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The German anti-Keynes? On Walter Eucken's macroeconomics

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The German Anti-Keynes? On Walter Eucken's Macroeconomics

Lars P. Feld, Ekkehard A. Köhler und Daniel Nientiedt

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Albert-Ludwigs-Universität Freiburg

The German Anti-Keynes? On Walter Eucken's Macroeconomics

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Abstract:

Germany's approach to solving the Eurozone crisis is supposedly based on the ideas of Walter Eucken (1891–1950), the founder of ordoliberalism. In this and other contexts, Eucken's work has been described as being in direct opposition to that of John Maynard Keynes. Our paper aims to clarify and differentiate the relationship between the two scholars by making two main points. First, we show that Eucken supported a proto-Keynesian stimulus programme at the height of the Great Depression, the so-called Lautenbach plan of 1931. Second, we critically examine Eucken's description of 'full employment policy', a strategy with obvious parallels to Keynesian economic policy. Additionally, the paper maintains that when comparing Eucken and Keynes, more emphasis should be given to the fact that the former favours a rule-based rather than discretionary approach to policy-making.

Key words: Ordoliberalism, Eurozone Crisis, Monetary Policy, Fiscal Policy, History of Economic Thought

JEL classifications: B31, D78, E63

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1. Introduction

Germany's approach to handling the Eurozone crisis after its start in 2009 has been highly controversial. The positions taken by Chancellor Angela Merkel and her government on key issues such as public spending, structural reforms and monetary policy have been questioned on both economic and political grounds (e.g. very prominently by Paul Krugman and Martin Wolf in their respective newspaper columns). This has led to an interest in the theoretical assumptions underlying the German point of view. Observers have often attributed this view to an unwillingness to accept the basic paradigms of John Maynard Keynes (e.g. Bibow, 2017; Blyth, 2013; Dullien and Guérot, 2012; Wren-Lewis, 2012). As the *Financial Times* quipped: 'German economists roughly fall into two groups: those that have not read Keynes, and those that have not understood Keynes' (Münchau, 2014).

How does the rejection of Keynesian ideas, if there is any, come about? The authors quoted above believe that it originates from the Freiburg School of the 1930s and 1940s, a group of neoliberal¹ economists and lawyers who developed their theoretical and policy stance in opposition to National Socialism (Rieter and Schmolz, 1993). The group's founder and main representative was the economist Walter Eucken (1891–1950).² The ideas of the Freiburg School – better known today as ordoliberalism – provided the basis for Germany's Social Market Economy that was implemented after WWII. It has long been maintained that they also contributed to the underdevelopment of Keynesian thinking in Germany (Allen, 1989).

What was the actual influence of the Freiburg School on German macroeconomics? A clear-cut hypothesis is formulated by Peter Bofinger. He argues that, to this day, German economic

¹ We use the term liberal in the sense of classical liberalism or libertarianism and not in the US sense of the word. The members of the Freiburg School were neoliberals, however, who wanted to remedy the deficiencies of 19th century laissez-faire liberalism by assigning a more active role to the state.

² For an introduction to the research programme of the Freiburg School, see Sally (1996). For biographical details on Eucken, see Kolev (2016).

discourse and policy adhere to a ‘*specific paradigm of macroeconomics*’ which was developed by Walter Eucken and which is diametrically opposed to Keynesian economics’ (Bofinger, 2016, p. 8). Bofinger identifies three main components of this particular German paradigm, namely ‘an almost religious fixation on *balanced fiscal budgets*’, ‘a very strong preference for *price stability*’ and the ‘conviction that *flexible prices* are the most important contribution to the solution of unemployment problems’ (ibid., pp. 8–9).

It can be seen immediately that the three components named by Bofinger correspond to important aspects of the German position during the Eurozone crisis: The advocacy of fiscal consolidation, as in the case of Greece; the criticism of the ECB’s bond buying programme; and the recommendation for crisis countries to improve their competitiveness by lowering production costs. The question to what extent Germany’s policy stance during the Eurozone crisis followed from ordoliberal principles – rather than, say, national interest – has spurred a wide-ranging debate (see the contributions in Beck and Kotz, 2017; Biebricher and Vogelmann, 2017; Hien and Joerges, 2017).

This paper contributes to this debate by focusing on the underlying issue of the relationship between the macroeconomics of Eucken and Keynes. More precisely, the paper asks whether Eucken’s work is really ‘diametrically opposed to Keynesian economics’, as Bofinger claims. The comparison between Eucken and Keynes seems particularly appropriate because both were working simultaneously to address the pressing economic issues of the 1930s. We will assess the relationship of their ideas by making two points. First, by recalling the little-known fact that Eucken supported a proto-Keynesian stimulus programme at the height of the Great Depression; and second, by analysing his critique of full employment policy, a strategy with obvious parallels to Keynesian economic policy.

Regarding the first aspect, Eucken was in favour of the Lautenbach plan, a fiscal stimulus package designed to overcome the Great Depression in Germany. The plan was discussed at a secret meeting of the Friedrich List Society in September of 1931, but never implemented. It was named after its architect Wilhelm Lautenbach (1891–1948), a senior official at the Reich Ministry of Economic Affairs. In retrospect, the expansionary fiscal measures proposed by Lautenbach and others to counteract the crisis have been described as ‘proto-Keynesianism’

(Klausinger, 1999).³ This similarity did not escape Eucken, who referred to Lautenbach as ‘the German Keynes’ (Eucken, 1951, p. 59). Eucken’s approval of the Lautenbach plan has been noted before (Feld *et al.*, 2017; Hutchison, 1979) but his position has never been analysed in detail.

As for the second aspect, Keynesian economics is usually understood to refer to the theoretical concepts put forward in *The General Theory of Employment, Interest and Money* (Keynes, 1936). One of the central ideas of this work is that the level of employment does not only depend on the level of real wages, as was previously believed, but additionally on the effective demand faced by producers (on the defining elements of the *General Theory*, see Blaug, 1997, pp. 641–75). As a policy implication government intervention may be required to induce investment and move the economy in direction of full employment. Although the *General Theory* changed economics profoundly within a short time, at least in the Anglo-Saxon world, Eucken barely discussed the book.⁴ He did, however, discuss a strategy of economic policy he calls full employment policy (*Vollbeschäftigungspolitik*).⁵ Bofinger claims that ‘[Eucken] uses this term for a Keynesian style expansionary fiscal policy but without mentioning Keynes’ (Bofinger, 2016, p. 13).⁶ Thus, we investigate full employment policy and its connection to Keynes’ arguments.

According to the analysis in this paper, Eucken’s relationship with Keynesian ideas is more nuanced than indicated by the literature on Germany’s role in the Eurozone crisis. Firstly, Eucken’s support of the Lautenbach plan reveals that he recognised the need for expansionary fiscal policy in a time of deep recession. We describe Lautenbach’s proposal and Eucken’s motivation to support it, adding new evidence from their private correspondence. Secondly, we show that Eucken considered full employment policy to be a general strategy of economic policy of which Keynes may be one representative, but his ideas are not necessarily Eucken’s

³ Hansjörg Klausinger defines proto-Keynesianism as ‘the advocacy – before the publication of the “General Theory” – of expansionist policy, and in particular of public works, as a remedy for depression and unemployment’ (Klausinger, 1999, pp. 378–79). While the Lautenbach plan is an example of Keynesian economic policy before Keynes, it does not follow that its proponents anticipated the theoretical arguments of the *General Theory*. In this sense, German proto-Keynesianism is to be distinguished from true ‘anticipations of Keynes’ (ibid., pp. 385–94).

⁴ In Eucken’s two main works – published in 1940 and 1952, respectively – the *General Theory* and its German translation are cited a total of five times (Eucken, 1950[1940], pp. 339, 343; Eucken, 2004[1952], pp. 236, 350, 361). All five instances are extraordinarily brief.

⁵ An early prominent use of the English term is by William Beveridge in his book *Full Employment in a Free Society* (Beveridge, 1944). Eucken uses the German equivalent *Vollbeschäftigungspolitik* in an editor’s note published in the same year (Gestrich, 1957[1944], p. 110, fn. 6).

⁶ Similarly, Landmann (2017, p. 130) maintains that ‘[Eucken] was adamant in his rejection of any systematic Keynesian countercyclical demand management. ... He felt vindicated by the experience of the “epoch of full employment policy” in Germany’.

main concern. We critically examine Eucken's description of full employment policy, in particular his claim that it leads to Soviet-style central planning. Furthermore, we argue that the most important difference between Eucken and Keynes is that the former favours a rule-based (rather than discretionary) approach to policy-making.

The paper is organised as follows. Section 2 summarises the initial reception of Keynesian ideas in German academic economics and their impact on economic policy. Section 3 describes Eucken's position on the Lautenbach plan (3.1) and his critique of full employment policy (3.2). Section 4 analyses the relationship between the ideas of Eucken and Keynes. Section 5 concludes with a summary and additional remarks.

2. The Reception of Keynesian Economics in German Academic Economics and Economic Policy – An Overview

When talking about the initial influence of Keynesian ideas in Germany, it seems helpful to distinguish between the influence of these ideas on professional economists, i.e. in academia, and the influence on economic policy-making.

Let us first consider the impact in academia. The *General Theory* was published in 1936 and almost immediately translated into German. Keynes was already popular in Germany because of his opposition to the Treaty of Versailles.⁷ His newest work was widely discussed among German-speaking economists, both inside and outside the country (Hagemann, 2009). There was, however, no Keynesian revolution in the German economic profession during the 1930s. One reason can be found in the drastic change of academic life in Germany after 1933. The rise of the National Socialists led to the forced political conformity (*Gleichschaltung*) of academics and intellectual isolation from the outside world. The *Neue Wirtschaftslehre* of the Nazis was detached from international developments and geared towards providing the basis for economic planning and rearmament (Janssen, 2012). Opponents of the regime, such as the members of the Freiburg School, were not exempt from the state of seclusion – especially after war began in 1939.⁸

⁷ In 1926, Keynes delivered a speech on *The End of Laissez-Faire* in Berlin which received much public attention. He also published extensively in the Hamburg-based journal *Wirtschaftsdienst*. On Keynes' popularity in interwar Germany, see Köster (2013).

⁸ Looking back in March of 1946, Eucken acknowledges this fact: 'When one, which is our case, has been cut off from the rest of the world for so many years, it is absolutely necessary to quickly re-establish full contact with the intellectual work being pursued outside of our borders' (quoted in Goldschmidt and Hesse, 2013, p. 138).

In the Anglo-Saxon world, Keynesian economics radically changed the discipline in a time span of roughly ten years (Blaug, 1997, p. 642). The same is true for Germany, although with a marked delay. The end of WWII brought the end of isolation. In the following, German academic economics underwent a transformation that ‘included wide acceptance of Keynes’s *General Theory* as well as other aspects of Anglo-American economics’ (Dillard, 1986, p. 120). A particularly influential person to enable this transition was Erich Schneider, whose 1952 textbook *Einführung in die Wirtschaftstheorie III* introduced young economists to Keynesian arguments in the form of Paul Samuelson’s neoclassical synthesis. When Keynesian ideas began to dominate German academia in the early 1950s, the influence of ordoliberalism had already faded (Hesse, 2010, pp. 48–50). Due to Eucken’s untimely death in 1950, he could not react to these developments anymore.⁹

Thus, German economists adopted Keynesian thinking, although relatively late. If there was a lack of impact of Keynesian economics during the post-war years, it was because of economic policy-making. After Allied controls ended, Germany adopted the economic model of the Social Market Economy, based largely upon the work of the Freiburg School (Goldschmidt and Wohlgemuth, 2008). The implementation of ordoliberal ideas can be attributed in particular to Ludwig Erhard, the Minister of Economic Affairs between 1949 and 1963. One of Erhard’s closest advisors was Eucken’s student Leonhard Miksch, who drafted the 1948 *Leitsatzgesetz* to abolish price controls (Goldschmidt, 2015, pp. 39–42). Together with the introduction of the German mark, this law triggered the German economic miracle. Germany’s new economic system proved highly successful, obviating the need for further policy debate for some time.

It should be noted that Keynesian policies became popular in Germany only when the political tide turned against Erhard’s Christian Democratic Party (CDU) in the 1960s. The 1963 act to establish the German Council of Economic Experts (GCEE), while still adopted under Erhard, has been interpreted as a first step towards Keynesian fine-tuning of the economy (Allen, 1989, pp. 275–76).¹⁰ In 1966, the CDU was forced to enter a coalition with the Social Democrats and Karl Schiller became Minister of Economic Affairs. This marked the beginning of a Keynesian period in German economic policy that extended into the early 1970s (ibid., p. 263; Dillard,

⁹ Interestingly, Schneider argued that Eucken enabled the acceptance of the international mainstream in an indirect way. As Gottfried Bombach recalls, ‘for Schneider, Eucken was the man who dealt the mortal blow to the historical school and paved the way for modern theory’ (Bombach, 1990, p. 38). All translations by the authors, unless indicated otherwise.

¹⁰ On the changing importance of Keynesian arguments within the council, see Sievert (2003), who contends that while being a child of Keynesianism the GCEE has never left its ordoliberal grounds.

1986, p. 123). It found its clearest expression in the 1967 Law to Promote Economic Stability and Growth that introduced demand management as a tool to counteract business cycle fluctuations and established ‘a high level of employment’ as one of the major goals of German economic policy.

This adoption of Keynesian economic policy arrived relatively late in Germany and was quickly pushed on the defensive when the phenomenon of stagflation emerged in the 1970s after the breakdown of the Bretton Woods system and the first oil price shock. German academic economists and economic policy quickly adopted monetarism and rational expectations theory. In particular, the rules vs. discretion debate (Kydland and Prescott, 1977) fell on fertile ground in Germany given the familiarity with rule-based economic policy due to ordoliberalism. In comparison to the US or the UK, Keynesian economic policy only had a short time of prosperity and was quickly superseded by the next developments in macroeconomics.

3. Eucken and Keynesian Ideas

How was Eucken’s relation to Keynes’ ideas? Firstly, the discussion about the Lautenbach plan in 1931 may serve as evidence for Eucken’s thinking about expansionary fiscal policy, which is, secondly, corrected by his views about full employment policy.

3.1 Before the Keynesian Revolution: The Secret Meeting of the Friedrich List Society and the Lautenbach Plan

The Lautenbach plan must be viewed against the background of the deflationary policy of the Brüning government between March 1930 and June 1932. In Germany, the early 1930s were characterised by a deep economic recession, illustrated by the rise in unemployment to around 4.5 million people in October 1931 (Spoerer and Streb, 2013, p. 85).¹¹ Given the severity of the crisis, economists such as Lautenbach, Hans Neisser und Wilhelm Röpke argued in favour of expansionary measures including public works programmes, although the ability of the government to conduct such measures was severely limited by financial and political considerations.¹²

¹¹ For the year 1931, this translates to an average of 34.3 percent of industrial workers (Eichengreen and Hatton, 1988, p. 6).

¹² A prominent representative of this view is Knut Borchardt. His arguments can be summarised as follows: ‘Among the many obstacles to an expansionist policy were (1) the need first to correct the structural imbalances of the German economy, (2) the economic and political constraints on the availability of the relevant instruments – for example, the impossibility of financing public works other than by credit creation, which, however, would have violated the restrictions of the Young plan – and, above all, (3) the lack of a public consensus for such an alternative policy’ (Klausinger, 2001, p. 241).

Lautenbach proposed a plan that was supposed to ‘break the deadlock’ of the crisis and serve as an ‘initial spark’ to ignite economic activity (Lautenbach, 1991a, p. 307). The plan was the subject of a secret meeting of the Friedrich List Society that took place on September 16 and 17, 1931. Among the attendees were academic economists such as Eucken, Neisser and Röpke, but also Hans Luther, the president of the Reichsbank. Detailed minutes of the conference were kept and eventually published (Borchardt and Schötz, 1991).

The meeting was preceded by an exchange of letters between Eucken and Lautenbach. On September 1, 1931, Lautenbach sent a memorandum to Eucken entitled ‘Possibilities of an (active)¹³ stimulation of business activity by means of investment and credit expansion’. This memorandum, which was later made available to the attendees of the meeting, is usually referred to as the Lautenbach plan. In a letter to Lautenbach dated September 4, Eucken comments on the plan, adding that he would like to discuss it further in person. Eucken’s arguments in this letter anticipate his position at the meeting of the Friedrich List Society (described below). Interestingly, our investigation has shown that Eucken’s manuscript ‘Remarks on the Lautenbach memorandum’ (*Bemerkungen zur Denkschrift Lautenbach*), which is contained in the Lautenbach papers, is unconnected to the 1931 plan.¹⁴

As explained in the memorandum (Lautenbach, 1991b), the Lautenbach plan has two elements, namely a public works programme combined with nominal wage and price cuts. The public works programme includes the expansion of roads and railways as well as similar investments (ibid., p. 315). Lautenbach proposes that the government could spend 1.5 billion Reichsmark on such a programme within six months, 580 million of which would go to wages (ibid., pp. 322–23).¹⁵ The programme would be financed by promissory notes issued by the national railway company, i.e. a form of hidden money creation (ibid., p. 317). The second element of the plan is referred to as the ‘liberalisation’ (*Auflockerung*) of prices. It consists of an immediate lowering of cartel prices ‘by way of direct government intervention’ and the subsequent

¹³ In Eucken’s copy, and all other surviving copies, the word ‘active’ was crossed out (see Borchardt and Schötz, 1991, p. 309, fn. 328).

¹⁴ Borchardt (1991, p. 33, fn. 42) argues that this manuscript was part of the correspondence between Eucken and Lautenbach preceding the September 1931 meeting. However, the letters of Eucken, currently under investigation at the Thüringer Universitäts- und Landesbibliothek in Jena, contain an untitled memorandum of 14 pages dated VIII. [August] 1932 presumably written by Lautenbach. Eucken’s *Bemerkungen* clearly refer to the latter text. We would like to thank Uwe Dathe for granting us access to the Eucken papers.

¹⁵ This number is confirmed by Lautenbach during the meeting (Borchardt and Schötz, 1991, p. 163). For comparison, a stimulus of 1.5 billion Reichsmark equals 2.4 percent of 1931 GDP (data from the Jordà-Schularick-Taylor Macroeconomy Database).

increase in the flexibility of wages in order to increase German competitiveness (ibid., pp. 319–20). Lautenbach expects that a possible decrease in demand associated with the latter measure would be overcompensated by the public works programme (ibid., p. 322).

During the two days of the conference, Eucken contributes to the discussion twice. On Wednesday, September 16, he emphasises the importance of the second element of the Lautenbach plan. In Eucken's assessment, the liberalisation of prices is necessary in order to 'free the steering wheel of the economy [i.e. the price system], which is now tied down' (Borchardt and Schötz, 1991, p. 146). This observation refers to both cartel prices and wages. Eucken adds that wages need to become more flexible in the sense that they need to indicate economic scarcity, which, depending on individual characteristics, could result in both higher or lower wages (ibid., p. 147). The conjecture that current wages do not reflect market conditions is based on the role of collective bargaining and (mandatory) public arbitration in Weimar Germany (see James, 1986, pp. 190–245).

When commenting on the general feasibility of the Lautenbach plan, Eucken differentiates between two scenarios. If Germany were an isolated economy, the plan would work as intended. However, in Germany's actual situation, an increase in domestic demand could lead to a trade deficit, which in turn could cause the deterioration of currency reserves.¹⁶ Despite this concern, Eucken ends his contribution with the words: '*Nunquam periculum sine periculo vincitur*. We are in danger ... which we will not overcome without danger' (Borchardt and Schötz, 1991, pp. 148–49). On Thursday, September 17, his resolve to support the Lautenbach plan appears even more pronounced: 'I agree with this plan in this form, that is to say, if it is preceded by the liberalisation [of prices]' (ibid., p. 243).

Eucken's decision to support the Lautenbach plan surprised observers such as Miksch, who noted as much in his diary (Köhler, 2015, p. 71). In order to fully understand the decision, it seems necessary to consider a non-economic argument, namely the political costs associated with the crisis. Looking back at the meeting of the Friedrich List Society many years later, Eucken emphasises this line of reasoning:

¹⁶ Under the gold standard, 40 percent of Reichsmark in circulation should have been covered by either gold or foreign currency. On the interwar gold-exchange standard and Germany's difficulty to meet the 40 percent requirement see Eichengreen (1995, pp. 19–21).

My friends and I recommended [the Lautenbach plan] in view of the appalling situation at that time, when there were some five million unemployed. One of my friends declared¹⁷ that to continue the existing policy of contracting credit would not only entail the fall of the President of the Reichsbank, the Reich Chancellor and the government then in power, but also the end of the Republic. (Eucken, 1951, p. 65)

In another instance, he puts it even more bluntly: ‘If the [Brüning government] had accepted [Lautenbach’s] proposals, there might perhaps never have been a National Socialist revolution’ (ibid., p. 59). Eucken’s decision seems to have been motivated, at least in part, by the realisation that continuing a policy of deflation was associated with political risks that may outweigh the economic risks of the Lautenbach plan.

The Lautenbach plan was never realised. Unemployment, however, continued to rise to a staggering 6 million people in the following winter (Spoerer and Streb, 2013, p. 85). Beginning in June of 1932, the von Papen and Schleicher governments engaged in expansionary fiscal policy, although on a smaller scale than Lautenbach had recommended (ibid., p. 106). It was too little too late: while economic recovery began in the fall of 1932, the political collapse could not be prevented and Hitler’s government – which continued the policy of expansion and public works – eventually took credit for creating employment (ibid., pp. 101–09). Eucken did not only accept expansionary fiscal policy according to this account, but he also clearly foresaw what would happen without it.

3.2 After the Keynesian Revolution: Eucken’s Critique of Full Employment Policy

In the 1940s, Eucken started to refer to the expansionary policy of the previous decade as full employment policy. Consider this description of the German experience starting from the policies of von Papen and Schleicher:

In 1932–3 the full-employment policy began with public works, expansion of credit, a cheap money policy, and a pegging of the exchange rate. As this policy threatened to bring a sharp rise in prices, a general price-freeze was ordered in 1936. ... Prices ceased to give expression to the scarcity of goods and services on the markets. This state of affairs gave rise to the creation of a central administrative apparatus to direct the economy. (Eucken, 1948, p. 79)

¹⁷ The minutes of the meeting (Borchardt and Schötz, 1991) do not report this statement. Eucken may have thought of Röpke, who wrote in his report on the work of the Brauns committee: ‘If the collapse of the economy spreads even to the internal and external politics of a country ... then it seems that, as in the case of our unhappy country, nothing can prevent it from falling into disaster’ (Röpke, 1931, p. 451).

Thus, in Eucken's opinion, the use of expansionary fiscal and monetary policy to combat unemployment contributed to Germany's turn towards central economic planning under National Socialism. His description is historically accurate in the sense that the Nazis did decree a general price freeze in connection with the implementation of the Four Year Plan (Tooze, 2007, p. 231). They also engaged in a form of central planning similar to that of the Soviet Union (Temin, 1991).

However, Eucken not only uses the term full employment policy to describe a certain historical episode. He also uses it to describe what he considers a general strategy of economic policy. Eucken touches on this strategy and its implications in the first issue of the *ORDO* journal (Eucken, 1989[1948]), a series of talks entitled *This Unsuccessful Age* (Eucken, 1951) as well as the posthumously published *Grundsätze der Wirtschaftspolitik* (Eucken, 2004[1952]).¹⁸

In the *Grundsätze*, full employment policy is defined as a mixture of monetary and fiscal policy measures aimed at stimulating investment,¹⁹ namely deficit financing, low interest rates and credit expansion²⁰ (ibid., p. 140). Sometimes this definition is extended to include price and foreign exchange controls (ibid., p. 142, p. 254). Keynes is mentioned as one of the intellectual sources of this type of policy, as is Weimar politician Walther Rathenau (ibid., p. 57, p. 140). Interestingly, Eucken believes that full employment policy is currently pursued 'in most countries' (ibid., p. 140). Specific examples include Germany between 1933 and 1936 as well as the US and England after 1945 (ibid., p. 56, p. 165).²¹ Full employment policy must be distinguished from Soviet-style central planning, which Eucken discusses under the heading of the centrally administered economy (*Zentralverwaltungswirtschaft*).

Eucken has two main objections against full employment policy. The first objection is that it endangers the information function of the price system. Eucken explains that the price system acts as a 'calculating machine' or scarcity indicator that coordinates individual actions by

¹⁸ Oliver (1960, p. 127, fn. 2) provides a comprehensive list of ordoliberal writings on full employment policy, including but not limited to Eucken's contributions.

¹⁹ While Eucken (at this point) rejects the concept of regular business cycles, he views a lack of investment as typical of any recession (Eucken, 2004[1952], p. 309; see also Eucken 1950[1940], pp. 242–62).

²⁰ Eucken uses the term credit expansion to describe an increase in money supply (*Geldvermehrung*). See Eucken (2004[1952], p. 258).

²¹ In the case of the US, this assessment refers to low nominal interest rates in particular (Eucken, 2004[1952], p. 220). Full employment was one of the key objectives of the UK's 1945–51 Labour government (Labour Party, 1945).

providing information about the most effective use of resources. This ensures a rational organisation of the production process, extensive division of labour and, ultimately, an optimal provision of consumer goods. The latter goal is what Eucken refers to as the ‘real ... purpose of economic policy’ (Eucken, 1989[1948], p. 44).

According to Eucken, full employment policy tends to compromise or disable the control mechanism represented by the price system.²² This basically follows from the definition given above: the measures listed there either directly manipulate the information content of prices (price and foreign exchange controls) or have been linked with the possibility of inflation. Eucken warns that as a result of compromising the price system, labour will not be directed to its most efficient use and the economy will remain below its potential output (ibid.). He cites England as an example of a country where full employment policy currently prevents the price system from working.²³

Eucken’s second objection against full employment policy is even more fundamental. We have already seen that he attributes Germany’s turn towards central economic planning – at least in part – to the expansionary fiscal and monetary policy of the years 1933–1936. As John Jewkes notes in his introduction to *This Unsuccessful Age*, Eucken uses the German case to make a general argument concerning the dangers of full employment policy. In this volume, as well as in the *Grundsätze*, Eucken asserts the following:

Our review of German experience leads us to a grave and serious conclusion. Economic policy is faced with a dilemma: on the one hand, mass unemployment necessitates a full employment policy; on the other, the policy of full employment ... forces economic policy in the direction of central planning. (Eucken, 1951, p. 66)

Here, Eucken introduces a slippery slope argument saying that full employment policy has a tendency to lead to central planning – just as it did in Nazi Germany. The underlying idea is that in order to halt inflationary pressures, politicians will be forced to impose an increasing amount of restrictions on prices and the allocation of goods.²⁴ He goes so far as to claim that

²² Eucken also makes the related point that full employment policy tends to focus on aggregate variables rather than microeconomic factors (Eucken, 1989[1948], p. 45).

²³ To be sure, in the UK, price controls on certain consumption goods were continued long after the war ended (Zweiniger-Bargielowska, 2000, pp. 45–59).

²⁴ Based on Jewkes’ description of Eucken’s argument, the alleged sequence of events is as follows: high unemployment → expansionary fiscal and monetary policy → inflation → price controls → state allocation of goods (including rationing of imports) → central planning and totalitarianism (Jewkes, 1951, pp. 10–11).

this tendency constitutes ‘*perhaps the most crucial economic and social problem of our time*’ (ibid.).

How can this problem be solved? Eucken argues that the solution lies in a new style of economic policy that does not try to manage business cycle fluctuations but to improve the overall framework in which economic activity take place (ibid., p. 94). He refers to this new style of economic policy as ‘ordoliberal policy’ (*Ordnungspolitik*). It can be distinguished from interventionist policy-making (*Prozesspolitik*).²⁵ In the *Grundsätze*, Eucken proposes a specific framework of rules for a market economy that is both efficient and respectful of individual freedom. This ‘competitive order’ is based on a number of constitutive principles, the most important of which is the functioning of the price system. Other principles include a stable currency, open markets, personal liability and anti-monopoly legislation (for an overview, see Sally, 1996, pp. 238–40). Eucken seems confident that a market economy based on these principles will render business cycle policy largely obsolete.²⁶ Thus, the issue of unemployment should be dealt with indirectly by improving the coordination function of markets.

4. Toward a More Nuanced View of the Relationship between Ordoliberalism and Keynesian Economics

The preceding discussion sheds some light on the relation between the macroeconomics of Eucken and Keynes. The first topic addressed was Eucken’s endorsement of the 1931 Lautenbach plan. Conceived at the height of the Great Depression, this plan was precisely the kind of active demand policy that ordoliberalism – according to its modern-day critics – opposes.²⁷

Why did Eucken support the Lautenbach plan? As described by Klausinger (1999), the theoretical basis of Lautenbach’s proposal is the distinction between two types of depression, one that is part of the regular movement of the business cycle and a ‘secondary’ type that serves no economic purpose while sending the economy into a tailspin (ibid., pp. 382–85). In a similar manner, Eucken’s decision to support the Lautenbach plan must be seen as a concession to the exceptional severity of the crisis. Both Lautenbach and Eucken view the market system generally as stable. They acknowledge, however, the possibility of coordination failures that

²⁵ On the ordoliberal approach to policy-making, see Vanberg (2004, pp. 7–9).

²⁶ ‘Whether, in the competitive order, additional measures will be necessary to offset business cycle fluctuations? – Probably not’ (Eucken, 2004[1952], p. 311).

²⁷ For example: ‘[Ordoliberalism] rejects the use of expansionary fiscal and monetary policies to stabilise the business cycle in a recession and is, in that sense, anti-Keynesian’ (Dullien and Guérot, 2012, p. 2).

require non-standard policy responses.²⁸ As we have seen, another important factor in Eucken's decision was that he was aware of the political risks associated with letting the recession run its course.

One prerequisite for Eucken to accept the Lautenbach plan was its dual character, i.e. the combination of expansionist elements with measures to increase price and wage flexibility. Eucken's emphasis on the liberalisation of prices is consistent with his later argument that the most important element of a market economy is the functioning of the price system (Eucken, 2004[1952], pp. 254–55). Thus, while Eucken did not give up completely on the neoclassical approach to remedy unemployment, his support of the Lautenbach plan shows that he was not nearly as dogmatic as Bofinger (2016) suggests.

Eucken's response to the crisis appears particularly reasonable when compared to other policy proposals based on the orthodox explanation of unemployment problems. Consider Friedrich Hayek's stance on the (very similar) proposal of the Brauns commission earlier in the same year. He fundamentally opposes the idea of a government-funded stimulus, arguing that:

No temporary emergency measures, but only the adjustment of price relations to the given data can get production off the ground again. No trick can help to avoid the inevitable reduction of wages and the constraint on per-capita consumption of the working population that is necessary to permanently eliminate the capital shortage. (Hayek, 2015[1931], p. 505)

The second topic addressed was Eucken's discussion of full employment policy, which Bofinger says is 'a Keynesian style expansionary fiscal policy' (Bofinger, 2016, p. 13). As we have seen, the definition of the term is much broader. It also includes monetary policy tools, as well as more radical policies such as price and foreign exchange controls. Full employment policy seems to be defined not so much by its individual measures, but by the overarching decision to pursue employment over all other economic policy goals.

It is important to note that Eucken does not necessarily associate full employment policy with Keynes. While he views Keynes as a proponent of this type of policy, he thinks that full employment policy is a strategy of economic policy that has been pursued before, and independently of, the *General Theory*. The historical example which he cites most frequently

²⁸ Eucken references the concept of secondary depression on the first day of the conference (Borchardt and Schötz, 1991, p. 145).

are the expansionary policies of the von Papen, Schleicher and Hitler governments during the early 1930s.

Indeed, Eucken argues that the main idea of full employment policy – that overcoming unemployment is the most important goal of economic policy – can be traced back even further, to the theory of mercantilism. Based on Heckscher (1935), Eucken describes mercantilism as a politico-economic system with the aim to increase production and employment regardless of the implications for consumption. Therefore, '[full employment policy] is a regression to ... mercantilism, to its policy of production for the sake of employment' (Eucken, writing in Gestrich, 1957[1944], pp. 111–12).²⁹

A remarkable aspect of Eucken's critique of full employment policy is his claim that it leads to central planning. As pointed out by Jewkes, empirical evidence does not support this claim, not even in the early 1950s (Jewkes, 1951, pp. 19–25). While Eucken's claim may be indefensible, it was informed by the conviction that the German experience held an important lesson in this regard. This is the political economy style argument that measures to fight unemployment may lead to inflationary pressures that could then prompt politicians to interfere with the free movement of prices. Eucken's motivation to expose this risk is discussed in a letter to Hayek written on 12 March 1946. From this letter, we also learn that it was Hayek's *The Road to Serfdom* – which contains another, more famous slippery slope argument – that inspired Eucken to present his case against full employment policy in the first place.³⁰ Moreover, such slippery slope arguments must be evaluated from the perspective of that time in history when the Cold War was looming and fears that West Germany could get closer to socialism dominated.

So far, we have evaluated Eucken's position on various measures of business cycle policy. In this process, an important difference between the approaches of Eucken and Keynes has possibly not received enough attention. From a Keynesian perspective, there are good reasons why governments should respond to changing economic conditions by intervening in markets. As we have seen, Eucken supported such an intervention during the Great Depression. In general, however, his approach to policy-making is much different. Ordoliberal policy aims to improve the framework of rules in which economic transactions take place. It rejects measures that interfere with these transactions directly (Eucken, 2004[1952], p. 242). For example, price

²⁹ This analogy also provides the basis for a doctoral thesis which Eucken oversaw, entitled 'The economic doctrine of mercantilism and J. M. Keynes' full employment policy – a comparison' (Haas, 1949).

³⁰ The letter is reproduced in Goldschmidt and Hesse (2013, pp. 138–39).

stability – one of the constitutive principles of the competitive order – is a policy rule, while government-set prices are not.

The distinction between ordoliberal and interventionist policy is mirrored, in the Anglo-Saxon context, by the distinction of rules and discretion. According to Kydland and Prescott (1977), in a world of rational economic agents, policymakers can best achieve their objectives by relying on rule-based rather than discretionary economic policy. The reason is that policy rules allow the policymaker to credibly commit to future actions, and the agents to adjust their expectations accordingly. The basic intuition of this argument is also included in Eucken's *Grundsätze*.³¹ Eucken's insistence that economic policy should generally focus on the 'rules of the game' (Eucken, 2004[1952], p. 264) rather than accommodate current circumstances is by far the most important aspect separating him from Keynes.³²

5. Conclusion

Germany's controversial approach to solving the Eurozone crisis has sparked interest in the intellectual foundations of German economic policy, in particular the tradition of ordoliberalism founded by Eucken in the 1930s. One way in which ordoliberalism supposedly influenced German economic thought is by impairing the expansion of Keynesian ideas. Against this background, this paper investigates the relationship between the macroeconomics of Eucken and Keynes.

To summarise our findings, we consider the three main elements of Eucken's macroeconomics as identified by Bofinger, namely price stability, price flexibility and balanced budgets. Remember that these elements motivate his assessment that the macroeconomics of Eucken and Keynes are 'diametrically opposed' to each other.

Price stability undoubtedly occupies an important place in Eucken's thought. The risk of inflation is his most important argument against full employment policy and the reason why he suggests that it may lead to central planning. Still, it should be noted that for Eucken, price

³¹ 'The nervous restlessness of economic policy, often discarding today what was effective yesterday, creates a great measure of uncertainty and prevents ... many investments. What is lacking is an atmosphere of trust' (Eucken, 2004[1952], p. 288).

³² Another important difference between Eucken and Keynes is their theory of interest and capital. Keynes (1936) famously describes the interest rate as determined by the demand for money ('liquidity preference'). Eucken, however, argues that the interest rate ensures the equality of saving and investment. For a comparison, see Lutz (1954).

stability is not an end in itself. In a competitive order, it is subordinate to the goal of maintaining the functioning of the price system, which alone guarantees the efficient allocation of resources and a high level of consumption.

The overarching importance of the price system affects the second element as well. As seen from the discussion of the Lautenbach plan, Eucken advocates flexible prices (and wages) because of their function as a scarcity indicator. While he seems convinced that price flexibility is a necessary condition for the solution of unemployment problems, our paper shows that, in the critical situation of 1931, Eucken no longer considers this condition sufficient.

As for the third element, balanced budgets, it should be noted that Eucken rarely deals with fiscal policy issues at all. The best evidence to corroborate Bofinger's claim comes from one of Eucken's earlier works. In *Kritische Betrachtungen zum deutschen Geldproblem*, he argues that budget deficits lead to inflationary pressure and should therefore be avoided (Eucken, 1923, pp. 78–80). Later, public debt does not play an important role in Eucken's thinking.

When comparing Eucken and Keynes it is important to keep in mind that they take two radically different (if not necessarily incompatible) approaches to economic policy. While the *General Theory* draws our attention to the fact that governments can counteract short-term economic imbalances, Eucken proposes a kind of business cycle policy that does not address current conditions at all. Instead, it focuses on providing a framework of rules that is conducive to the coordination function of markets.

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