

Comparative Study on Liberalism of Friedrich von Hayek and Walter Eucken¹⁾

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Abstract

Purpose of this paper is to clarify some ambiguities in the discussion on economic liberalism by comparing Hayek and Eucken. Even though the two liberals share individual freedom as meta-economic goal, they have different views about the function of market competition. For Hayek, market is an information system which enables mobilization of dispersed knowledge in society. Eucken considered market competition as a mechanism which protects economic agent from the abuse of power by the state or private agents including interest groups. As to competitive order of the market, Eucken considered the active role of the state (Ordnungspolitik) to be important, while Hayek believed in the spontaneous order and evolution, whereby 「nomocracy」 plays an important role. Thus, the precondition for the 「natural freedom」 seems to be different between the two liberals.

Key words: Liberalism, Competitive Order

1. Introduction

In recent years, we have witnessed intensive discussions about

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philosophy and problems of economic liberalism on the global scale. Korea is no exception in this regard. Perhaps three factors have intensified such discussions.

The first factor has to do with internal economic policy in Korea. Since the financial crisis in 1987, Korean government introduced a series of reform policies to invigorate market economy, based on the critical self-reflection about the government-led development policy under previous regimes. Economic policies of the present government however, seem to be rather interventionistic. Notwithstanding her repeated proclamation of free market philosophy, market intervention of the government has shown increasing tendency. This resulted in drastic increase of government expenditure and tax burden of private sector.

The second factor has to do with the system transformation of the previous socialist countries. The economies in transition have introduced many reform measures to transplant market economic system. This transformation process caused intensive discussions about the 「desirable」 market economic system. China, for example, declared its economic system officially as "socialist market economy". The state ownership structure of industries endows legitimacy to the prefix "socialist". However, as the privatization process of the state owned enterprise proceeds, China's economic system will suffer qualitative change. Such kind of discussion is gaining importance in Korea: Korea is interested in prospect of socio-economic reform in North Korea.

The last factor, which caused controversial discussions about economic liberalism, has to do with the globalization of the world economy. In the wake of the globalization, the Anglo-American type of free market has been criticized, not only by intellectuals of developing countries but also in industrialized countries. They raised their voices against the 「unbridled」 expansion of so called 「turbo」-capitalism or wild-western capitalism.

Even though the socio-economic philosophy of liberalism has history of several hundred years, the terminology liberalism seems not to be clear. There seems to be a wide range of streams and interpretations of the terminology. The purpose of this paper is to find out such differences and similarities between two representative liberals of modern times, namely Friedrich von Hayek from the

younger Austrian school and Walter Eucken, the founding father of German Ordo-liberalism.

At first, this paper deals with their views on the role and function of competition on the market. And then we will compare their views and their different thought about the relationship between state and market, focussing on function of state in securing competitive order on the market. This will be followed by analysis of role of state relating to social policy. In the last part of the paper, we will give a synoptic comparison as summary of the content.

2. Function of Market Competition

Hayek and Eucken are considered to be the most influential protagonists of modern liberalism. Hayek has been decisively influenced by the liberal tradition in England, for example D. Hume, J. Locke and A. Smith. Eucken's Ordo-Liberalism is the result of his critics against state monopoly of power under fascism in Germany.

Since the beginning of his scholarly activity, Hayek was mainly concerned with problems relating to economic system. According to him, elementary function of market competition is effective utilization of dispersed knowledge in society.³⁾ In formulating his famous 「impossibility theorem」 of socialism - centrally planned economy can not function - he augured that the main problem of socialism is not the problem of solution of equations for resource allocation, but the inability of effective mobilization of dispersed knowledge. According to Hayek knowledge means not the simple accumulation of static facts but the ability to solve problems in continuously changing circumstances.

This is the main reason, why Hayek denied the general equilibrium concept of the Austrian school, represented by Walras and Pareto. The starting point of his argument is that relevant factors, which are considered to be given in the static equilibrium model, are in reality not given and incessantly changing. In a given period of time, resources, technology and taste are not given, and uncertainty pervades every decision making of economic agents. For Hayek

3) Hayek(1948)

competitive process on the market is interpreted as an information system which coordinates the dispersed knowledge through the mechanism of prices.

In this regard, key concept of the Hayekian exchange system or 「catallaxy」 is 「competition as a discovery procedure」.

"..... the market is not merely an allocative device, by which factors are assigned to their most important uses, it is a discovery procedure through which economic agents try out new techniques, experiment with different use of resources and exploit new opportunities".⁴⁾

Key concepts in the philosophy of Hayek are directly related to such function of market competition. For example, catallaxy and nomocracy are the institutional facilities of the market system. These institutions undergo evolutionary process. Instead of the general equilibrium, Hayek suggested 「spontaneous order」 as the result of market competition, I. e. an order that is not, or more accurately, can not be designed by any central authority.

Whereas the effective utilization of dispersed knowledge in society is the main function of market competition in the Hayek's system of market theory, power problem is the central notion in case of Eucken. According to Eucken, main factor which threatens individual freedom, results from abuse of power by individuals, interest groups and the state. Thus, his primary concern was how to control such abuse of power to guarantee individual freedom. Franz Böhm, Professor of Law at the University of Freiburg, joined in developing such institutional devices, and exercised great influence on Eucken's philosophy.⁵⁾ As will be discussed in the following part of this paper, the state should assume more active role to facilitate market competition.

Relating to the methodology of economics, Eucken tried to keep distance to both the methodology of the German historical school and of the Austrian school. In case of historical school, he criticized lack of theoretical way of thinking: accumulation of historical facts do not guarantee economic theory. As to neo-classical approach of

4) Barry(1984)

5) Böhm(1961)

theoretical models, Eucken joined the criticism that assumptions of hypothesis do not reflect the circumstances of real world. In this regard the starting point of his methodology seems to have some similarity with Hayek: Both of them stressed the 「interdependence of orders (Ordnungen)」.

Eucken tried to explicitly analyse the data (「Datenkranz」), which are assumed to remain constant in the neo-classical model. This 「ceteris paribus」 clause assumes methodologically immunizing function against any critic to the model.

Thus, both of them argue that, social and legal institutions should be considered in building economic theory. According to Eucken, competitive order (「Wettbewerbsordnung」), that is the key concept of his thought, is the natural order, which conforms to human nature. Formation of free and natural order shall be the guiding principle of economic policy. In this regard, it is interesting to note clear difference between Eucken and A. Smith. A. Smith was optimistic about establishing 「simple system of natural freedom」 through laissez-faire. In contrast, Eucken stressed the active order creating function of the state.⁶⁾

Another aspect concerning the methodology of economics is the fact that Hayek and Eucken shared the view that value judgement is necessary in social sciences. Social science experienced long history of controversy over this issue. G. Schmoller, the representative scholar of the German historical school, asserted that value judgement assumes positive role in judging direction of social-economic development, while M. Weber has suggested the proposition of 「value-neutral」 social science. Purpose of science is, according to him, not only the explanation of the causal relationship, but also contribution to policy formulation, which contains value judgement. Hayek's concept about 「rules of just conduct」 also necessitates value

6) There are different opinions as to the question, whether this 「naturliche Ordnung」 reflects 「Naturrechtsordnung」. Eucken defined his competitive order as natural order, which corresponds to the will of God. (Eucken, 1952/90. P. 176). At the same time he criticised the concept of natural freedom of A. Smith, who was influenced by the 「philosophy of natural law」 of the physiocracy. Thus, it remains unclear, if Eucken's concept has been influenced by the philosophy of natural law.

proposition as to the normative code of human behaviors. In this regard, he seems to be influenced by the English tradition of moral philosophy.⁷⁾

3. State vs Market

Although Hayek and Eucken share common goal of free society, they have somewhat different views about function of market competition. Furthermore, they have also different perspective on the realization of competitive order on the market. The starting point is interdependency of orders of society: economic order can be established only when relevant legal system is effective.

On the one hand, both of them acknowledge importance of legal system to protect market competition from external disturbances and to guarantee private property. On the other hand, they have somewhat different thought about role of state in this regard.

For Hayek, state assumes the role to facilitate "freedom to compete" for economic agents, whereby each individuals are required to keep "rules of just conduct." These rules are explicitly embodied in 「nomos」, which in turn can be influenced by convention and tradition of the society and undergo evolutionary process. 「Nomos」 is, according to him, legal framework, which enables spontaneous order, and it is end-independent. In this regard, Hayek considered it to be of the utmost importance to distinguish nomocracy from teleocracy. While the teleocracy pursues specific political goal, the former does not. Design of society according to a plan -social constructivism- and teleocracy are concepts that are emphatically refuted by Hayek.

Eucken seems not to be optimistic about the self-generating possibility of the spontaneous order of the market. Hayek obviously has been strongly influenced by the English tradition of liberalism, especially by A. Smith. Thus, his concept of 「catallaxy」 and nomocracy is clearly in line with the invisible hand and laissez-faire of A. Smith. In contrast, Eucken does not believe in the self-regulating mechanism of the market. His perception was that laissez-faire would result in power concentration on the market,

7) Böhm/ Eucken/ Grossmann-Doerth(1989)

disturbing the competitive order. The invisible hand of A. Smith and the spontaneous order of Hayek is substituted by the ordering hand of the state in case of Eucken.

In contrast to Hayek Eucken's 「Ordnungspolitik」 has been formulated based on his experience and observation of the German history since the late Weimar Republic. Increasing industrial concentration and the resulting exposure of politics to the ever increasing influence of interest groups seem to make Eucken pessimistic about the competitive order. He concluded that the government deteriorated as 「play ball (Spielball)」 of interest groups. Based on this observation, he persuasively requested 「small, but strong government」: small government with minimum intervention in economic process, but at the same time, strong enough to be free from and neutral toward various pressures and influences of interest groups. This seems to be ideal picture of government even today in many countries. And Eucken's perception of the 「Ordnungspolitik」 and function of government was conceived as alternative for laissez-faire as well as interventionism.⁸⁾

Hayek and Eucken share common opinion that government intervention in market process, whatever the reason might be, necessitate furthers intervention, resulting in cumulative vicious circle. The government is again forced to intervene. This is due to the fact that, in case of market process, each economic agent is responsible for his economic decision and action. But in case of government intervention, individuals are reluctant to take over sole responsibility and would try to share the burden of undesirable result. In this regard, the disturbance of market process due to the government intervention is cause and result for further intervention.

4. On Social Policy

Regarding to discussions of function of state in a market economy, redistributive function of the state assumes very important role. From the beginning of industrialization, there have been controversies on logic and extent of state intervention for

8) Streit/ Wohlgemuth(2000)

redistributive purposes.

Although Eucken has been concerned about social problems accompanying industrialization and showed sympathy toward the 「humane capitalism」, he principally was not affirmative about the redistributive policy of government. For him, competitive orders on the market is the guarantee for social justice. Freedom of decision making requires that each individual takes over responsibility of his decision. Such a view is in contrast with influential German tradition of economics, i. e. the historical school. According to this tradition, 「unbridled competition」 has been considered to cause social problems.⁹⁾

Hayek is far more critical about the state intervention in the market for social policies. From the beginning he repeatedly indicated the vagueness of the concept 「social」, and accordingly, he criticized the concept of 「social market economy」 of Germany.

For him, the only measure of justice is individual freedom and justice is meaningful only in relation to competition process, not to the results of transaction. Individual welfare depends on, he argues, his luck, inheritance and performance, the importance of these three factors being in that order.¹⁰⁾

5. Synopsis of Comparison

Common features and difference in economic liberalism of Hayek and Eucken can, in a very simplified form, be summarized as follows.

<Liberalism of Hayek and Eucken>

9) It was the ordo-liberals from the University of Koln, represented by Professor Muller-Armack, who asked more active social policies of the state. The social market economy has been greatly influenced by these Ordo-liberals. But the state intervention, they argue, should follow the principle of 「market conformity」.

10) Hayek(1982)

	Hayek	Eucken
basic value	individual freedom	individual freedom
market competition	control of power	discovery procedure (information system)
ideal market	competitive order	"catallaxy"
market order	construction	evolution
state	[Ordnungspotitik]	nomocracy

First, Hayek and Eucken considered individual freedom as the basic value and believed that it can only be realized in market economy, and not in socialist system.

Second, the market competition takes over somewhat different function: In case of Eucken, the competition contributes to neutralize asymmetric power distribution. For Hayek, however, the market competition facilitates maximum utilization of information and knowledge dispersed in society.

Third, market order is for Hayek, spontaneous order, which undergoes evolutionary process. Eucken, however, is not so optimistic about the spontaneity of order and requested active 「order policy」 of the state.

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