector of "The University of Siegen's Colloquia of Economics", Prof. Rüdiger Pethig.

Prof. Buchanan, it is indeed a great pleasure for me to welcome you to this colloquium. We very much look forward to hearing your presentation and lecture.



## Prospects for Economic Theory in the 1990s and Beyond

Lecture at the Economics Department of the  
University of Siegen on 15th May 1992

by

James M. Buchanan

### 1. Introduction

In an elementary sense, economic theory has been vindicated by the events of this century, culminating in the revolution that has signaled the failure of the great socialist experiments. Socialism, as an inclusive system of organizing economic activity, did not achieve the objectives that its advocates defined at its inception. Socialism did not produce the goods, defined as the economic values that can only emerge ultimately from the preferences of individual participants. Economic theory explains the failure of socialism through its focus of attention on incentive structures, on informational requirements and on the necessary uncertainties in the linkage between choices and consequences. The *ex post* explanation does not, however, excuse economists, generally, from their apparent failure to predict the consequences that did, in fact, occur. Why did the revolutions that marked socialism's death take place before more than a tiny minority of practicing, professional economic theorists made predictions of systemic failure?

I suggest that this woeful record of economists' performance stems from a set of scientific errors that must be put right before economic theory can begin to exert a productive influence on the hard problems of transition from socialism to alternative structures. We know, of course, that these scientific errors were, in part, driven by the ideological bias that economists shared with intellectuals generally. But the errors in scientific understanding can be divorced from the ideological setting. It is possible to discuss the role of economic theory, as such: first in its failure to predict socialism's demise, second, in its widely accepted explanation for the antisocialist revolution, *ex post*, and third, in its potential contribution to problems of transition in the postrevolutionary moment of the 1990s.

It will first be necessary to lay out the general domain for discussion. I do this in section 2, which will define my own understanding of economic theory in the sense used in this paper. Section 3 sketches out familiar territory in the history of ideas, with emphasis on the eighteenth century discovery of spontaneous order of market interaction, the discovery that sparked the genuine intellectual excitement of the classical political economists. In section 4, I discuss, briefly, the classical economists' presuppositions for the constitutional framework necessary for an effective functioning of economic order. In section 5, I trace out the collapse of the classical-neoclassical understanding of the working of an economy, a collapse that was influenced by the challenge of Marxian socialism, by the implicit acceptance of political idealism and by the loss of systemic evaluation and analysis. Section 6 continues the narrative and isolates the emergence of the maximization or allocationist paradigm, as aided and abetted by the particular mathematics of the calculus, and at the expense of emphasis on the catallactic subject matter of market organization. The impact of game theory as a complement to a catallactic approach is noted. Section 7 examines the elementary, but essential, contribution that economic theory can bring to participants, academic and lay alike, who have not experienced the history of market institutions. The genuine "miracle of the market" that did,



indeed, excite the classical economists can offer a basis for an enthusiastic public philosophy in postrevolutionary societies, a philosophy that the cynical, jaded and intellectually soft citizens in Western nations may have lost for ever (section 8). As economists in the West, we, too, must recover our *raison d'être* as political economists-cum-political philosophers, and not as social engineers. Our science has much to answer for, but, also, it has much to contribute.

## 2. The Relevant Domain

The subject matter of economic theory is a set of relationships among choosing-acting persons and the patterns of results or outcomes that these relationships generate. An alternative way of placing the emphasis here is to say that economics offers a theory of organizational-institutional *order*.

The theory tells in a generalized and pattern predictive sense "what will tend to emerge" under this and that set of circumstances, conditions and constraints. We use economic theory in precisely the same way that we use much other knowledge. We explain-understand why there is tropical fruit, say, grapefruit, on the supermarket shelves one thousand miles from the location where the fruit is grown. We use economic theory here just as we use physics to tell us why water runs down hill. We do not, of course, claim that theory enables us, in advance, to predict that grapefruit, as identified, will be on the market's shelves. Nor would we use physics to predict that the liquid substance to run down that ravine will be water. Economics allows us to predict that whatever it is that persons want to purchase will be available for purchase. Economic value will tend to be created in the form that persons prefer, as driven by the selfsame persons in their dual role as producers. The grower, the shipper, the distributor, the market manager, the shelf stocker, the cashier - all these put

grapefruit on the shelves because they expect that, in so doing, they can exchange grapefruit for money which will, in turn, allow for their own purchases of the goods that they desire, goods that will, in further turn, be put on the store shelves by those of us who purchase the grapefruit.

If my summary seems perhaps too elementary as well as too conventional, let me contrast my definition of the subject matter with more familiar claims. Economics or economic theory is not about "the allocation of scarce means among alternative ends" (Robbins, 1932). This familiar means-end formulation draws attention, first, away from the creation of value as opposed to some allocation or utilisation of value that is presumed to be in existence, and, second, from the interactive relationships among persons that define the order of an economy. Biblical mythology is helpful with reference to the first point. After the expulsion from the Garden, man's lot requires that he create economic value if he is to survive at all. Absent such creation, or production, there are no resources, no means, to allocate among ends or purposes. And if man moves beyond self-subsistent existence, production as a means of securing ultimate consumption must involve the establishment of exchange relationships with others. Economics allows us to construct a generalized understanding of the complex set of exchange relationships.

As noted earlier, economic theory in its essential respects is no different from other scientific knowledge, within the appropriate limits of its enterprise. These limits are transgressed, however, when attempts are made to move outside the constraints imposed by the human subject matter and to objectify economic reality on some presupposition that values can be divorced from the subjective consciousness of participants in the order. To recall Gertrude Stein's comment about Oakland "there is no there there" in the sense of an objectifiable economic universe that lends itself to scientific observation and evaluation, a universe that exists separately and apart from the interlinked set of human choices and actions that bring



"the economy" in to being. At best, therefore, the economist as scientist is restricted to potential explanation of patterns of results, and especially when noneconomic motivations for human actors are necessarily incorporated in that which may be observed.

The enterprise of economics is, however, sufficiently open-ended to allow the potential for genuinely exciting scientific advances, which will be influenced, in part, by the events of history. The unexpected and dramatic collapse of communist totalitarian regimes has renewed and reinforced the attention of economists in incentive compatibility in varying institutional structures, in the informational characteristics of choices made under uncertainty.

### 3. Order without Direction

Economic theory, as such, was born with the scientific discovery of the spontaneous coordination that emerges from separated, locally directed, and self-interested actions of participants in a nexus of exchanges. Prior to this breakthrough in the eighteenth century, there could scarcely have existed an "economic science," properly understood, since there was no reasoned understanding of the observed patterns of the order that resulted from human behavior directed toward economic purpose. Production, exchange and consumption could, of course, be observed, but there was no integrating vision that allowed the separated actions to be related.

At this point, we confront etymological confusion that has plagued the discipline from its beginnings, a confusion that is not, to my knowledge, matched in any other science. "Economics," as a term, finds its origins in Greek and refers to "management" or to "economizing," yes, to the utilization of scarce means by a *decision-making unit*. In this accurately derived etymological use of the term, "economics" was, of course, always with us, and there were

preclassical "theories" of economic management in which the direction of the national household by the king, the prince, the bishop or some other sovereign became the subject matter for learned discourse. German cameralism provided a set of precepts for the prince to follow in arranging the economic affairs of the principality, and the economizing on the use of scarce resources was central to any such exercise. Although mercantilism, as a descriptive term applicable to systems, was coined by Adam Smith, we find this term useful to refer to those sets of policy directed principles that offered guidance to those who "managed" the national economy, who established specific objectives such as national accumulation of treasure, national rates of growth, national levels of employment.

It is not surprising that Keynes found the mercantilist writers to be kindred souls, since in his attempt to shift the emphasis of economics back to macroaggregative management, Keynes necessarily moved away from the central thrust of the whole explanatory enterprise. The macroeconomic "theory" of midcentury was strictly within the management tradition and consistent with the etymological origins of "economics" as a term.

Adam Smith, himself, perhaps added to the ultimate confusion by the selection of the title for his treatise. *The Wealth of Nations*, read descriptively from the title's words alone, suggests that nations are the units that are wealthy or poor, and, by inference, that increases in nations' wealth are desirable. Smith did not, of course, have such a reading of his title in mind, since the whole thrust of his argument is that individuals, not nations, are the relevant units and that wealth consists in whatever it is that individuals desire. And Adam Smith's work was the channel through which "economic theory" in the sense used in this paper was established, a "theory" of the spontaneous coordination achievable through an interlinked network of market exchanges and a "theory" that demonstrates the inefficacy of attempted economic management for a whole society.



Throughout the two-and-a-quarter centuries of its history, economics, as a theoretical science, has been burdened with its two-track and mutually contradictory analytical cores. More than mere bifurcation is involved here. The mindsets required for analysis in the two research programs are categorically different. A theory that offers an explanation-understanding of the coordinating properties of an exchange network cannot be harnessed into "economizing" service in any strict "managerial" sense, although, of course, such a theory becomes an essential component in any design and construction of the framework of rules (the constitution) within which economic interaction is allowed to operate.

My own resolution of the confusion in economics is clear from my discussion. Economic theory, properly defined, is limited to the domain of exchange relationships, and the behavior within those relationships, along with the institutional structures that emerge or are constructed to constrain those who are participants. If progress is to be made, economics must, once and for all, throw off its etymologically influenced interpretation. Ideally, we should replace the very name; "catallaxy" or "catallactics" is etymologically descriptive. (See Buchanan, 1979.)

#### 4. The Constitutional Framework

As people in the CIS republics are finding out in 1992, the "free market" does not accomplish the coordination promised by some of its naive advocates in the absence of a set of constraints that may be considered to be the "rules" or the "constitution" for the "market game." The classical discoverers of the coordinating properties of markets did not sufficiently emphasize the necessary presence of such rules or institutions. If no such rules exist, the chaos that the nonsophisticate in economics more or less naturally imagines may, indeed, become descriptive of reality.

The elements of the constitutional framework are familiar, and these need not be discussed in any detail here, but a summary statement is

required in order to insure that there are some common bounds for subsequent analysis. The political-legal order must embody security of person and property, and the basic rights that define such security cannot, in themselves, emerge from an exchange-like process, despite the pronouncements of the libertarian anarchists. Without some prior agreement-acknowledgement of what is "mine and thine" how could you and I even commence a trading or exchange relationship? (See Buchanan, 1975.) Once we are secure in rights of ownership, we are free to make exchanges in rights, in the expectation that those received in trade will themselves be genuinely owned, once possessed. A regime in which rights are severally assigned, mutually acknowledged and legally protected defines the broad boundaries of the playing field for the inclusive economic interaction process.

A corollary of the ownership and control of person and possession is the enforcement of voluntary contracts of exchange, once made. The political-legal order must operate so as to insure that individual contractors abide by the terms of agreed upon, but not fully implemented, exchanges of rights. And, as with the initial assignments, we could scarcely expect effective contract enforcement to emerge, itself, from contractual foundations, although the libertarian argument here is somewhat more persuasive than in the former case.

There are additional, and supplementary, elements in a constitutional framework that allow a market order of an economy to function effectively. These elements, some of which remain subject to ongoing scientific debate (for example, monetary arrangements) need not be treated in this summary. My point here is to emphasize only that it is the constitutional framework (the "laws and "institutions," the constraint set) that becomes the appropriate focus for those who seek to reform or to improve the operation of the social process in its economic aspects.



The eighteenth-century discovery of the ordering properties of market exchange was a discovery of such properties *within* rather than independently from the political-legal structure. And classical political economy, the emerging science that elaborated this discovery, at least in early form, was interpreted as a challenge to the whole enterprise of economic management. *Laissez-faire* - to leave alone - this applied negatively to politicized effort to interfere with, and to improve upon, the workings of markets. It should never have been extended to the criticism of the necessary political effort aimed at establishing and maintaining the constitutional framework. The categorical distinction between these two levels or stages of politicization was never clearly articulated, and this ambiguity compounded that discussed earlier that involved the meaning of terms.

## 5. The Loss of Wisdom

What happened to economics after the fourth decade of the nineteenth century? We know that the excitement of scientific discovery that characterized classical political economy did not survive. Somehow the basic theoretical understanding of market order seemed to slip away, at least partially, and we observed a peculiar melange of scientific progress and scientific retrogression.

Several sources of difficulty can be identified. The classical economists' understanding of market coordination was seriously incomplete. There was no plausibly acceptable theory for the pricing of productive inputs. The cost-of-production theory for the pricing of outputs offered the basis for the Ricardian-Marxian backward extension to input pricing and notably to labor. The theory of surplus value, allegedly produced by but not fully received by labor, was used effectively by Marx to undermine the efficacy of markets, even within the mindset that embodied the earlier discoveries. The distributional implications of market coordination were moved to center stage, providing grounds for revolutionary political proposals

that were well beyond any mercantilist schemes for political management of national economies. The Marxist argument tended to weaken economists' normative evaluation of their whole scientific enterprise.

In this respect, it is singularly unfortunate that the theory of input pricing which emerged as a consequence of the 1870s marginalist revolution in economic theory could not have been developed a mere half-century earlier. Such a time shift might have forestalled the Marxist critique, which was clearly based on straightforward scientific error, and the consequences that we all know might not have occurred at all.

Quite apart from the Marxist extension of classical principles which indirectly caused economists to lose confidence in their own *raison d'être*, developments in moral philosophy were also of major importance. Influenced by the ideas of Hegel, philosophers lost the eighteenth-century skepticism about the operations of political-collective institutions, a skepticism that we can interpret to have been squarely based on both analytical and empirical hypotheses. As a substitute, there emerged a romantic model of "the state," a model that came to be increasingly dominant, an idealist vision of an omniscient and benevolent collective entity. Both common-sense observation and theoretical understanding were lost. Alongside idealism in political philosophy, and especially in Great Britain, classical utilitarianism provided the framework for normative evaluation of alternative policy propositions, with the effect of drawing attention away from problems of implementation through the realities of politics.

Political idealism and utilitarianism are important because, even in those societies that were not so directly influenced by the Marxian challenges, the romantic model of "the state" became the source for totally unwarranted comparisons between the market order, as observed in operation, and the state, as idealized. Developments in



economic theory did identify and classify institutional and operational failures in the workings of markets, as against the *laissez-faire* idealizations, but no comparable failures of politicized corrections were brought within the canon of political science until the public choice revolution of the last half of this century.

## 6. Maximization, Mathematization and the Theory of Games

Genuine scientific progress has been made in economic theory since the moment of its eighteenth-century origins in discovery. The marginalist revolution, and particularly the theory of input pricing that emerged in consequence, tended to complete, in broad basic outline, the theory of market coordination. Even in this respect, however, the contributions of axiomatic general equilibrium theory, midway through this century were necessary to round off the whole enterprise. But, as I also noted, the management or economizing conception of subject matter, and applied at the level of the national economy, has never been absent from economists' professional tool kit.

The potential for intellectual confusion was enhanced by some of the methodological implications of the marginalist revolution itself. In voluntary market choices made by participating individuals, values are determined at the relevant margins of adjustment, and the very idea of marginal comparison of values stems from mathematics, the central logic of the calculus. It is not then at all surprising that economic theory, as developed throughout this century should have use of more and more sophisticated mathematical tools. And, as applied to the decision making of individuals, the calculus of utility maximization is helpfully explanatory. But the availability of the applied mathematics surely generated a bias toward artificially forced and unwarranted extension beyond individual choice to collectivities,

to macrounits, to society, to the economy. Social engineering became one of the several postmarginalist versions of mercantilist economic management. And, as also noted, the depression inspired shift of attention to movement among economy-wide macroaggregates, a shift that Keynes and the Keynesians provided with quasi-scientific status, added powerful complementary force to economic management as the ultimate motive impulse for the formulation of economic theory itself.

Even without macroeconomics, however, the increasingly rigorous efforts to define the hard core of economic theory would have insured an emerging economizing framework, as readily mathematized through the maximization paradigm. Post-Marshall economics became the theory of allocation of scarce resources or means among competing ends, a formulation that lends itself more or less directly to a marginalizing calculus. Emphasis was shifted away from the coordinating, properties of interlinked markets, in which the separate participants may, indeed, be modeled as utility maximizers, and toward properties of markets conceptualized as if they were alternatives to or substitutes for economic management schemes for inclusively defined aggregations.

A major change of direction in economic theory may have occurred in midcentury when the theory of games provided an alternative mathematics to the marginalist calculus, a mathematics that carries important implications for the very way that economists conceive what their enterprise is all about (von Neumann and Morgenstern, 1944). In the theory of games, attention is immediately focused on the interaction process, as such, with participants modeled as taking separate actions within specified rules (the constitution), and out of which some solution emerges that is chosen by no one, either individually or collectively. During the second third of the century, the ongoing dominance of the maximization paradigm tended to obscure the potential contribution that game theory's elegance can make toward restoring, indirectly as it were, the catalytic focus of economic theory, a focus that was never totally absent. Only within



the last three decades of the century did game theory's economic emphasis shift from the choices of strategies of separate players to the search for solutions and to properties of alternative solutions and then, by inference, to the effects of alternative sets of rules on solution, the domain of constitutional economics.

## 7. The Miracle of the Market

I have found it useful to organize this paper as a history-of-ideas narrative of the development of economic theory, as personalized one sense, therefore, the whole discussion to this point becomes prefatory to the paper's main purpose. What role can economic theory play in those societies that have experienced genuine revolutions, in which socialist organizational structures have been explicitly rejected, both in practice and in idea, but in which market-like institutions have not emerged, at least in forms similar to those observed in Western mixed economies?

What role should economic theory play in the necessary transition from socialism? The 1990s are properly classified as a postrevolutionary moment in history. Will economic theory be of value in this moment?

I suggest that we can look for an answer in the historical epoch that describes economic theory's finest hours, the few decades that span the turn between the eighteenth and the nineteenth centuries, the period of classical political economy. The ideas of Adam Smith may or may not have themselves influenced events directly as initiating causes of political changes. (I do not engage George Stigler on this point here.) But we cannot deny the role that these ideas played in the undermining of the intellectual foundations, the putative legitimacy, of the eroding mercantilist structure of national economic

management. The economists were effective in convincing political leaders, and a sufficiently large number of citizens, that an economic order without politicized direction could not only be imagined but could also be expected to increase the well-being of the economy's participants generally. The central role played by economic theory during this whole epoch seems clear enough. Persons had to be, and were, convinced that a market economy would work, and work with tolerable efficiency before they would begin to feel comfortable in unstrapping the complex harness of politically controlled economic management.

The eighteenth century skepticism about the motivation as well as the predicted efficacy of political-collective action in furthering the interests of citizens provided fertile ground for the acceptance of the economists' ideas. The potential constitutional function of market arrangements was, and for the first time, understood, separate and apart from any concern with any prospect for efficiency in generating valued product. In retrospect, we can understand why the classical economists, along with their media and lay supporters, were so enthusiastic about the potential value of the newly emergent science of political economy.

The setting in the postrevolutionary societies in the 1990s is in many respects similar to that of the emerging industrial economies in the late eighteenth and early nineteenth centuries, at least similar enough to warrant speculation about the positive role that might be played by the more sophisticated, and more complete, modern theory or science of economic order. To the citizenry generally, to the intelligentsia, to newly enfranchised political leaders, all of whose history has dispelled any and all of the romance that collectivism-politicization might once have held, the miracle of the market, warts and all, offers promise. The observable consequences of socialism leave little space for the motivation of strictly distributional criticisms of market capitalism.



The timing seems ripe for an emergent and new found enthusiasm for a Central and Eastern European *Wirtschaftswunder*, an enthusiasm that can be jointly grounded in a loss of faith in politicized economic management and a generalized understanding of economic theory in its most basic, and elementary, sense. The highly sophisticated analyses of potential market failures, as evaluated against nonattainable perfection, can be put on the shelf for those who understand the current relevance of the hard core principles. To citizens in this postrevolutionary moment, simple analyses of market successes offer the essential components of attainable dreams. Vaclav Klaus, Minister of Finance in Czechoslovakia, is reported to have called for a "market without adjectives", and it is perhaps only in a postsocialist setting that we might have expected such comment from a highly successful political leader. (Can we even imagine his United States counterpart, Secretary of Treasury Brady, making such a statement?)

As noted, economic theory can provide postrevolutionary intellectuals with a much more sophisticated understanding-explanation of a market order than that which effectively energized the followers of classical political economy two centuries ago. And the body of doctrine incorporated in modern economic theory is sufficiently inclusive to offer continuing challenge to those scientists attracted by the aesthetics of new ideas. The hard core can excite the intelligentsia while the several research programs around the periphery offer promise to the practicing scientists.

For those who seek to use economic theory for more specific reform purposes, the critical distinction between adjustments in the constitutional framework, the constraints within which economic activity takes place, and attempted politicized interferences with market results remain of critical importance. The postrevolutionary institutional settings are in flux; rights have not been fully assigned and acknowledged; legal rules and norms of behavior have not been fully established; contracts among traders have not evolved through a

commercial history. And, significantly, a culture of reciprocal exchange is not descriptive of social reality, a culture that is embedded in our subconscious in Western economies (see Buchanan, 1991). The most elementary of all economic principles - "there exist mutual gains from trade" - even this principle remains to be absorbed into the mindset of persons in postsocialist societies. The teaching of economics becomes socially productive in these societies in ways that we can scarcely appreciate in Western cultures.

Economic theory, as such, is not itself an empirical science, but that it does provide the source for hypotheses that may be subjected to falsifiability tests. The dramatic events that have taken place, and others that will follow, in postrevolutionary economics must surely offer empirically minded economists wonderful opportunities for examining the implications of simple hypotheses. Never in history have economists been offered such near laboratory conditions and on so enormous a scale. Almost regardless of methodological preferences, the economist who concentrates on postrevolutionary societies must be excited about his scientific enterprise.

I should acknowledge that my interpretation prediction of the role that economics and economic theory will play in the 1990's and beyond is tinged with hope. My response is really to the question - What role can economic theory play? - rather than to the more neutral question - What role will economic theory play?

The management-economizing conception of economics, and especially as extended normatively to policy prescription, may not have been sufficiently exorcised, and I am concerned that economists in postrevolutionary societies will import many of the "wrong," or misguided, research thrusts of Western economics, rather than select carefully for potentially helpful research directions. Without attempts to be exhaustive here, I can list (alphabetically) several research programs that would seem to offer productive insights to professionals in the "new" postrevolutionary economies: Austrian



economics, catallaxy, constitutional economics, game theory, general equilibrium theory, experimental economics, law and economics, new institutional economics, property rights economics, public choice. By comparison and by contrast, the following programs would seem to offer little or no promise and, indeed, may be distracting elements: input-output analysis, industrial policy, linear and quadratic programming, optimal control theory, optimal growth theory, optimal taxation, social choice theory, social welfare functions, theories of planning.

## 8. Economic Theory in the West

As an end-note to the paper, it is appropriate to ask the question: What is the role for economic theory in the mixed economies of Western countries that have not experienced revolutionary changes in institutional structures? I am much less sanguine here than in response to the same question posed earlier for postrevolutionary societies. Western economists, as practicing scientists, tend to take the elementary principles of their discipline too much for granted, and they devote far too much effort, interesting though it may be, to esoteric intellectual puzzles that often have little relevant content, even in some remote sense. (The exception, as noted, may be in modern game theory, where the intricacies of the analytics may be required to force belated recognition of the foundational shift in approach to economic process).

Economists forget that, quite unlike the other sciences where professionally agreed upon principles command authority beyond the scientific community boundaries, economics must be made convincing to the public and its political leaders, a task that requires continued teaching of the elementary verities. "Every man his own economist" - this plague has been with economics since its inception as an independent body of thought. As a result, the failure of the

theory's professionals to renew the principles allows interest driven politicization to intrude continuously into the operations of the market order.

We observe little enthusiasm for the principles of markets based on a widening understanding of the market's efficacy in producing and delivering valued product. And, despite the impact of modern public choice theory in offering a partial explanation-understanding of political failures, we do not observe an intellectual rejection of "socialism in the small" that is anywhere remotely comparable to the near universal rejection of "socialism in the large" in the postrevolutionary settings.

The relatively pessimistic conclusion is that the future role of economics and economic theory lies with the postrevolutionary societies rather than in the sometimes "tired" science that is academically established in the West, and, merely by way of such establishment itself, will devote resources to the maintenance of whatever role serves its own interests.



economics, catallaxy, constitutional economics, game theory, general equilibrium theory, experimental economics, law and economics, new institutional economics, property rights economics, public choice. By comparison and by contrast, the following programs would seem to offer little or no promise and, indeed, may be distracting elements: input-output analysis, industrial policy, linear and quadratic programming, optimal control theory, optimal growth theory, optimal taxation, social choice theory, social welfare functions, theories of planning.

## 8. Economic Theory in the West

As an end-note to the paper, it is appropriate to ask the question: What is the role for economic theory in the mixed economies of Western countries that have not experienced revolutionary changes in institutional structures? I am much less sanguine here than in response to the same question posed earlier for postrevolutionary societies. Western economists, as practicing scientists, tend to take the elementary principles of their discipline too much for granted, and they devote far too much effort, interesting though it may be, to esoteric intellectual puzzles that often have little relevant content, even in some remote sense. (The exception, as noted, may be in modern game theory, where the intricacies of the analytics may be required to force belated recognition of the foundational shift in approach to economic process).

Economists forget that, quite unlike the other sciences where professionally agreed upon principles command authority beyond the scientific community boundaries, economics must be made convincing to the public and its political leaders, a task that requires continued teaching of the elementary verities. "Every man his own economist" - this plague has been with economics since its inception as an independent body of thought. As a result, the failure of the

theory's professionals to renew the principles allows interest driven politicization to intrude continuously into the operations of the market order.

We observe little enthusiasm for the principles of markets based on a widening understanding of the market's efficacy in producing and delivering valued product. And, despite the impact of modern public choice theory in offering a partial explanation-understanding of political failures, we do not observe an intellectual rejection of "socialism in the small" that is anywhere remotely comparable to the near universal rejection of "socialism in the large" in the postrevolutionary settings.

The relatively pessimistic conclusion is that the future role of economics and economic theory lies with the postrevolutionary societies rather than in the sometimes "tired" science that is academically established in the West, and, merely by way of such establishment itself, will devote resources to the maintenance of whatever role serves its own interests.



## References

- Buchanan, James M. *The Limits of Liberty: Between Anarchy and Leviathan* (Chicago: University of Chicago Press, 1975).
- \_\_\_\_\_. *What Should Economists Do?* (Indianapolis, Ind.: Liberty Press, 1979).
- \_\_\_\_\_. "Tacit Presuppositions of Political Choice" (Fairfax, Va.: George Mason University, 1991), mimeograph.
- Neumann, J.v. and O. Morgenstern. *Theory of Games and Economic Behavior* (Princeton: Princeton University Press, 1944)
- Robbins, Lionel. *The Nature and Significance of Economic Science* (London: Macmillan, 1932).
- Smith, Adam. *The Wealth of Nations* (New York: Random House, 1937).

## Catallaxy contra Management-directed Economic Theory.

Comments by Rüdiger Pethig

At the center of his paper Buchanan offers an impressive grand history-of-ideas narrative of the development of economic theory with its major achievements and pitfalls. He conjures the golden age of classical political economy about two hundred years ago leaving no doubt that he still shares the classical economists' enthusiasm and excitement of the "miracle of the market". It is his hope and desire that the classical understanding of economic theory will guide and solve the problems of transition in the Central and Eastern European post revolutionary societies, and he encourages Western economists, not to take the elementary principles of our discipline too much for granted and to stay away from esoteric intellectual puzzles. Instead, contemporary economists should revive the classical economists' concept of economic theory, they should revive the founders' intellectual excitement about the market and make the elementary verities of economics convincing to the public and policy makers.

Buchanan draws a clear-cut line between good and bad economic theory. Economic theory properly defined, - or catallaxy as he prefers to term it - "is limited to the domain of exchange relationships, and the behavior within those relationships, along with the institutional structures that emerge or are constructed to constrain those who are participants". The relevant domain of economics is, in his view, a theory of organisational-institutional order, an explanation-understanding of the coordination properties of an exchange network.



The classical political economists had already a good understanding of and important insights into the catallaxy. Unfortunately, beginning with the middle of the last century a major part of the economics profession went astray, according to Buchanan, by following and extending the mercantilistic, cameralistic, and utilitarian track of macroeconomic management and establishing influential schools of thought such as socialism and Keynesianism. Buchanan recommends to abandon all kinds of management-directed economic analyses, because these approaches are based on an ill-founded romantic model of "the state" which makes this theory categorically different and contradictory to catallaxy. The romantic model of the state with the idealistic vision of a benevolent government gradually replaced the "eighteenth century skepticism about the motivation as well as the predicted efficacy of political-collective action". Buchanan argues that the influence of this "romanticism" was supported and reinforced by neoclassical economic theory which detected sources of market failure by means of "totally unwarranted comparisons between the market order, as observed in operation, and the state, as idealised" and then called for interventionist government action as a cure against that market failure.

During the last decades, this rather one-sided government-biased concept of welfare economics, criticized by Demsetz as a Nirwana approach, became increasingly challenged and counterbalanced by public choice theory pioneered and significantly influenced by Buchanan. The public choice methodology is based on the simple but important observation that the behavior of public agents is driven by self-interest just as much as that of private agents. The more discretion is given to public agents for social engineering the greater is the potential of politicians and bureaucrats of doing harm to society. This perspective as well as casual empirical evidence dampened the optimistic and/or romantic view of government but did not (yet) manage to shift the entire economic profession to the study of catallaxy as Buchanan would like to have it.

To be sure, Buchanan does not urge economists to abstain from advising government altogether. He suggests, indeed, to use economic theory for studying - and possibly recommending - adjustments of the constitutional framework (constitutional economics). But definitely economists should not study and recommend politicized interferences with market results. They should rather think about how to adjust and improve the rules of the game such that the public players' discretion for politicized interferences is as small as possible (if not zero).

Buchanan's message to abstain from management-directed economic theory raises deep issues about the subject matter of economics and the *raison d'être* of professional economists. In his view economics is not only an empirical science advancing testable hypotheses to the end of eventually explaining real-world economic phenomena. He aims at explanation-understanding and economists ought to be political economists-cum-political philosophers. He advances an interesting, provocative and controversial methodological position. But rather than contributing to the debate of (proper) economic methodology I wish to proceed by responding to some central points of Buchanan's position. First, I address a few of his arguments which, I think, are valid, important and should hence be reinforced. After that, I turn to other aspects of his concept which I find less convincing.

*(a) The study of catallaxy is necessary and important.*

The increasing neglect of catallaxy since 200 years in Western countries has been partly caused by an increasing skepticism of economists and other social scientists about the performance of market capitalism, but to a larger extent, probably, because many economists took the elementary principles of their discipline too much for granted. The "failure of the great socialist experiments" should stimulate the rediscovery of and further research on elementary principles. Beyond any doubt, coordination of the economic process



via market exchange and free enterprise proved to be superior to command-and-control approaches. But do we already have sufficient knowledge and appreciation of the "miracle of the market"?

*(b) The distinction between adjusting the rules of the market game (Ordnungspolitik) and interfering into an ongoing match (Ablaufpolitik) should receive greater emphasis.*

The reason why this distinction is important is that constitutional choice (or adjustment) of rules should be guided by other collective decision processes and institutional arrangements than social engineering. Rules of the game are designed to last beyond the time horizon and life of the decision makers, whereas "interference with market results" very often is about shifting the distributional positions of interest groups which directly or indirectly participate in the current public choice process.

*(c) The romantic model of "the state" has to be rejected.*

The idealist vision of a benevolent - let alone omniscient - government cannot be maintained any more against the hard empirical facts. Disillusion of citizens and economists and their policy vexation (Politikverdrossenheit) demonstrate that the romantic model already lost much of its fascination. But Buchanan is right in going far beyond that empiricistic position. To be more specific assume, for the sake of the argument, that there are still politicians sincerely concerned about the "general welfare" or that, in fact, all politicians are found to be benevolent. Even then the rules governing public choice and government actions should be such that Adam Smith's famous observation regarding the private market provision with food from "the butcher, the brewer, or the baker ..." could be rephrased and applied to the public domain about as follows:

"It is not from the benevolence of the member of parliament, the government, or the public bureaucrat that we expect our provision with public services, but from their regard to their own interest"

The rules governing the public domain are to be designed so that the citizens benefit even if the public decision makers' self-interest should turn out not to coincide with the "general welfare".

As mentioned above, another aspect of the romantic model of the state is the government-biased welfare economic Nirwana approach. But in my view, the implied naive use of welfare economics has by now been vigorously corrected by public choice economics which identified "policy failure" and juxtaposed that property of political allocation processes to inefficient market results. Comparative institutional analysis is required to make a choice in the world of second best.

*(d) The romantic model of "the market" is no good substitute for the romantic model of "the state".*

The government-biased Nirwana approach is subject to the fallacy of the Roman emperor who is said to have organized a song contest between two less than perfect contenders and conveyed the prize to the second immediately after the awkward performance of the first without having listened to both. Buchanan would be guilty of a reversed Nirwana reproach if he would jump from the diagnosis of 'policy failure' to the recommendation that the provision of the service under discussion should be left to the market. When he encourages us to be enthusiastic and excited about the "miracle of the market" I wonder a little bit whether such euphorism could impede an unbiased research attitude: A lover runs the risk of being convinced of the



beauty and/or integrity of his beloved even if everybody else disagrees.

Being aware of the emperor's mistake in the song contest I do believe, contrary to Buchanan, that the neoclassical market failure approach should be taken seriously. Adam Smith's fascinating idea that selfish persons are led by an invisible hand to promote social welfare has been made precise in modern economics and, in doing so, more sophisticated and rigorous analysis has been developed specifying the conditions of coincidence between individual self-interest and social welfare. The absence of externalities is one of these conditions, the absence of large transaction costs another. Needless to repeat that the imperfect working of the invisible hand is not a sufficient condition for demanding government action. But it strongly suggests to engage in comparative institutional analysis, as argued in point (c) above.

*(e) To avoid the reversed Nirwana approach, the domain of public economic management should not be restricted to adjustments of the constitutional framework, narrowly defined.*

The force of this point depends crucially on the specification of the concept of constitutional framework, which is described by Buchanan as 'the "laws and institutions", the constraint set'. Does the public infrastructure, political interference in the educational sector, pollution control, tax laws etc. belong to the constraint set? If not, (as I expect Buchanan would answer) then how should I know without any analytical and empirical investigation that there is no institutional arrangement other than the unfettered market which might improve the operation of the economic process. Those who recommend to draw the appropriate dividing line between the public and private sector of an economy in such a way as to push back public action - as well as the legitimate focus of economic analysis - to shaping and maintaining a narrowly defined constitutional framework are in danger of adopting the reversed Nirwana approach, in my view.

*(f) Economics should not ignore the fact that issues of fairness and distribution matter in real-world societies.*

Public choice analysis demonstrated convincingly that the consequences of politicized social engineering and negative-sum redistributive rent-seeking games played by individual agents and special-interest groups may be very detrimental. But on the other hand, citizens and groups of citizens seem to articulate notions of fairness and justice related to outcomes (and not only to rules or processes - as von Hayek and others maintain). If the politicized interference should turn out to improve the fairness of outcomes as conceived by major groups, then this might well "improve the operation of the social process" even though the distributional change is accompanied by an efficiency loss. Besides, in contrast to the Virginia school of rent seeking Becker argues that the political process of pressure-group competition may even enhance efficiency, i.e. reduce market failure.

Moreover, I think it is realistic to assume that no matter how the constitutional rules are designed and what the size of government is: there will be always some discretion for post-constitutional public or collective choice. This discretion will be used by voters, politicians, bureaucrats and pressure groups. In my view, it would be a mistake for economists not to assume the role of consultants in this complex process of decision making, because there is no other profession without heavily vested interests which would be more competent in making informed policy proposals and evaluations.

The process of transition of Central and Eastern European societies from command and control to some sort of market capitalism is a difficult task involving more than the design and implementation of new (constitutional) rules. It is also about finding a path of transition which is politically feasible, and political feasibility is closely linked



to the fairness of burden sharing by all major groups. Issues of fairness cannot be solved in any other way than by politicized action.

## Public Choice: Toward a new Paradigm for Economics ?

by

Richard Brinkman

The volatile transformation and flux characteristic of the current period appear beyond compare. In the matrix of Thomas S. Kuhn, it appears that the crisis of the Great Depression, resulted in the innovation of Keynesian economics as well as a great transformation of the economy and economic policy. Similarly, will the severity of the economic anomalies and crisis characteristic of the current period also nurture a comparable metamorphosis, not only in the structure of the economy and economic policy, but in the science of economics itself.

In addressing the apparent intransigent state of anomalies and economic malfunction of the current period, our discussion will focus on the paper presented by the Nobel laureate, James Buchanan, at the University of Siegen. The enthusiastic and large overflow (SRO) crowd of students, faculty, and administrators, attested to Professor Buchanan's internationally recognized scholarly achievements and reputation. His wide-range contributions to the literature are voluminous, seventeen plus books, and beyond. The "main purpose" of Buchanan's Siegen paper is to clarify the role which economic theory can play in the context of the "Post Revolutionary Moment of the 1990's." Our discussion will address this issue, but in addition will deal into a more generalized perspective vis-a-vis Buchanan's innovative matrix. To be noted is that other Nobel laureates, of illustrious reputations, have also addressed the same field of inquiry [Arrow (1951); Samuelson (1954)]. But it is the name of James Buchanan which stands out and has come to be identified with the paradigm known as "Public Choice."



For a variety of reasons many economists, both liberal and conservative, have voiced reservations to the current mainstream of economics and have expressed the need for change. Critique and questioning relate to methodology and the overall relevancy of economics to the current problems holding back the wealth of nations today. Professor Buchanan bears no exception in terms of dissatisfaction or harshness of critique. As practiced in the 1980's, "economics is a science without ultimate purpose or meaning... captive of the technical tools that it employs without keeping track of just what it is that the tools are to be used for ...are illiterate in the basic tools of their own discipline...they seem to be ideological eunuchs... seem to get their kicks from the discovery of proofs of propositions relevant to their own fantasy lands... Our graduate schools are producing highly trained, highly intelligent technicians who are blissfully ignorant of the whole purpose of their alleged discipline." [Buchanan (1986): 14-15].

As an alternative, does the "Public Choice" of Buchanan provide the basis for the next disciplinary matrix for mainstream economics, as an accepted path for a "New Political Economy." Is Buchanan's paradigm potentially relevant, to contribute and resolve (among a myriad of other economic problems), the "problems of transition in the post-revolutionary moment of the 1990's." Science moves forward and evolves with the evolution of concepts. As the British anthropologist, E.B. Tylor demonstrated in 1871 with his seminal conception of culture, a new field of inquiry can be established via a new conceptual origination. Concepts, in addition, establish paradigmatic boundaries for the development of theory. Paradigm boundaries, in addition, also serve to delineate which problems are inserted for analysis and to be addressed, as questions, in the process of scientific inquiry.

Buchanan rejects the conception of economics as formulated by Lionel Robbins during the 1930's. There is perhaps a basic logic in rejecting economics as a study of scarcity. It is afterall somewhat

ironic that Robbins formulated this conception during the period of the Great Depression when the global economy was actually being glutted with overproduction. Buchanan's reasoning, however, is somewhat different. The efficient use of scarce resources deals with the tail end of the story. Buchanan, by comparison, argues that the problem rests with "... the creation of value as opposed to some allocation or utilization of value that is presumed to be in existence." The basic issue for a correct conception of economics, does not relate to its epistemological roots in terms of "economizing" or "management" (of the household be it national or private). But rather the correct focus, and that provided for by Adam Smith, resides in the processes of exchange.

Economics is the science of "catallaxy," as the science of exchanges [On "The Scope and Methods of Catallactics," note von Mises (1949):233-237; Buchanan (1986):19-23]. Economics does not concern a process of "management," but rather constitutes a process of "spontaneous coordination." Defining the subject of economics in this manner also predicates the specific direction of theory. Consequently, to Buchanan, "Economic theory, properly defined, is limited to the domain of exchange relationships, and the behavior within those relationships, along with the institutional structures that emerge or are constructed to constrain those who are participants."

How then to address the query of Hayek: "What is the problem we wish to solve when we try to construct a rational economic order?" [Hayek (1945); Sowell (1980)]. It is Buchanan's (and many others in the growing literature of "Public Choice"), contribution to apply the same principles of exchange not only to the domain of the market for private goods, but also to that of the market for public goods as well. The subject matter for supply and demand analysis is no longer confined simply to economics, but rather, is expanded as a new approach directed toward public goods as well as private [Buchanan (1968)]. The problem is one of creating value in the context of



individual choice demarcated by self-interest in the nexus of catallaxy.

Whereas Marx gave us class conflict; Veblen, by comparison, gave us a conflict between institutions. In the Veblenian matrix, for example, the pecuniary and ceremonial, in terms of how to make money, conflicted with the institutional behavior embedded in technology and in the making of goods. The matrix of Buchanan also offers a conflict theory of sorts in which one market battles against another. Buchanan's cultural cosmos of conflict relates to the ongoing battle between the market for private goods versus the market for public goods. And it is the insidious encroachment of the public market in its regulation of the private market, formulated outside of the mold of catallaxy, that results in government failure. Consequently, to promote a rational economic order, humankind must also submit the political structure to the same rational pursuit of self interest adjudicated in the playing field of catallaxy.

The key to the "New Political Economy" is to understand that the same laws and principles, as elucidated by Adam Smith in relation to economics, apply also to politics. The same process of "spontaneous coordination," driven by the force of individual rational choice and self interest, is relevant to politics as well as to economics. Consequently, dirigism and social engineering are out and the sui generis, in the endogenous force of spontaneous coordination, is in. Leontief, Galbraith, Reich, Thurow, and others, seeking outside or exogenous direction to the processes of political economy are consequently in error. There is the need to emancipate the market of private goods from the shackles imposed by the current failure of the public goods market. The public market, nurtured in catallaxy, should provide institutional concomitants promoting amelioration of the private market rather than constraint. Buchanan, consequently, is striving for a new approach to political science based upon the rational process of individual choice explicated by the science of catallaxy. Given that the "...basic behavioral postulate of public choice, as for economics, is that man is an egoistic, rational, utility maximizer." It is clear that the new methodology suggested by

Buchanan "...involves the application of the principles... of neoclassical economics..." to political science. [Mueller (1976) :395; Braeman (1991) :1879]. "At a more sophisticated level, public choice theory. ... building in this respect on the economists' postulate of methodological individualism, with utility-maximizing actors in varying public choice roles." [Buchanan (1989):25, 3-23, and on]. This basic insight and Buchanan's methodology have inspired some "new economic historians" to apply neoclassical theory, not only to an economic analysis of economic history, in particular, but to institutional change in general. [Davis and North (1971):3,#1] Historically, institutional change and adjustment had always been the bete noir of economics and, as such, was considered to have been a basic weakness of economics. Now however given this new application of neoclassical theory, institutional change is, ipso facto, brought into the paradigm of economic analysis.

In summary, the foundation of Buchanan's pioneering paradigm rests with his redefining economics as a science of catallaxy rather than that of scarcity. From this he then attempts to derive a relevant and compatible theory. In a sense, Buchanan offers a new version of the Marshallian scissors. For Marshall, two blades in the form of both supply and demand, are necessary in order to cut price and equilibrium in economic analysis. By comparison, Buchanan seems to be saying that a restricted economic analysis, by itself, is not enough and that more is required for countries making the transition out of the socialist collapse.

The innovation of free and competitive economic markets, by themselves, will not be enough. Nations in transition cannot expect the innovation of free markets, alone, to be functional if they are divorced from necessary and concomitant political structure. Constitutional buttresses of property rights, and on, must be established before these rights can be exchanged. Consequently, in Buchanan's paradigm, two blades appear as necessary in order to understand and address the problem of an overall rational order for



political economy. The two blades necessary to understand the wealth of nations (as a focus on individuals, rather than nations) comprise the blade of the private market on the one hand versus the public market on the other. The nexus of the cutting process, juxtaposing the blade of "welfare politics" to that of "welfare economics," is to be lubricated and oiled via the science of catallaxy.

Will it all sell? Conceivably, will Buchanan's paradigm, "Public Choice," become the basis for a New Political Economy for economics? Is the case as put forward by Buchanan strong enough to convince and convert nonbelievers to become believers of the faith. We speak here in the restricted sense of those economists in the realm of the post-revolutionary transition (Buchanan's main focus in the Siegen paper) as well as those economists in the more expanded domain of the Western world, in general.

Assessments of Buchanan's "Public Choice" matrix are quite varied. Jack Gurley (editor of the American Economic Review, during the 1960's) stated "that Virginia's graduate students were submitting more interesting manuscripts than those of any other institution in the country." By comparison, a "secret study" by the University of Virginia concluded that "the Department of Economics as 'rigidly committed to a single point of view' which it labelled as 'nineteenth-century ultra-conservatism' ." [Buchanan 1986]:12].

As to prognosis, we concur with Buchanan's pessimism, "In any short-term context, I am not all optimistic that the required methodological revolution will take place." [Buchanan (1986):17]. Not only do economists behave as Ricardian "rent-seeking" maximizers, but as Robert Merton has pointed out science, itself, is a social institution. And social institutions, as is well-known, frequently experience sclerosis and are difficult to change. Consequently, and for a variety of additional reasons now to be discussed, we feel that the "Public Choice" matrix, will not prove permeable even to those

economists limited to the "post-revolutionary moment," let alone to economists of the West, in a more general sense.

Is Samuelson, another Nobel laureate, and the paragon of mainstream economics in the context of the "neoclassical synthesis," to be included in "the cynical, jaded and intellectually soft citizens in the Western nations..." noted by Buchanan. Also, the core of Buchanan's proposal to innovate a "New Political Economy" rests upon a new conception and definition of economics. To nurture a new field of science via a new conception, as we have previously noted, constitutes a basic mechanism for the advance and evolution of science. But to be warranted and acceptable, the new conception, it can be argued, must be predicated on logic, rationality, and relevancy, and have an empirical base. In the last analysis, "science" entails problem solving. In epistemological inquiry a basic conclusion is that, "...science fundamentally aims at the solution of problems." [Laudan (1977):4, passim]. What problems are identified and solved, given the paradigmatic boundaries of "Public Choice."?

A given matrix of concept and theory serves as a prism to regulate which problems are allowed to penetrate inside the paradigmatic boundaries for analysis. In this context, to our viewpoint, the conception and theory as presented by Buchanan's "New Political Economy" results in too many relevant questions being avoided and, consequently, unanswered. Buchanan's conception, based upon the science of catallaxy, manifests a conceivable logic and rationality within its own paradigm and framework. But it apparently lacks logic and rationality in its relevancy to the real world. Analysis and policy recommendations for nations in the process of adaptation and metamorphosis, in the setting of "the post-revolutionary moment," would logically in the context of such a transition (metamorphosis) require a theory of economic evolution.

A basic question, and an old one at that, left unanswered by Buchanan, remains. How can one relate a static theory, such as



embodied in neoclassical economics, to the dynamics of economic evolution. Given the crisis nature of our current economic anomalies and the need for resolution, there is currently a beehive of activity outside the paradigm of "Public Choice," among economists searching for new theories of economic evolution. We speak here of many books and associations, along the more traditional lines, such as the EAEPE (European Association of Evolutionary Political Economy) and AFPE (Association for Political Economy). But we also see attempts along more orthodox lines and relevant to the work of Joseph A. Schumpeter. We speak here of the recently (September 1986) established ISS (International Joseph A. Schumpeter Society). "The crisis of neoclassical theory is evidently one reason for this development." [Hanusch (1988):1]

Changing rates of exchange does not necessarily nor ipso facto entail the dynamics of structural change (a key condition for metamorphosis and evolution). Given the neoclassical approach as exemplified by the Marshallian offer-curve analysis, as a case in point, we find that the results to be derived from the newly formed international terms of trade to be "as if" the transformation curve had moved outward, when in actuality it had not. Improvements in the domestic terms of trade through international trade lead to welfare gains conceptualized in general equilibrium theory. But such utility advances, do not constitute, necessarily, a change in economic structure characteristic of economic evolution. Economic evolution entails more than simply changing rates of exchange.

It is accepted in the literature and well-known, that the neoclassical pure theory of trade is at best a theory of "comparative statics." Schumpeter by comparison, conceptualized the distinction between growth and development. In Schumpeter's theory of economic evolution the focus is on the entrepreneurial innovator rather than catallaxy and the static processes of exchange. Schumpeter's explanation of the dynamics of structural transformation resided in

the "perennial gale of creative destruction" and stressed entrepreneurial innovation as the key area of technological change.

Consequently, and by comparison, while Buchanan speaks of the need to understand and cope with transition and transformation, his conception and theory of the economic process do not. Consequently, it is predictable that the paradigm of "Public Choice" would essentially avoid Schumpeter and the dynamics of economic evolution. "One of the curiosities of the public choice literature is the slight direct influence Schumpeter's work appears to have had." [Mueller (1976): 395,#1] The close connection of game theory offers additional credence to the static nature of the paradigm of "Public Choice." "We repeat most emphatically that our theory is thoroughly static. A dynamic theory would unquestionably be more complete and therefore preferable" [Neumann and Morgenstern 1953]:44; Marschak (1946)]. How then can Buchanan purport to deal with transition and adaptation, obviously relevant to the processes of economic evolution, and at the same time apply a static conception and theory (neoclassical economics) of the economic process?

In actuality, the issue at hand really deals with the processes of culture evolution. Elsewhere, in Buchanan's discussion of "Cultural Evolution and Institutional Reform," he draws attention to a point of view that "Hayek is a cultural, not a biological, evolutionist." [Buchanan (1986):79]. As with many others, Hayek draws attention to the primary role of knowledge in the "...adaptation to changes in the particular circumstance of time and place." Hayek argues that the "...problem of the utilization of knowledge not given to anyone in its totality" is basically covered for a given "time and place" by the coordinating role of the price system [Hayek (1945):520,524,526]. According to Hayek, this represents a somewhat "heretical" view to the more accepted position that such coordination is performed by science.



The more prevalent view on culture evolution, during the modern epoch, interrelates invention and the dynamics of evolution with the methods of science, not the process of exchange. Inventions, as new combinations of existing elements innovated as technological change, promote the dynamics of ongoing cultural evolution. It has been said that the greatest invention was the invention of the method of invention, better known as science. For example another Nobel laureate, Simon Kuznets, relates modern economic growth to the "scientific epoch." It is the application of a science-fed technology, relevant to both economic production and social organization, which accounts for the dynamics of the economic process during the modern epoch. [Kuznets (1966): 1-16,487, passim]. Given this conception, the question relates not to catallaxy, but rather becomes very Galbraithian: who and/or what controls science and for which purpose?

Posing the question In this way, would it not then behoove economists in the transition to ongoing modern economic growth, as the "Post-Revolutionary Moment," to understand the dynamics of a science-fed technology, rather than the statics of catallaxy? In converse to Buchanan's antipathy to any attempt at "social engineering" or at being "constructively rational," it is the potential application of science to social organization which accounts for the dynamics of institutional adjustment. The application of systematic or disciplined knowledge to social organization, as social technology, is characteristic of new social inventions manifest in the U.S. Constitution, the IMF, the EC, and institutional adjustment via Keynesian economics, and on, as cases in point. And while all this is obviously subject to debate; it is a debate which, to our view, is not resolved by Buchanan's "New Political Economy."

To argue that "cultural evolution cannot be directed" and that we should "relax before the slow sweep of history" places a large amount of faith in the principle of spontaneous order as the guiding mechanism of culture evolution. (Buchanan (1986):119,76] Such a

*sui generis* explanation of culture evolution places Buchanan with an odd bedfellow. We speak here of another noted authority in the domain of culture evolution, the anthropologist Leslie A. White. Really, what the application of neoclassical theory to institutional adjustment gives us is, more so, of the nature of a *gyroscope*. What humankind needs, more urgently, from the professional economist is a *gyrocompass*.

It appears that, indeed, the "Tide is Turning" today, but not in the ideological direction of *laissez faire*. The failure of the Soviet system of totalitarian planning does not necessarily mean a victory for the opposite polarity of *laissez faire*. Buchanan's enthusiasm for *laissez faire* hardly needs amplification and logically follows from the principle of spontaneous order, "... *laissez faire* not only maximizes liberty but also the wealth of a nation." [Buchanan (1986):75, (1975):91; Reisman (1990): 112] Relevant to the empirical record, as a basic test of concept and theory, did *laissez faire* as policy resolve the British "climacteric" taking place circa, 1873-1911? Did the *laissez faire*, characterizing the American economy during the 1920's, produce prosperity during the 1930's? And further, the whole "industrial policy" debate has been nurtured in a milieu characterized by the successes of economies who have used governmental cooperation, not to negate the market process but rather have shown how to make it work better. Is not the "social market economy" of Germany, and serving to explain the German economic miracle of the post-WW II era, predicated on the proposition that *laissez-faire* policy is not enough. Given Buchanan's paradigm and obvious policy predilection and derivative, how then to explain why the Japanese economic bumblebee flies so well? Would it be rational or logical, however these terms are defined, for the Japanese to dispense with MITI? By any stretch of the imagination, would a *laissez-faire* policy orientation really make the U.S. competitive, once again, in the global economy and serve to overcome its long-term productivity decline?



It appears that the Reagan/Bush era in the U.S. and the Thatcher/Major era in the U.K. could serve as policy role models for the New Political Economy as advocated by Buchanan. "It is this modern milieu that eventually elected Thatcher, Reagan, and Bush and that set the fingers of the Invisible Hand moving once again in Eastern Europe." [Johnson (1991):357]. However, given the empirical record wrought during the Reagan/Bush era we feel that a more visible and "Humanistic Hand" of governmental social and economic responsibility is in order [Barlett and Steele (1992)]. And while many economists today might express reservations concerning Samuelson's "neoclassical synthesis" not too many would disagree with his dictum that "Capitalism, in the sense of undiluted laissez faire, died before Queen Victoria died." It appears that for humankind to survive, and make it somehow into the next century, that the raw, unmitigated pursuit of greed and self interest, and devoid of social regulation, will have to give way to a more humanistic ideology. The Germans have an expression for it; the Germans call it "Leben und Leben lassen."

#### REFERENCES:

1. Arrow, Kenneth. 1951. *Social Choice and Individual Values*. New York: Wiley.
2. Barlett, Donald L. and James B. Steele. 1992. *America: What Went Wrong?* Kansas City: Andrews and McMeel.
3. Braeman, John. 1991. "Public Choice." In Frank N. Magill, ed., Vol. III, pp. 1878-1885. *Survey of Social Science: Economics*. Pasadena: Salem Press.
4. Buchanan, James M. 1989. *Explorations Into Constitutional Economics*. College Station: Texas A & M University Press.
5. Buchanan, James M. 1986. *Liberty Market and State*. Brighton: Wheatsheaf.
6. Buchanan, James M. *The Demand and Supply of Public Goods*. Chicago: Rand McNally.
7. Hanusch, Horst. 1988. *Evolutionary Economics: Applications of Schumpeter's Ideas*. Cambridge: Cambridge University Press.
8. Hayek, F.A. 1945. "The Use of Knowledge in Society." *American Economic Review* 35(September):519-30.
9. Johnson, David B. 1991. *Public Choice: An Introduction to the New Political Economy*. Mountain View, CA: Mayfield Publishing Company.
10. Laudan, Larry. 1977. *Progress and Its Problems*. Berkeley: University of California Press.
11. Marschak, J. 1946. "Neumann's and Morgenstern's New Approach to Static Economics." *Journal of Political Economy* 54:97-115.
12. Mueller, Dennis C. "Public Choice: A Survey." *Journal of Economic Literature* 14(June):395-433.
13. Neumann, J.V. and O. Morgenstern. 1953. *Theory of Games and Economic Behavior*. Princeton: Princeton University Press.



14. Reisman, David. 1990. *The Political Economy of James Buchanan*. College Station: Texas A & M University Press.
15. Samuelson, Paul. 1954. "The Pure Theory of Public Expenditures." *Review of Economics and Statistics* 36 (November) :387-389.
16. Sowell, Thomas. 1980. *Knowledge and Decisions*. New York: Basic Books.
17. von Mises, Ludwig. 1949. *Human Action: A Treatise on Economics*. New Haven: Yale University Press.

## The Jena Pioneers of the Freiburg School

by Bodo B. Gemper

During the period of the Communist regime in the Soviet zone and the "dictatorship of the proletariat" in the so-called German Democratic Republic 1945 to 1989 the universities in this part of Germany were unable to exercise politically unrestricted research and academic education. The regained unity of Germany gives rise to trace the intellectual roots which laid the foundations of the reputation of those German universities before the division of Germany.

The Friedrich-Schiller-Universität Jena is a good example for a venerable German university with high international reputation in the fields of Natural Science, as well as Liberal Arts and Sciences and the Humanities.

This contribution traces a current of thought which led to the mainstream of socio-economic thinking in Germany, "the thinking in social orders" (Walter Eucken).

"Ordnungstheorie" and "Ordnungspolitik", however, provided outstanding scholars to evolve the economic order, called "Soziale Marktwirtschaft", which became the concept of the economic policy for West Germany an which is still valid under the conditions of unification.

Jena, at the heart of central German intellectual life of the 18th and 19th century, was the home of such renowned personages as the physicist *Ernst Abbe*, the chemist *Johann Wolfgang Doebereiner*, the jurist *Paul Anselm Feuerbach*, the philosopher *Jakob Friedrich Fries*, the philosopher *Johann Gottlieb Fichte*, the zoologist *Ernst Haeckel*, the philosopher *Georg Wilhelm Friedrich Hegel*, the historian *Heinrich Luden*, the natural scientist *Lorenz Oken*, the experimental biologist *Julius Schaxel*, the philosopher *Friedrich Wilhelm Joseph Schelling*, the prince of poets *Friedrich Schiller*, the



philosopher and man of letters *August Wilhelm Schlegel* and the mathematician and educationalist *Erhard Weigel*. It should be not forgotten, that in 1841 the philosophical department of this university conferred the degree of a philosophical doctor on *Karl Marx*, in absentia.

In the thirties and forties of our century such important scholars, such as *Franz Boehm*, *Walter Eucken*, *Erich Gutenberg*, *Fritz Neumark*, *Erich Preiser* and *Wilhelm Roepke* lived and worked at Jena. These men of merits distinguished themselves with regard to the free democratic constitutional ideal and its interlocking economic system of a socially engaged market economy in the Federal Republic of Germany. Before the partition of Germany, it was in Jena as well as in Freiburg that the characteristic outlines of the new system were developed which was later to become the *social market economy* of the western zones.

This line of intellectual history, which has been disregarded up to now, points to a rather strong rooting in liberal economic thought. From this new "Jena" point of view the observer is faced with a picture of continuity in the history of dogmas that is quite different from what we already know. On the one hand, it is obvious, that the concept of a liberal economic system, which is at the same time dedicated to the solution of social questions, has had several important designers in addition to *Ludwig Erhard* and *Alfred Müller-Armack*. On the other hand, it is evident, that this idea, which later became the "ordo-liberal" movement with the Freiburg School as one of its intellectual centres, had originated in Jena. On this background a clearer view of Erhard's achievements is possible. Now, it becomes obvious, that Erhard acquired the theoretical fundamentals for the realization of his economic policy to much larger extent on his own than has been recognized so far by the public. Alfred Müller-Armack stated: "The line developed by Erhard's institute for market research in Nuremberg has to be regarded as the result of his self-acquired fundamental theoretical conviction" <sup>1</sup>. Of course, Ludwig Erhard,

also relied on Jena's Boehm, Eucken and Roepke. Wilhelm Roepke's work "Gesellschaftskrisis der Gegenwart" (Social Crisis of the Present) already fell into Erhard's hands during the war - as an intellectual contraband from Switzerland <sup>2</sup>.

Müller-Armack's contribution to the complete works of the economic system of the Federal Republic of Germany came during the period of his close cooperation with Ludwig Erhard, when the latter was the head of the economic framework Department in the ministry of economics from 1952 on and later as his under-secretary from 1958 to 1963. Above all, he contributed the thought behind the roots of the social and economic system in intellectual history to Erhard's conception <sup>3</sup>. Without any direct contact to Jena or Freiburg Müller-Armack shared the Jena pioneers' opinion of a socially obliged market economy that only a liberal economic order could provide for. This component would secure the overall performance, a stable democracy and a more just social order, in which "in the best sense of the word - a socialization of progress and profit is achieved and, additionally, the individual striving for performance is kept alive" <sup>4</sup>. Ludwig Erhard's goal, "wealth for all", to be understood as the absence of need and existential insecurity, and his conviction, that this aim could only be reached in a competitive economy, was based on a well founded framework. Thus, the personage Erhard, well aware of the historic facts and relying on his hearty conviction, was able to launch a political attack, that was successful in the end. His intention was to allow "a break out beyond the horizon of mere administrative work" and to mobilize "the free creative powers" <sup>5</sup>, that were still alive in post-war Germany. Moreover, Ludwig Erhard had studied "pure" economic theory quite thoroughly, when he was head of the institute for industrial studies, a quasi forerunner of the present modern institutes of economic research, and thus closely observed the instrumental aspects of the economic development process. Many details, that have not yet been examined, are hidden behind the statement: "as to its effect, the economic and currency reform of 1948, that put an end to the chaos and established a new



meaning of human work and dignity, without any doubt, has to be characterized as the decisive change, that destroyed the evil and oriented personage, who was able to completely transfer basic "ordo-political" ideas and created world-wide effects. In 1966, the "Economist" paid fair respect to this when comparing the British and German situation: "Germany was lucky to bring about this policy" <sup>7</sup>. But now back to those men in Jena before and during the second world war, who worked against the National Socialist economic doctrine and towards the aim of a liberal and social post-war economy. This was partly done in close cooperation with the antifascist resistance. The "ordo-theorists" of market economy, that finally paved the way for West Germany's rehabilitation after 1945 were the jurist *Franz Boehm* and the academic economists *Walter Eucken*, *Erich Preiser* and *Wilhelm Roepke*.

### Freedom and Order in a Democracy

Among the stylistically instructive architects of the order system, that was later established as the social market economy in the Federal Republic of Germany and in Switzerland, was *Walter Eucken*, the son of the philosopher and Nobel prize winner for literature (1908) *Rudolf Christoph Eucken*. He was the doyen of the advocates of a "policy for the establishment of an economic order as a social policy" <sup>8</sup>. Thus, he took up "the crucial question of all sciences dealing with social life, i.e. the great antimony between historical and theoretical thought" <sup>9</sup>, as *Erich Preiser* put it in his obituary on *Eucken* in 1950. His reasoning centred on "the thinking in orders", "the legal and economic constitution" <sup>10</sup>. He, as the Nestor of the Freiburg School, was searching for the "limits within which the social process" <sup>11</sup> proceeds in orderly ways.

The up-to-dateness of these thoughts has been proven by the Freiburg economist *Erich Hoppmann* in the summary of his sociocritical study

sociocritical study of the relations between "Freedom and Order", where he attained the resultant warning: "Where orders disintegrate, there is no room for personal freedom" <sup>12</sup>.

### Not the Conditions but Men have to be made responsible

Beyond its epistemological importance the ordo-thought, at the same time, provided a "guidline for practical steps to be taken" in the fields of economic, social and legal politics <sup>13</sup>. *Eucken*, who was born in Jena in 1891, taught economics in Tübingen from 1925 on and then from 1927 till his death in 1950 in Freiburg. He, as well as *Roepke*, objected to the opinion of an inevitable course of economy and advanced the thesis, according to which economy is not disarranged by the "conditions" but by men.

The currency and economic order of the Federal Republic of Germany and Switzerland is based on *Eucken's* idea, that a given economic order does not just grow by itself from the real economy, i.e. "it does not materialize without assistance" but "there must come into effect certain basic principles to allow the order to become an ultimate success" <sup>14</sup>.

The design of *Erhard's* economic order is based on the cultural values developed over the years and, on the basis of a general economic decision, brings to bear the order principle as defined by *Walter Eucken*. As this general decision on the order of the economy had been made in 1948 and 1949 while the Federal Republic of Germany was being formed, the competitive order as a model for the organization of the economic activity was able to establish itself. It was a decision on a currency, financial, social and economic order, that united the striving for economic efficiency and social responsibility with the highest degree of individual freedom. At the same time it pays tribute to the fact, that there is also a connection



between the economy and other spheres of life - such as religion and art - and that this has to be observed as a "unity of all signs of life".<sup>15</sup>

### With Courage against the National Socialist Dictatorship

Like *Eucken*, *Franz Boehm* endeavoured to give society and state a framework order that set effective limits to any kind of violence especially to the abuse of power. *Franz Boehm* personifies the unity of thought in the dimension of a democratic constitutional state and social market economy.

The jurist *Franz Boehm*, who was given a substitute professorate for civil, commercial and labour law, was denied a full professorate at the instigation of the National Socialists. The son-in-law of the poetess *Richarda Huch* had to go through hard times. In 1938, the Reichsminister for higher education, science and popular education, *Bernhard Rust*, revoked *Boehm's* substitute professorate at the Jena university. In 1940, he was finally ousted from his university service, after he had been denied a lectureship at the Freiburg university in 1939. *Boehm*, who kept close contact with Ph. D. *Carl Goerdeler*, a member of the resistance, contributed to the work of a group of anti-National-Socialist economists from all over Germany. As he stated, this group did "the intellectual preliminary work for a currency, economic and social policy..., i.e. for politics, that implied the fall of National Socialism and aimed to promote - in close cooperation with ... the peace loving nations - social progress and better living conditions upon steadily increasing freedom for all."<sup>16</sup>

After the war, *Franz Boehm* taught at the Frankfurt am Main university. As a student of economics, who inevitably had to change from the Karl-Marx-University in Leipzig to the Johann-Wolfgang-von-Goethe-University in Frankfurt, I owe my final turn to the liberal order idea to him. As the leader of the German delegation at the

reparation negotiations in Israel and concerning his involvement in bringing the Federal Republic of Germany into the community of the world's free nations *Boehm* earned the highest merits. Being a member of the German Bundestag and a professor he vigorously advocated, in his speeches and his writings, that the German post-war citizen should show the mental attitude of a free and tolerant man and that he should be constantly aware of the privilege of being allowed to live in the free society of the Federal Republic of Germany.

### Freedom and Social Justice

Rejecting the Hitler dictatorship, *Erich Preiser*, besides *Erich Gutenberg*, found his way to the Freiburg opposition group around *Erwin von Beckerath*, *Franz Boehm*, *Constantin von Dietze*, *Walter Eucken*, *Adolf Lampe*, *Theodor Wessels* and others. *Preiser*, like *Erhard* a disciple of *Franz Oppenheimer*,<sup>17</sup> in his efforts towards a swift and smooth transition from war to peace-time economy, attached great importance to a social component, without ever thinking of collective answers. *Erich Preiser*, who had taught economics and social sciences at the Jena university from 1940 to 1946, also made the question of the control of the economic process and its order the basis of his consideration. In this connection, he compared the market economy as a self-regulating control system with the administrative economy as an example for the centralized control of all economic proceedings. In accordance with *Walter Eucken*, *Preiser* stated that "there is no ingenious solution in the field of economic policy - least of all in the social question" and that we have to be content with "establishing a certain order for the multitude of tasks and possibilities and thus indicate a general direction for the economic policy"<sup>18</sup>. In this context, *Erich Preiser* was especially impressed by a model comprising "in principle the renunciation of profit-making for private purposes" that could be successful in practice. On this score, he referred to the "most famous example" of a



works constitution still valid in the Federal Republic of Germany which is "the Zeiss-Company in Jena, that had been converted into a foundation by *Ernst Abbe*, and whose profits are for the benefit of its personnel and, partly for scientific and social purposes even outside the company" <sup>19</sup>.

Preiser pointed out, that the fact that turned the scale when deciding against the administrative and for the market economy was the freedom postulate <sup>20</sup>. As far as the solution of the social question was concerned, he came to a conviction as early as 1955: "Anyhow, when one takes into consideration all the things that are already self-evident or partly under way, the condition does not seem utopian in which the market economy really deserves the adjective 'social'" <sup>21</sup>.

### Peace in Freedom

*Wilhelm Roepke*, side by side with *Boehm*, *Eucken* and *Preiser*, compiled the success-decisive equipment, that enabled *Ludwig Erhard* to realize his idea of the social market in the West Germany of 1948. Wilhelm Roepke, who was the author of probably one of the most brilliant textbooks for the introduction to economics "Die Lehre von der Wirtschaft" (The Science of Economics), taught at Jena from 1924 to 1928. *Fritz Marbach*, an economist from Berne, called him an "early diagnostician of Hitler's vile regime". In a lecture on 8th February 1933, immediately after Hitler's seizure of power, Roepke daringly pointed out: "The technological and organizational miracle depicted by our economic system, even in spite of its hardships and imperfections that call for reforms, will be doomed to scraping along, if the three cardinal conditions - reason, peace, freedom, - are not even wished worth striving for by the masses that press heedlessly for power... You simply cannot run back to Germania's virgin forests, preach mass stupefaction (brainwashing) and raise a storm of destructive and disorderly feelings while the apparatus of our mass

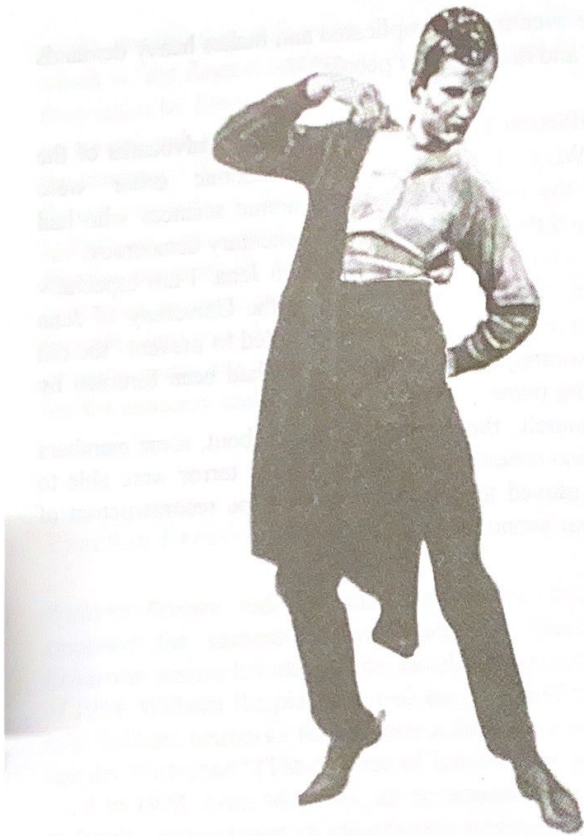
supply has become even more complicated and makes heavy demands on the intelligence and discipline of people" <sup>22</sup>.

It gives deep satisfaction to know, that the leading advocates of the conception of West Germany's new economic order were representatives of the jurisprudence or economic sciences who had unreservedly devoted themselves to the parliamentary democracy.

As an economist, who was born and raised in Jena, I am especially proud to point out, that it was precisely at the University of Jena where all those brave men worked who attempted to prevent "the old tragedy of a blossoming culture's decline", as had been foreseen by Roepke, from taking place.

Although, unfortunately, this decline did come about, some members of the resistance movement against fascist mind terror were able to survive and thus played an important part in the reconstruction of Germany's post-war economy.





The Swiss economist *Walter Adolf Joehr* at the St. Gallen university for economic and social science recalled that the central figure in the picture of the famous Swiss painter *Ferdinand Holder* "The Setting-out of the Jena Students" concerning the war of liberation against Napoleon, was the young *Walter Eucken* at the age of 17, who had served as an artist's model. Fortunately, this impressive picture from 1908 outlasted two world wars without any damage. Presently, it is on display at the great hall of Jena's Friedrich-Schiller-University. The above study for this painting is in the possession of the Bavarian Painting Collection in Munich.

#### References:

- 1 Alfred Müller-Armack, Wirtschaftspolitik zwischen Wissenschaft und Politik. In: Gerhard Schröder, Alfred Müller-Armack and others (eds.), Ludwig Erhard, Beiträge zu seiner politischen Biographie. Festschrift zum 75. Geburtstag, Frankfurt am Main, Berlin, Wien 1972, p. 475.
- 2 Op.cit., p. 474.
- 3 Alfred Müller-Armack, Genealogie der Wirtschaftsstile, 1st.ed.1941.
- 4 Ludwig Erhard, Wohlstand für alle. Düsseldorf und Wien 1964, p.8
- 5 Goetz Briefs, Von der "Mondlandschaft" zum deutschen Wirtschaftswunder. In: Ludwig Erhard, Beiträge zu seiner politischen Biographie. Op. cit., p. 434.
- 6 Ludwig Erhard, Wandlungen, Umbruch oder Umsturz unserer Gesellschaftsordnung? In: Bodo B. Gemper (ed.), Marktwirtschaft und soziale Verantwortung, Köln 1973, p. 23 following pages.
- 7 In: the Economist of 15th October 1966, p. 111 following pages.
- 8 Walter Eucken, Grundsätze der Wirtschaftspolitik, 6th unchanged ed., Tübingen 1990, pp. 314, 315.
- 9 Erich Preiser, Walter Eucken in memoriam. In: Jahrbuch für Nationalökonomie und Statistik, 1952 (Vol. 162), p. 242.
- 10 op.cit



11 op.cit.

12 Erich Hoppmann, Freiheit und Ordnung in der Demokratie. In: Orientierungen zur Wirtschafts- und Gesellschaftspolitik, No. 17, Bonn 1983, p. 20.

13 Erich Preiser, Die Zukunft unserer Wirtschaftsordnung. 3rd. enlarged edition, Göttingen 1960, p. 243.

14 Walter Eucken, op.cit., pp. 325 and 373.

15 Walter Eucken, Die Grundlagen der Nationalökonomie, 5th unchanged edition, Godesberg 1947, pp. 392 and 393.

16 Quoted in accordance with Volker Wahl, Richarda Huch, Jahre in Jena, Jena 1982, p. 23.

17 Cf. Horst Friedrich Wünsche, Ludwig Erhards Gesellschafts- und Wirtschaftskonzeption, Stuttgart 1986, pp. 57 - 73.

18 Erich Preiser, op. cit., p. 75.

19 op.cit., p. 73

20 op. cit., p. 57.

21 op. cit., 2nd ed., p. 75.

22 Wilhelm Röpke, Wirmis und Wahrheit, ausgewählte Aufsätze, Erlenbach-Zürich, Stuttgart 1962, pp. 106 and 107.