

[SUMMARY]

**Economic Order and Depression:  
Four Essays on the Business Cycle Analysis of  
Three Ordoliberal Thinkers:  
Wilhelm Röpke, Walter Eucken and Friedrich A. Lutz**

GRUDEV Lachezar\*

---

\* University of Freiburg i.Br.

My contribution responds to a debate in the European academic area that was summarized by a book, *The Euro and the Battle of Ideas* (2016). The authors Markus Brunnermeier, Harald James and Jean-Pierre Landau claimed to have discovered the inherent reason for the rather “odd” German position during the sovereign debt crisis when this criticized rescue packages due to moral hazard concerns. Critics as e.g., Krugman, 2014; Biebricher and Vogelmann, 2017 saw in the German position the source of unnecessary austerity that exacerbated the crisis in the Eurozone. The authors of the book argued that German policy makers were strongly influenced by the idea of ordoliberalism that put huge emphasis on the relevance of rules defined in general terms and formulated that “the state’s actions should be confined to the enforcement of such general laws” with the aim to achieve competitive order (Brunnermeier, James and Landau 2016, p. 61).

This argument ignited a vast discussion about whether German economic policymaking was really shaped by ordoliberal thinking. This discussion took place in books as *German macro: How It's Different and Why That Matters* (2016), *Ordoliberalism A German Oddity?* (2017) and *The Birth of Austerity: German Ordoliberalism and Contemporary Neoliberalism* (2017). The discussants concentrated their efforts and energies to revitalize the works of Walter Eucken (1891-1950) and his colleagues the jurists Franz Böhm (1895-1977) and Hans Grossmann-Doerth (1894-1944) who were the founders of Freiburg School. Eucken’s students Friedrich A. Lutz (1901-1975) and Leonhard Miksch (1901-1950) also experienced a revival. The discussants did not stop with the Freiburg School. The intellectual legacies of Wilhelm Röpke (1899-1966), Alexander Rüstow (1885-1963) and even Friedrich A. Hayek (1899-1992) occupied papers and books in order to stress the many facets of ordoliberalism.

According to these exegetical works, the yardstick with whose help one can judge whether the German economic policy was “ordoliberal” during the sovereign debt crisis can be constructed

by answering the question whether the rescue packages and thus the government interventions during the sovereign debt crisis would have been endorsed by the main representatives of ordoliberalism. If the research concluded that German economic policy makers acted exactly as Eucken and Röpke did during the Great Depression which exacerbated the severity of Depression, then the intellectual legacy of Freiburg School became subject to harsh criticism and current economists were required to overcome the long shadows of some dead intellectual figures (Bofinger, 2016). In case that authors concluded that actually Germany endorsed rescue packages and debt reconstruction, and thus promoted a policy which was an obvious violation of fiscal rules, then they argued that German economic policy actually took a pragmatic position. Such pragmatic position was also accepted by Eucken and Röpke during the Great Depression which justified the conclusion that ordoliberals were actually pragmatic people and the current German economic policy was compatible with their thinking (Feld, Köhler and Nientiedt, 2015; 2017).

My contribution claims that this is an inadmissible way of treating the intellectual legacy of economists who produced their major works in the context of intellectual tendencies that were dominating the German academic landscape several decades ago. This kind of treatment becomes more peculiar when the reader realizes that the scholars have actually been taking the normative part out of research programs of intellectual figures with the aim to search for an answer to the question whether the long shadows of these intellectual figures still haunt us or not (see Bofinger, 2016; Feld, Köhler and Nientiedt, 2015; 2017), whereas the descriptive (or analytical) parts of the aforementioned research programs remained rather neglected and even completely forgotten. Consequently, if a current student of economics takes any book or paper about the intellectual legacies of Eucken, Lutz, Miksch, Röpke and even Hayek, he would get the impression that these economists concentrated their entire lives and energies on normative issues such as the role of

government in the context of proper functioning of markets and the relevance of rules for stability of economics. If these economists insisted on these normative issues, then the logical question arises how they explained the occurrence and essence of economic phenomena so that rules were so important. I claim that actually the issues about rules and the role of the state should comprise the advanced and even the last chapters of any history of Freiburg School's research program.

My thesis consists of four papers that concentrate on how three ordoliberal economists Wilhelm Röpke (1899-1966), Friedrich A. Lutz (1901-1975) and Walter Eucken (1891-1950) treated the emergence of economic crisis and persistence of depressions during the interwar period. One should bear in mind that during this period German-speaking economists understood under crisis the upper turning between prosperity and depression whereas *depression* denoted the long phase of the whole contraction from the upper turning to the lower turning point (Klausinger, 2014, p. 72). My thesis arrived at the conclusion that representatives of the ordoliberalism did not share the same idea about occurrence of economic crisis and essence of depression. This can be shown with the help of Wilhelm Röpke's and Walter Eucken's writings.

My first paper raised the question in which relationship stood Röpke's early considerations about the boom period with his later concept of secondary depression. In Röpke's eyes, the secondary depression was a result of the failed purification process, reflected by the primary depression. The former exerted disastrous impact not only on the economy, but also the fundamentals of free Western society. Hence, the secondary depression should be combated with all measures available to the government. My paper contributes to Röpke scholarship by establishing the relationship between the primary and secondary depression and elaborating on those factors occurring during the primary depression that could give rise to the secondary one. Although he struggled to precisely demarcate primary and secondary depressions, Röpke hinted that the roots

of the secondary depression should be traced back to structure of the primary depression, which in turn depended on the evolving boom period that had preceded it. This explains why the paper concentrated on Röpke's theory of upswing. My paper arrived at the conclusion that Röpke considered the duration of the monetary induced boom period as relevant for understanding how long the misallocation of resources would take place and thus whether the primary depression would turn out into secondary.

My second paper discusses why Eucken rejected the idea of business cycle theory as a method of explaining the occurrence of economic crisis. The best candidate for understanding Eucken's rejection represents Friedrich A. Lutz's habilitation thesis which was written under Eucken's supervision. The main message of his thesis was his criticism of wave-like movement of capitalism subsequently adopted by the Historical School and Joseph Schumpeter. The cornerstone of Lutz's thesis was his critical discussion of Clément Juglar's "unconditional" observation which provided the statement that depression had always been preceded by prosperity and the former always occurred in periodic manner. Even though Lutz endorsed the first part of the observation that prosperity and depression stood in any relationship, he treated the periodic recurrence of crisis and thus depression as unjustified observation which stood in the context of Marxist idea about predetermined development of capitalism, something, against which Freiburg School's research program was oriented. This observation provided the basis for business cycle research that attempted to 'squeeze' all crises into a general scheme trying to formulate general dynamic laws that can explain this recurrence.

These attempts either ended up mere descriptions which were the cases of Arthur Spiethoff or Gustav Cassel, or pure logical explanation that was the case of Schumpeter who changed a fundamental assumption by introducing a static proprietor whose purpose was to show the internal dynamics of capitalism and thus the

essence of the cycle. These theories failed to contribute to understanding of why crises occur at all and more importantly why economies could experience severe depressions. Lutz asserted that each depression represented a unique historical phenomenon caused by historically given factors whose impact on the economy depended on the institutional framework within which the economy was embedded. Lutz pleaded for construction of models that could show hypothetically how exogenous factors disturbed the equilibrium. The main message of these models was to convey how institutional factors could affect those tendencies that were necessary in order to reestablish the equilibrium. The models were ideal types such as case studies that should examine how a change in the underlying factors could affect the equilibrium. The theoretical propositions deduced from these case studies were fundamental for the theoretical explanation of economic crises.

As we can see, Lutz and Röpke formulated two different views regarding the reasons for severity of depressions: Lutz claimed that institutional factors were responsible for deep downturns, whereas Röpke was looking for endogenous economic factors arising during the boom period that can prolong the primary depression and transform into secondary one. My third paper focuses on Lutz's message that the economist should concentrate on severity of economic depressions rather than proving its periodicity. My third paper established the linkage between Lutz's recommendation and Walter Eucken's construction of ideal types. Lutz described in a very tentative way how these ideal types should be constructed which should identify how institutional factors affected the economic crises. Eucken explicitly focused on the concept of ideal types which were general models of human interactions with the aim to show how the institutional framework affected the results of the interaction. With these models, Eucken intended to provide a solution to a long-standing problem in the social sciences reflected by the conflict between theoretical approach and observed reality which

was crucial for the debate of methods (Methodenstreit) between the Austrian School of Economics and the German Historical School.

With different upswing phases, Eucken attempted to demonstrate the fruitfulness of his concepts of ideal types that constitute economic orders. He aimed to show how the institutional framework affected the interaction among individuals and thus the boom phases preceding the crisis of 1907 and the crisis of 1929. In this vein, he drew the attention of the readers to the role of institutional framework which affected the course of the different depressions and was responsible for the severe Great Depression. At abstract level, Eucken understood economic orders in the context of the impulse-propagation mechanism that Ragnar Frisch developed in his "Propagation Problems and Impulse Problems in Dynamic Economics" (1933) (Stackelberg, 1940, p. 276). The propagation mechanism translated the exogenous shocks into the system according to the mathematical assumptions about this system. In Eucken's view, however, the translation of the shock into the system, i. e. order, depends on the institutional framework because this affects the ability of economic agent to adjust their activity to this shock. This ability depends on the power which the economic agents himself possessed in his price-setting policy or to which the economic agent himself was subject in his decisions regarding the economic activity (e.g., investment policy; employment decision). The theoretical propositions from these models should provide the basis for theoretical explanation of how a given order dominated by specific ideal types would *approximately* readjusts to the equilibrium after outbreak of the crisis. Even though Eucken's model thinking possesses many drawbacks, it contains an important message regarding the incorporation of institutional factors into the coordination mechanism which is fundamental for theoretical explanation of severity of crisis. These are implications which should be considered in future business cycle theory trying to explain the persistence of shocks.

Eucken intended to contribute to the developments of Anglo-Saxon economics with his approach of economic orders and thus to establish an intellectual conversation between the rather isolated Freiburg School and Anglo-Saxon economics whose progress was facilitated by importation of German-speaking economists in the 1930s. But his sudden death did not allow him to popularize his approach and us to conclude whether he would have been successful in his endeavor. My fourth paper focused on whether the Anglo-Saxon economists would have taken Eucken's approach into account when they aimed to discuss macroeconomic phenomena. Lutz's intellectual development represents the best candidate for answering this question. He made a stellar career at Princeton as a monetary theorist, which indicates that he was deeply involved into the developments and intricacies of Anglo-Saxon economics. The latter focused on improving and refining the Marshallian economics which made an increased use of mathematics and stood in contrast to social economics dominating the German-speaking area where economic theory was embedded in the methodological and institutional awareness. In this tradition, Lutz received his economic education before he left his native Germany.

As an assistant professor at Princeton, Lutz attempted to popularize Eucken's ideas. A most conspicuous example provides a discussion evening at the Economic Club at Princeton when Lutz intended to make his colleagues familiar with Eucken's methodological book *Grundlagen der Nationalökonomie* and thus central ideas of Freiburg School. With huge regret, he described in a letter to his teacher "it was impossible for me to convince the participants of the relevance of the issue. I was thoroughly discouraged". In the same letter, he informed his teacher about the failure to find a publisher for a translation of Eucken's book (Lutz to Eucken, 23.07.1940)<sup>1)</sup>. With this paper, I showed that Eucken would not have achieved the expected success from his LSE lectures. The economics of 1950s were already engulfed by the Neoclassical synthesis which was strongly

promoted by mathematical and econometric research whereas any thinking in terms of orders as a probable explanation of severity of depressions was out of question.

With my thesis, I would like to draw the attention to concepts of analysis such as economic order that we, economists, should take into account if we really want to find new ways of how to explain the occurrence and essence of macroeconomic phenomena. This can help us provide solution to these economic problems which are of striking similarity with the problems faced by Hayek, Eucken and his students. History of economics identified that the content and meaning of analytical concepts have been lost, but more importantly these concepts could contain insights that could help us understand the current economic problems. And if we are still on the quest for an answer to Joseph Stiglitz's question "Where modern macroeconomics went wrong?" (2018), then modern macroeconomists should allow historians of economics to explain where exactly modern (macro)economics went wrong.

#### Note

- 1) Walter Eucken Papers, Folder "Friedrich A. Lutz", Thüringer Universitäts- und Landesbibliothek, University of Jena.

#### Archival Collections

- Walter Eucken Papers, Thüringer Universitäts- und Landesbibliothek Jena, University of Jena.

#### References

- Beck, Thorsten and Hans-Helmut Kotz (eds.) (2017), *Ordoliberalism: A German Oddity?* London: CEPR Press.
- Biebricher, Thomas and Frieder Vogelmann. (eds.) (2017), *The Birth of Austerity: German Ordoliberalism and Contemporary Neoliberalism*, London: Rowman & Littlefield.
- Bofinger, Peter (2016), "The German Macroeconomics: The Long Shadow of Walter Eucken," in: Bratsiotis, George and David Cobham (eds.), *German Macro: How It is Different and Why That Matters*,

- European Policy Centre, pp. 8-19.
- Bratsiotis, George and David Cobham. (eds.) (2016), *German Macro: How It's Different and Why That Matters*, European Policy Centre.
- Brunnermeier, Markus, Harold James, and Jean-Pierre Landau (2016), *The Euro and the Battle of Ideas*, Princeton: Princeton University Press.
- Eucken, Walter (1940), *Die Grundlagen der Nationalökonomie*, Jena: Gustav Fischer (in German).
- Frisch, Ragnar (1933), "Propagation Problems and Impulse Problems in Dynamic Economics," in: *Economic Essays in Honour of Gustav Cassel*, London: Allen & Unwin, pp. 171-205.
- Feld, Lars, Ekkehard Köhler and Daniel Nientiedt (2015), "Ordoliberalism, Pragmatism and the Eurozone Crisis: How the German Tradition Shaped Economic Policy in Europe," *European Review of International Studies*, Vol. 2, No. 3, pp. 48-61.
- Feld, Lars, Ekkehard Köhler and Daniel Nientiedt (2017), "The "Dark Ages of German Macroeconomics" and Other Alleged Shortfalls in German Economic Thought," in: Beck, Thorsten and Hans-Helmut Kotz (eds.), *Ordoliberalism: A German Oddity?* London: CEPR Press, pp. 41-51.
- Klausinger, Hansjörg (2014), "Hayek Translated: Some Words of Caution," *History of Economics Review*, Vol. 37, No. 1, pp. 71-83.
- Krugman, Paul (2014), "Ordoarithmic", *New York Times*, October 01, 2014, <https://krugman.blogs.nytimes.com/2014/10/01/ordarithmic/> (accessed July 23, 2021).
- Lutz, Friedrich A (1932), *Das Konjunkturproblem in der Nationalökonomie*, Jena: Gustav Fischer (in German).
- Röpke, Wilhelm (1936), *Crises and Cycles*, London: William Hodge.
- Stackelberg, Heinrich F. v. (1940), "Die Grundlagen der Nationalökonomie. (Bemerkungen zu dem gleichnamigen Buch von Walter Eucken)," *Weltwirtschaftliches Archiv*, Bd. 51, S. 245-286 (in German).
- Stiglitz, Joseph E. (2018), "Where Modern Macroeconomics Went Wrong?" *Oxford Review of Economic Policy*, Vol. 34, No. 1-2, pp. 70-106.