

Essays on Contextual and Cultural Approaches to the  
Economics of Social Policy: A liberal political economy-  
approach to contemporary social problems

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## List of underlying publications

- Fritz, Roland. 2020. “Social Services as impure Public Goods. Ostromian Lessons for their Provision in contemporary Welfare States”. In: Boettke, P., R. Herzberg and B. Kogelman, (eds.): *Exploring the Political Economy & Social Philosophy of Vincent & Elinor Ostrom*, 87-103, Lanham, ML: Rowman & Littlefield.
- Fritz, R., N. Goldschmidt and M. Störring. 2021. “Contextual Liberalism: The Ordoliberal Approach to private Vices and public Benefits”. *Public Choice*, October 2021 Vol. 9, Special Issue: Freiburg and Virginia, <https://link.springer.com/article/10.1007/s11127-021-00879-w>.
- Fritz, R. and R. Novak. Forthcoming. “Order beyond equilibrium: Ludwig Lachmann’s bridging of seemingly irreconcilable traditions”. Forthcoming, *HOPE – History of Political Economy*, June 2022.

## Directory of tables

Illustration 1: the dissemination of ideas according to Hayek

Illustration 2: Social services shifting from public- to allemande good due to rivalry of consumption existing despite societal non-acceptance of exclusion

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# 1. Introduction

The dissertation at hand is an attempt to fruitfully contribute to the interrelation between social policies and informal institutions. It hereby makes use of what was recently described as cultural or contextual approaches to economics and tries to push these two approaches further. In doing this, the dissertation does not chiefly make use of empirical approaches, but instead picks up "forgotten gems" from the history of economic thought and applies them to contemporary problems. The introduction at hand shall a) carve out the common theme in the three papers that form the core of the dissertation, thereby linking "mainline political economy" with the emerging field of contextual economics, b) explain the methodological premises underlying them, c) present the three papers making up the dissertation in a concise fashion, whereby additional intellectual excursion into the field of inquiry are made for some of them and d) draw policy-conclusion from them, which mostly center around taking seriously the existence of informal constraints and stress the importance of economic education for the upkeep of free and prosperous polities.

## 1.1. Common Theme: Welfare state reform & cultural economics

At its core, the papers included in this dissertation deal with the applicability of programs of social policy in liberal political and economic regimes. The dissertation does not so much ask questions about the permissibility of welfare states in liberal conceptions of government, but instead focuses on the effects that social policies might have on the constitution of a polity. With regards to this, the usual favorite variables of economists, such as the cost of doing social policy or its fiscal sustainability in times of demographic change, are neglected in favor of questions about its long-term influence on the values and attitudes prevalent in the societies in question. These "cultural effects" of welfare state policies are described by some commentators as mostly negative, in the sense that they might create "cultures of poverty" (Harrington 1962; Lewis 1966) and subsequently hollow out or undermine the normative basis for a market order (e.g. Murray 1984; Huntington 2006). While theoretical speculations about the precise workings of this process go back to the middle of the 20<sup>th</sup> century, more systematic inquiries of the complex interrelationships are still lacking to this day. This can partly be explained with the "dicey" nature of the research subject as well as with the "tricky" nature of capturing the unfolding processes statistically (Small, Harding, and Lamont 2010).

As such, the dissertation contributes to two distinct trends in economics that have gained considerable traction recently: Applying economic analysis to questions of social policy, as

well as being part of the recent "cultural turn" in the field. In the face of growing worries about the sustainability of contemporary systems of social protection - be it debates about the long-term efficacy of pay-as-you-go pension schemes, rising health care-spending as well as persistent problems with unemployment in some parts of the developed world - the discipline of economics has increasingly been asked for proposals to reform said systems over the past decades. Examples of this are, e.g. the debates about "New Public Management" of the implementation of quasi markets to provide public services, which has been facilitated - with varying degrees of success (cf. van Berkel and van der Aa 2005 or Le Grand 2011) - in many developed economies over the past few decades (Kapucu 2006). It is simply due to the staggering size of most social sectors (Ortiz-Ospina and Roser 2016) that dealing with this oft-neglected segment has gained traction in economics again. However, it is fair to say that - if the topic is studied at all by economists - the focus of their efforts lie chiefly on finding ways to reform existing systems of social policy provision, especially on reducing their cost to taxpayers or governments. The aforementioned efforts in NPM and quasi markets fall chiefly into that category, even though considerations of incentive-setting in order to improve quality were of course also considered in these approaches. However, economic research about welfare states has normally not attempted to answer how differences in social policy systems come about, let alone finding ways of influencing the channels through which differences in national welfare state systems emerge.

This is where the second current that the dissertation "swims" comes in as useful: the recent reintegration of cultural variables into economics. While historically at the center of economic analysis (just think of Adam Smith's carving out of the subject matter of economics from moral philosophy), the "fuzzy" nature of cultural variables did not fit well into the 20th century project of mathemazing and "scientizing" economics and transforming it from a moral science into something more like an exercise in social engineering. This practice has been somewhat revised over the past few decades, with questions about the distinction between "formal" and "informal" rules of the game (North 1991) and culture coming to the forefront once again. No matter whether individual contributors speak of "shared mental models" (Denzau and North 1994), "interpretative filters" (Lavoie 2011) or "dynamic, bi-direction effects" (Salter and Wagner 2018), work about the intersection of things economic and cultural has been on the rise recently. One variable explaining this shift in focus are undoubtedly the experiences of the transitioning economies of Eastern Europe: While the Washington Consensus and its relatively simplistic demands as to how the economies formerly integrated into the Comecon could be transformed into market economies seemed plausible at first, its failure to deliver tangible results in practice

lead to a cultural turn in development economics that later fused into other fields of the profession. One much broader and highly ambitious take on the matter is, e.g., McCloskey's (McCloskey 2007; 2010; 2016) trilogy "The Bourgeois Era", which focuses not on the informal preconditions of catch-up growth in today's developing economies, but instead uses a cultural lense to explain the the "Great Enrichment" of Western Europe and its overseas offshoots in the late 18th and early 19th century. After debunking a host of other common explanations for the rapid economic development of certain parts of the world post 1800 (such as colonialism, exploitation, Weber's "Protestantism-thesis, etc.), McCloskey lays out how a shift in perception and rhetoric about "bourgeois values" should be seen as the most plausible explanation for the explosion in wealth experiences globally over the past 200 years. In line with this "non-economic" explanation of economic events, McCloskey also chooses to prove her point by aid of unorthodox data sources, at least judged by what is commonly used in modern economics: Even though she does not abstain from incorporating data and statistical analyses in her argument, the core of the illustration still rests on a careful tracing of subtle changed in qualitative documents, such as letters, literature and official documents, through which a change in attitudes towards economic activity, can be shown. This new atmosphere, more conducive to business activity, was paramount in triggering the industrial revolution and hence the enrichment of the modern world, McCloskey argues.

However, in recent years this new cultural paradigm has even reached modern econometric approaches: Berggren and Nillson 2016 showing the conducive effects of high trust and tolerance in societies on economic productivity, Alesina et al's (2013) efforts to explain current levels of gender discrimination with recourse to historical farming practices or attempts to demonstrate the cultural determinants of saving rates (Fuchs-Schündeln, Masella, and Paule-Paludkiewicz 2020) or preferences for employment status (Fuchs-Schündeln 2009) all expand upon the traditional notion of what the scope of economics ought to occupy itself with.

The papers included in this dissertation – in some form or another – pick up on this general theme and, while not contributing to the empirical investigation into the phenomena themselves, carve further ground at laying out the various ways in which social policies and cultural norms interact. Given that the papers all employ a strictly theoretical approach and additionally engage in debates in the history of economic thought, as opposed to contributing to contemporary debates, it will be seen as necessary to first lay out the methodological premises that the dissertation follows. The introduction turns to doing this in the next section.

## 1.2. Methodological Stance

While economics does of course aspire to be a positive science and I do not wish to call this desideratum into doubt at all, it still bears notice that the progress of knowledge in economics – viewed as a social science – is of a different nature than the one taking place in the natural sciences. It is assumed that progress in the natural sciences can be described as taking place in a linear fashion, with antiquated and “bad” ideas almost automatically being weeded out in the process of advancing and continually refining research practice. The same principles might not hold for the social or human sciences. It has been documented that “fads” and “fashions” play an indispensably big role, also in economics, on determining what counts as “respectable research” at any given moment in time. This operational model can of course lead to contributions that are valuable in of itself being unjustifiably disregarded, simply because a) their subject matter does not conform to what are seen as the boundaries of a discipline (Streissler 2002) or b) they do not employ the methods that are currently fashionable (Boettke, Coyne, and Leeson 2014, The Economist 2016). Additionally, the entire notion of “progress” in economics can be cast into doubt, necessitating the periodic review and re-interpretation and application of contributions from past ages (Boulding 1971).

With reference to the previous section, the dissertation at hand aims to carve out "forgotten gems" from the history of economic thought, reinterprets the historical debates and attempts to reapply the learnings onto contemporary problems at the intersection of welfare state research, economics and sociology. While – as has been shown – institutional and cultural elements have recently started to be integrated again in economics, it is still not the case that every potentially fruitful path from the past has been trodden down already. Especially the interplay of formal and informal institutions, which holds potential for well-meaning policy reforms that target the molding of formal institutions to be completely ineffective due to an incompatibility with the prevailing informal environment, was strongly debated by the group of economists that the dissertation deals with. Hence additional learnings, inspiration for new research questions or perhaps a shortened route to insights, might accrue from the look to the past undertaken here.

In terms of the aforementioned re-interpretation of historical debates, the papers included in the dissertation employ a reconciliatory approach: by uncovering similarities and continuities between approaches, they counter the common tendency to read the history of thought as one of great upheavals and rapid breaks, where futile traditions are replaced by new ways of

thinking and are oftentimes rendered completely redundant in the process. The history of economic thought viewed in this manner presents itself as a history of discontinuities: Adam Smith's "Wealth of Nations" made the mercantile system obsolete; John Maynard Keynes buried neoclassical thinking by conceiving a new macroeconomics and the Austrian and German Historical Schools rightfully clashed towards the end of the 19<sup>th</sup> century, given that their notions about the respective roles of theory and history in economic thinking were fundamentally irreconcilable. Understandably, it is mostly the thinkers of these new views themselves, as well as their devoted followers, who proclaim this break with old tradition most loudly. From their point of view they are of course absolutely right. And one can indeed say that these new ways of thinking are often revolutionary - especially when judged from the context of the time – and depart from familiar paths of research and teaching.

However, one can tell a different story and it is this approach that the papers in this dissertation follow. Research on the history of thought here becomes research on continuities, connections, tiny steps and different paths of thinking that temporarily converge, but might separate again. It is not speculation about epochal upheavals, but more a careful and small-scale dwelling into connections, overlaps and mutual influences. Thus, the history of economic thought can be best understood as a history of ideas that seeks to include the wider context in which economic thought is developed in its analysis. Hence, historical analysis becomes something that is not limited to one author or a particular work, but where ideas and strands of theory are located and merge in the context of the history of time. This procedural commitment also makes it easier to apply presently unutilized but potentially rewarding residua of historical approaches to contemporary problems, i.e. to the context of our own time. In this endeavor it is not attempted to contrast supposedly opposing schools of thought which each other or additionally fuel (perceived) conflicts, but instead to carve out where economic thinking actually converged, even though the rhetoric of the time would not have their contemporaries see and believe this. Nowhere does this become more apparent in the dissertation than when Ludwig Lachmann's reform program for the Austrian School is uncovered to be partially rooted in the main tenets of the German Historical School. Instead of following the ancestral reflex that two approaches to opposed to each other (at their time) cannot potentially have a lot to say each other, careful reconstructive analysis uncovers that, through the mediation of Lachmann, a significant part of the research practice of contemporary Austrian Economics actually derives from techniques and outlooks originally stemming from German Historicism.

Having briefly introduced the subject area and the methodological tenets of the dissertation and in this context having just mentioned the Austrian School already naturally leads to next section: a brief overview of the approaches of “Mainline-“ and “Contextual” Economics – two recently branded approaches to economics, in both of which the ideas of the Austrian School play a decisively important role.

### 1.3. Mainline Economics & Contextual Economics

Boettke (2012, xvii) defines mainline economics as “a set of positive propositions about social order that were held in common from Adam Smith onward” and differentiates it from “mainstream economics”, which regards as “a sociological concept related to what is currently fashionable among the scientific elite of the profession”. Thus, while mainstream economics is “the dominant economics at any given time” (Boettke, Haeffele-Balch, and Storr 2016a, 3), economists in the mainline “are attempting to address the questions advanced by [Adam] Smith and are working to critically engage and advance the propositions that Smith introduced” (Boettke, Haeffele-Balch, and Storr 2016a, 3). In practice, the authors argue, this pursuit of the mainline approach boils down to three propositions (Boettke, Haeffele-Balch, and Storr 2016a, 4):

- “The existence of limits to the benevolence that individuals can rely on, as well as the cognitive and epistemic limits in negotiating the social world” that this bring with it
- “Formal and informal institutions guiding and directing human activity” as well as the conviction that, under the right circumstances,
- “social cooperation is possible without central direction”.

Carving out this thread of economic thought, its rooting in the ideas of Adam Smith and current applications to contemporary problems is of special interest to this dissertation, given that the economists of the Austrian, Virginia and Bloomington School – the main protagonists of the individual papers that make up the dissertation – can all be classified as falling into the mainline of economics. However, all the papers included in the dissertation have also classified their “protagonists” as employing a “contextual” approach to economics. This strand of economic thinking is – like the mainline – not a recent invention, but has in fact been with the profession, at least to some degree since its founding by Adam Smith. Recent contributions in that field

(e.g. Zweynert, Kolev, and Goldschmidt 2016)<sup>1</sup> have delineated the contextual approach from what is termed “isolating” economics, with the latter referring to an economics that zeroes in solely on the strictly economic processes unfolding on markets. The contextual approach on the other hand is mostly interested in “the relationship between the economic sphere and the wider social system” (Zweynert, Kolev, and Goldschmidt 2016, 2), meaning that it does not focus on concepts such as human rationality or the automatic clearing of markets as a consequence of interaction on markets, but rather seeks to inquire how the environment in which these interactions take place, can alter the outcomes of the decisions taken by the actors. As such it does of course not deny the usefulness of analysis in isolating economics, but simply puts forward its own vision for how economic research can be most fruitfully employed. Another form of context is also taken into consideration by this approach, namely the ever-changing circumstances under which economic thinking – at one point in time and one place – is developed. As such, the protectionist ideas stemming from the (younger) German Historical School in the second half of the 19<sup>th</sup> century can be seen as a quite natural response to the vastly different experiences that these German economists made in a rapidly developing and industrializing society. It is not a coincidence then that contextual approaches to economics have been gaining traction over the past three decades, which multiple systemic changes unfolding such as the fall of the iron curtain, persistent economic and social inequality in developed societies, the rise of China as a global superpower or widespread digitalization transforming the way in which humans interact with one another (Zweynert, Kolev, and Goldschmidt 2016, 1). In other words: While an isolating economics might have brought more rigor to economics and can clearly claim to be useful in times of relative social and economic stability, the contextual approach may be a more promising device for understanding the problems of our own age.

In many ways, the contextual and mainline approach are "brothers in arms" in the "battle" for a more realistic and relevant discipline of economics. The biggest communality between them is clearly the methodological one. Apart from turning chiefly to the study of institutions and how these shift human incentives, the two approaches have rather particular convictions about how these “societal signposts” ought to be researched in the best possible manner. While Boettke, Haeffele-Balch, and Storr (2016b, 252) explicitly invoke Gilbert Ryle’s (Ryle [1968] 1996) distinction between a twitch and a wink only being accessible via the use of “thick

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<sup>1</sup> It bears noting at this point that there are a number of competing and at times differing conceptions of what the contextual approach entails, e.g. Goodwin 2010, as well as Goodwin et al. 2013 and 2014.

descriptions” (as opposed to the “thin” ones commonly used in economics) that uncover the hidden meaning actors subscribe to their action (Geertz 1973), the current approaches in contextual economics also explicitly link the aims of their approach to the one of anthropology. Consider Zweynert, Kolev, and Goldschmidt (2016, 10) on the matter:

“As in anthropology, contextual economics is sensitive to the specificity of cases. It is interested in thick description, but it is also committed to comparison with the aim of both a better understanding of the singular cases and the arrival at contextual generalizations, typologies, or grounded theories that apply to several or all the studied cases. The contextual approach is also theory-driven, but it is more pragmatic and less focused on equilibria than on processes of change and transformation. Ultimately, it is the problem at hand that determines what methods are appropriate and what ultimately counts as useful generalizations or insights. High-level formal theory, if it is used, is only ever a tool of analysis, not an end in itself.”

As such, the two approaches here are in fundamental agreement about economics being a social science that ought to be studied with the tools appropriate for uncovering the subjectivity of meanings that motivates actors to do what they are doing. The approaches also largely agree about the contributors and schools of thought included in them. As such, the mainline approach subsumes the Austrian-, Bloomington- and Virginia-Schools of Political Economy, which are central to the three papers making up the dissertation, but also includes, according to Boettke, Haeffele-Balch, and Storr (2016a), the contributions of Ronald Coase, Douglass North and Vernon Smith, though references to the property rights tradition associated with UCLA (Alchian and Demsetz 1972), the economics of governance á la Oliver Williamson and a broader set of approaches stemming from New Institutional Economics are also made. In additional research on the topic, and with a somewhat broader underlying definition, further linkages with the ORDO school (cf. Aligica, Lewis, and Storr 2017) and can be established. Many of these contributors (most predominantly Hayek of the Austrian School, but also Walter Eucken’s ordoliberalism and Douglass North’s institutionalism) also feature very prominently as role models in the emerging contextual literature (Zweynert, Kolev, and Goldschmidt 2016, 11). However, the contextual paradigm seems to have a somewhat broader scope and also claims kinfolk to traditions as diverse as the Chicago School of urban sociology, the German Historical School, the practitioners of the case study-method at Harvard Business School, Herbert Simon as well as Otto Neurath’s conception of a “situated social science” (Zweynert,



Kolev, and Goldschmidt 2016, 11), thereby clearly widening the amount of reference points available for the approach.

It is at this point that we, despite the numerous overlaps, become aware of some slight differences between the two approaches. Those pertain mostly to the postulates #a and #c as put forward by the theorists of the mainline approach. The “cognitive and epistemic limits” that mainline economics postulates individuals are subjected to when they navigate the social world resonate very strongly also in the contextual approach. It is also the case that the “limits to the benevolence that individuals can rely on” from which these limits supposedly derive is a proposition that most practitioners of the contextual approach will have no problem subscribing to. However, it seems as if most are not comfortable with elevating this regularity to the status of a “postulate” and would instead prefer to investigate the degree to which benevolence can order societal affairs in every individual case. Indeed, the explicit stressing of this postulate on the part of the mainline-contributors can be seen as somewhat puzzling. After all, a thorough devotion to point b) – the primacy of formal *and* informal institutions guiding human behavior – should alert economists to the possibility that the degree of benevolence that individuals navigating the social world can rely on will vary from society to society. Even though it is reasonable to assume that – and here also the contextual approach is thoroughly in line with Adam Smith’s ground-breaking observations from 1776 – societies run completely on principles of benevolence will be hard to find, contextual economics does not find it necessary to postulate that supposed fact right into the premises of its methodological approach, but rather finds it useful to examine differences in the behaviors of members of different societies as it goes along. Similarly, the contextual approach finds it less useful to state that “social cooperation is possible without central direction”. While this is undeniably true (again, F.A. Hayek – who probably stressed this point more strongly than anybody else – is explicitly considered as a main precursor of the contextual approach), contextualism does not conceive it to be necessary to include it as one of its main postulates. It almost seems as if there is a certain “political economy” underlying the mainline tradition, in the sense that the postulates that make up this tradition all easily lend themselves to undergirding classical liberal position on matters of economic policy. Again, economists in the contextual tradition do not, as a rule, generally oppose liberal solutions where they are appropriate, but it is certainly the case that this does not predetermine their research agenda, let alone suggest which conclusion they might draw from said research.

One can – and definitely should – also stress the many areas of overlap between the two approaches compared here. After all, the dissertation takes three approaches associated with the mainline and carves out in which sense the protagonists of the various papers clearly also employed a contextual approach. However, it seems that the contextual approach to economics has less of an “ax to grind” than the mainline approach, is more inclusive to contributors who are not associated with classical liberal approaches and is – perhaps as a result of what has been stated above – more interested in genuinely “understanding” the interrelations between the economy and other societal subsystems, without having to stress any particular postulates in the process.

One aspect that both contextual and mainline economics can agree on is that three particular schools of thought – namely the Austrian-, Virginia- and Bloomington Schools of Political Economy, could all be subsumed as falling in their respective approaches. Given the recently undertaken “mélange” of these three schools thought at George Mason University, and the successful application of a combination of these research traditions on a host of areas of rather diverse areas applied political economy (e.g. Boettke and Snow (2014) on Public Choice, Boettke, Coyne, and Leeson (2008) on development economics and Boettke and Coyne (2011) on monetary theory), the three papers making up this dissertation each deal with a contributor of one school of thought, thereby attempting to apply the methods of practitioners of both mainline and contextual economics onto the problem set of the interrelationship of culture and welfare state research. The introduction now turns to a short summary of the three papers composing it, and will – after having provided this – come back with takeaways for the practice of economics as well as for economic policy making.

## 1.4. Summaries of the the individual papers

### *1.4.1. Ludwig Lachmann’s take on finding order beyond equilibrium*

The first paper explores the fascinating evolution of Ludwig Lachmann’s economic thought. While he started out as a convinced equilibrium-theorist in the 1930s, his worries about the proper integration of (potentially) diverging expectations in equilibrium analysis gradually led him to doubt the necessarily coordinating functions of goods markets altogether. Over the further course of his career however, Lachmann came to take his doubts much further still: by the 1970s his preoccupation cannot be described as lying with equilibrium at all anymore,

choosing to focus much more on broader societal order instead. However, the paper also carves out how Lachmann's particular outlook on economic interactions, rooted in the diversity and subjectivity of human wants, interpretations and capabilities, leads to an institutional economics that takes seriously the possibility for social discoordination, sclerosis and institutional failure. By introducing Lachmann's concept of a "neutral institution"<sup>2</sup> from two less well known (and untranslated) German-language papers of Lachmann (1937; 1963), his intellectual "wrestling" at the borderlands between economics and other social sciences, and his gradual shift to the latter category, can be neatly illustrated. Additionally, the paper offers lessons for the self understanding of contemporary economists in the Austrian tradition: The paper also demonstrates how Lachmann's outlook on institutional evolution is actually deeply rooted in the methods as well as the research interests of the German Historical School. Picking up on his socialization in the aftermath of Max Weber's time of main activity and his education under Werner Sombart, Lachmann tried to link the openness of the Austrian approach with the GHS' focus on what Eicholz (2017) termed the "variability of thought", meaning a thoroughly deep subjectivism of agents in his economic analysis. Lachmann's analytical lense, which switches over time from price to plan coordination, ultimately effectuated an abandonment of the "pure logic of choice" on his part, to the benefit of a broader, integrated socioeconomic approach to economics. This very particular lens is also what could be seen as forming the glue between his numerous – and at times conflicting – intellectual influences and displays that Lachmann's oeuvre must not be seen as "being all over the place", but instead represents a body of work that enables us to draw sensible connections between seemingly irreconcilable intellectual traditions.

As is clear from the sometimes less than favorable reception of Lachmann in Austrian circles, his implicit linking of AE with elements from the GHS, and the fresh outlook on socio-economic phenomena that this entailed, can be described as a "precarious tightrope act", during which especially the praxeological tradition within AE had severe limitation against the methodological flexibility that Lachmann sought to implant into it. The paper picks up this tension by contrasting Lachmann's (less than favorable) introduction (Lachmann 1978) to the reprint of Ludwig von Mises' 1929 "Theory and History" (Mises 1929) with the much more sympathetic introduction to an even more recent reprint, written by a modern proponent of the

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<sup>2</sup> An institution that once had a clear societal purpose, has since then lost it, but is yet "permitted" to remain in place due to the absence of feedback mechanism or the – erroneous – societal conviction that the institution is indeed still needed. For further explanation and concrete examples from Lachmann's writings, see the relevant passages in chapter two.

praxeological approach to AE. Ultimately then, the paper maintains that this aforementioned “tightrope act” undertaken by Lachmann can indeed be considered as having been successful, having implanted a different understanding of what economics ought to accomplish in modern AE, which has enabled it to flourish by applying the abstract theories of long forgotten Austrian economists to contemporary questions in applied economics. It goes without saying that the GHS-infused approach to AE unfolds its comparative advantage precisely in those problem areas where the subjective interpretations of economic actors play the biggest role, i.e. with questions that pertain to culture.

#### *1.4.2. Ostromian suggestions to view systems of social protection as common pool resources*

The second paper making up the dissertation is the most applied, although it also employs an approach principally rooted in the history of thought. The paper attempts to classify social services – and “goods” “traded” in welfare states more generally – as impure public goods, or common pool resources. Attempts have been made to describe the process of redefining these sorts of services from purely private goods as a shift to public goods, where government intervention attempts to create non-rivalrous and non-excludable properties in social services. The paper argues that this notion is mistaken. While it is granted that social perception of fairness might lead to social services being indeed non-excludable (after all, people that find it acceptable to deny non-payers access to life-saving medical treatments are quite rare in most developed societies), the automatic transformation of these non-excludable areas of economic life into the realm of “public goods” is faulty. In order to demonstrate this, the paper goes on to show how in “markets” for social services rivalry of consumption still leads to exclusion of some (potential) consumers, even though the exclusion is not permitted to be undertaken along the lines of the willingness to pay on the part of prospective consumers. The paper documents how it instead is nonprice rationing mechanisms that take over in those situations, such as exploiting connections to jump queues for necessary surgeries, or the provision of goods and services demanded completely shifting to the informal economy. In some cases, such as childcare service or long term home care in many western societies, it is not even these alternative rationing mechanism that cast doubts on the “public goods argument”, but even more so the demonstrated inability of supply to provide the necessary quantity of output for the simple reason that not enough qualified labor is available to do so. Thus, what ends up happening in the market for social services is a shifting from the desired status of the care service as “public good” to a “common pool resource”, or an impure public good, which – despite being non-excludable, is still plagued with the criterion of rivalry. The remainder of the

paper then goes on to apply Elinor Ostrom's "design principles" for the sustainable use of common pool resources to the case of social service provision, the goal being to create a solution for the "samaritan's dilemma" prevalent in this particular solution. Ostrom's great contribution to a better understanding of this type of good consists in having shown that the conclusions drawn from theoretical models about their optimal provision are oftentimes quite inadequate. Whether we are talking about the tragedy of the commons, the prisoner's dilemma, or Mancur Olson's logic of collective action – reality, Ostrom found, is always a bit more complicated. While authors who approached the problem theoretically were often only able to see two possible solutions to the tragedy of the commons (either privatization or nationalization / state control / regulation), the Ostromian approach sees a multitude of potential alternatives here. In the course of her many years of research on real commons around the world (including grazing pastures in the Swiss mountains, groundwater reservoirs in southern California or irrigation systems in Indonesia, Spain and Turkey), Ostrom found that these do not necessarily have to be affected by overuse - it simply depends on the institutional design and the observance of some rules so that commons can be managed sustainably.

After having introduced the Ostromian approach to preventing overuse in traditional common pool resources, the paper then provides a careful definition of the actual common pool resource in question. In turn, it turns to examining which Ostromian design principles are most likely to be fulfilled in contemporary welfare states, and which ones would seem to need most reform/care in order to enable the sustainable use of this precious common pool resource. As such, the a) setting of boundaries of welfare states and b) the congruence between appropriation rules and the polity subjected to those are seen as largely being fulfilled. Instead, the areas most in need of reform are judged to be c) the possibility to withdraw from existing provision systems and correspondingly obtain rights to self-organize certain aspects of care services, d) participation in the setup of the rules and recurring conflict resolution mechanisms as well as the e) ineffective ways of monitoring and sanctioning-devices available to the administrators of welfare states. Especially the last two points once more explicitly link to the general theme of the dissertation: the difficulty of enforcing formal constraints if the informal norms in a society do not support them, as well as pounding on the importance of having the populace – ultimately the addressees of any sort of governmental social policy – take an active part in the underlying decision processes as much as possible. While the paper does not, most probably to the great disappointment of the Ostroms themselves (if they were still around), offer concrete advice on how to modify social policies as a consequence of this, it does lay out how the Ostroms' take on policy making could be transferred onto the particular questions of the welfare state and

connects their approach to the idea of a “participatory welfare state” (e.g. Delsen 2016). This conclusion can, even though expanding the scope of governmental activity somewhat, generally be seen as being thoroughly in line with Ostroms conception of liberalism, which is not based on doctrinaire natural law arguments, but instead on the insight that people often find the best solutions to their own problems themselves. The state, whose acceptance of self-governing mechanisms is immensely important and which in individual cases may be able to improve the coordination of human actions with small assistance, is nevertheless in most cases an inconceivably unsuitable vehicle to promote human self-organization and to protect commons from overuse. Most problematic is the tendency of governments to develop template solutions and apply them without prior adaptation to local conditions (geographical, political or cultural). Since this refusal to let local people find their own solutions to social and environmental problems is unfortunately all too common in reality (Ostrom [1990] 2017), Ostrom has been more than critical overall of much of what some governments have implemented (Ostrom 2010). This again would seem to suggest that more participatory forms of welfare states might have been more to her liking.

In this context, the particular liberalism of Elinor Ostrom shall receive some more further attention. Especially in connection with the works of her husband Vincent, Ostrom's system of thought results in an extremely strong plea for a liberally structured and highly federal state system in which citizen participation and self-government play an important role. A central point with regards to this is the insight that a free society will not exist without active citizen participation and a certain tradition of or appreciation for liberal institutions. Thus, in addition to - as the Ostroms also liked to do, speaking with Alexis de Tocqueville - the "habits of the mind," the liberal must also insure that the "habits of the heart" (de Tocqueville 2002), the cultural underpinnings of a community or society, are compatible with liberal principles. At the policy level, the Ostromian notion of polycentricity (Ostrom 1999a, Ostrom 1999b) is relevant here, recognizing that state institutions need by no means always be oversized, bureaucratic and impersonal entities – in Vincent Ostroms' terminology: “Gargantua” (Ostrom, Tiebout and Warren 1961: 831), but that state structures can also be redesigned in such a way that there are several centers within them endowed with decision-making power, or that there are competitive structures between individual units, which the Ostroms hope will lead to better results in the provision of public services. In this sense, Elinor Ostrom can also be seen as an important pioneer of quasi-markets and public-private partnerships (Ostrom and Ostrom 1977).

### *1.4.3. Ordoliberalism, the Virginia School and a truly “Cultural” Constitutional Political Economy*

The third paper that makes up the dissertation employs, again, mostly a history of thought-approach and establishes novel links between the Virginia School, one of our three approaches to mainline political economy, and the Freiburg School. The paper first carves out the peculiarities of the ordoliberal approach to liberalism, describing it as a “contextual” liberalism, which gets its philosophical underpinnings not from the “usual” liberal sources (property rights, self-determination, etc.), but is instead rooted in the practical experiences with the lack of freedom of its proponents during the times of the Third Reich. The contextual nature of the Freiburg School, and Ordoliberalism more generally, is carved out in a twofold way: Firstly, it “requires the presence of public benefits in terms of a societal order *ex ante* so that individual action can be assumed to function in a desirable way”, thereby “invert(ing) the perspective of classical liberalism” into the direction of embedding the individual in its social context. Secondly, and somewhat connectedly, this ordoliberal particularity leads its representatives to “extend their economic analysis far beyond ‘economics proper’” and right into “what can be called the (societal) environment in which economic activity takes place”. It is with reference to this second meaning of the term “contextual” that the paper establishes links with the Virginia School that are of considerable interest for the dissertation at large. While ordoliberalism is often portrayed as a specifically German variant of liberalism that – as has been shown – gets its convictions from very different sources than most Anglo-Saxon approaches to liberalism, it is not the case that this way of reasoning is not found anywhere else. As the paper demonstrates, this contextual way of thinking about the ordering processes in society, and the realization that the context in which economic actions are performed is actually more crucial than these processes themselves, is also at the heart of “Virginia-style” political economy. This is illustrated by the example of James M. Buchanan, whose conception of Constitutional Political Economy (CPE) is reinterpreted as actually being a Contextual Constitutional Political Economy (CCPE). Besides showing how Buchanan’s concern for citizens being able to effectively congregate to devise the rules that they want to subject themselves to depends on the presence of an effective moral order (Buchanan 1981), the paper also offers tentative solutions for some perceived puzzles in Buchanan’s CPE.

One of these is his take on anarchism. While Buchanan was very clear in his rejection of the feasibility of anarchistic political structures and directed some quite considerable efforts at debunking theories of social organization that saw as viable a complete self-organization of

social orders, he nevertheless maintained that anarchy was a legitimate goal (at least as a an analytical starting point) (Buchanan [1975] 2000) and maintained that "when it comes to philosophical matters I am something close to an anarchist" (Horn 2009, 127). This apparent contradiction has been the source of a wide-ranging debate. However, we suggest that much of the debate loses relevance if one considers how Buchanan envisions social cooperation under conditions of a universally adhered to moral order:

"In the extreme case where, literally, all persons behave in accordance with the rules of moral order, there would be no need for government at all. 'Orderly anarchy' would be produced by the universalized adherence to rules of mutual respect among persons."  
(Buchanan 1981, 191)

The crucial role of a functional moral order in facilitating something close to anarchy helps explain the ambivalent position Buchanan took towards the subject. While anarchy certainly is not a feasible policy choice under contemporary conditions, Buchanan at least played with the thought that – at some point in the distant future – human behavior might correspond so much to the requisites of a perfect moral order that the state indeed "withers away".

The paper also sheds light on the somewhat antiquated debate about the tension between construction vs. evolution in Buchanan (Runst and Wagner 2011, Boettke and Lemke 2018). Buchanan's references to Hayek's *Law, Legislation & Liberty* are plentiful throughout his later works, and he wrestled a lot with the relationship between construction and evolution (e.g. Buchanan [1977] 2001). While Buchanan's focus always remained on humanity's constructive abilities, understanding his constitutional efforts as partially also as a cultural/contextual project, as distinct from a merely political one, opens up possibilities for a more nuanced reading of the debate. It has been argued that Buchanan's notion of a "moral order" fully corresponds to Hayek's idea of a "great society/extended order" (Gaus 2018). Bearing in mind Hayek's conclusion that humans have to learn how to live in "two different worlds" and balance the demands of an extended order with the instinctual devotion to small groups and the family, carving out the cultural preconditions of a functional moral order actually seems to diminish the distance between Buchanan's and Hayek's approach. The issues raised in the paper clearly place some doubt on Buchanan's self-styled characterization as a "constructivist".

The third research area to which the paper might offer conclusions is the broad field institutional/cultural/contextual economics. Research attempting to understand informal rules/constraints in societies and stating their effects on economic outcomes has certainly



gained traction within institutional economics recently. However, while reform of formal constraints is a widely discussed topic, institutional reform is seldom extended to pertaining also to informal institutions. Demonstrating how even an approach usually deemed as one solely focusing on changes in the formal, political arena strongly rests on influencing moral values and cultural convictions further demonstrates the necessity to think about the possibility to mould informal constraints and the role of institutional economics in informing that process. Realizing that affecting the desired changes in the moral order of a society might be much trickier and less predictable than simply changing formal constraints, we will pick up some potential ways to do so towards the end of the last section of the introduction, to which we shall now turn.

## 1.5. (Policy) Conclusions – Bringing it all back together

Having introduced common themes, methodology and now also the content of the three papers featured in the dissertation, it remains to show what conclusion can be drawn from their findings. In this, I will first focus on conclusions for the practice of the history of economic thought and then some general reflections about the approach to economics that the subjects of the dissertation practiced. Only then will I endeavor to make sense of the policy conclusion that “my economists” pronounced, trying to determine whether the “moderate, humble and humane liberalism” that they all stood for can be applied to contemporary problems in the economics of social policy. With respect to this, the integration of the promotion of economic education/understanding on the part of the general population will get a separate mention, given that all contributors saw public opinion, which is of course shaped by the public’s thinking on all matters economic, as a dangerously neglected piece in the puzzle that is the upkeep of a free and prosperous society.

### *1.5.1. New understanding of debates in the history of economic thought*

In terms of aspects purely related to the history of economic thought, the dissertation strikes conciliatory notes and pleads for a more sober re-interpretation of some historical episodes. As was shown in paper #3, ordoliberalism’s self-styled delimitation from the German Historical School must largely be seen as either a misinterpretation or a conscious ploy to mask the manifold similarities and areas of overlap (or – as the paper refers to them – continuities) between these approaches. Additionally, paper #1 locates some of the most defining influences

on Ludwig Lachmann as not coming from the Austrian School, but rather directly out of the methodological toolkit of the GHS, to which he was exposed to while a graduate student with Walter Sombart in Berlin. Moreover, the paper even argues that many of the fruits of this Lachmannian “tightrope act” to bridge these supposedly antagonistic schools of thought have actually been carried deep into the practice of modern Austrian Economics, especially into the approach practiced at George Mason University. As such, the dissertation urges the history of economic thought not only to trace developments, ideas and people, but also to uncover previously hidden or neglected connections between contributors to the discussions in economics. Furthermore, the connection uncovered in the papers suggest that economists placing themselves in the classical liberal tradition ought to be more willing to recognize that their own approaches might not be that different from the ones of economists not sharing their own ideological convictions. As such it is no surprise that all authors covered in the dissertation were principally willing to throw their potential preconceived notions overboard and – so to speak – “let the data speak for itself”. This clearly is most pronounced in the case of Elinor Ostrom, who repeatedly stressed the non-ideological character of her research and who was especially unwilling to let her work be used for political purposes (Ostrom 2010, Tarko 2017). But also the side of Ludwig Lachmann portrayed in this dissertation displays the eclectic character of the approach that he chose to bring to the table of socio-economic analysis. Even though he was principally committed to the Austrian School of Economics, heavily influenced by Carl Menger as well Ludwig von Mises and especially Friedrich Hayek and devoted a lot of his energies to advancing the “Austrian” research program, he nevertheless would not let himself get captured by some of the more “fundamentalist” currents in that approach. Instead, he left open doors to incorporating the insights of other approaches to the discipline and fruitfully combined the ideas of thinkers as diverse as George Shackle, Werner Sombart, Ludwig von Mises and John Hicks in his own writing. Additionally, he moaned that economists were far too reluctant to venture out in the real world to test their theories, a practice that he very much would have liked to see changed and argued for in such a prosaic manner so that I cannot possibly outdo him in that:

“Economists, not unnaturally, prefer to do their field-work in a pleasant green valley where the population register is exhaustive and everybody known to live on either the right or the left side of an equation. Only on rare occasions-and scarcely ever of their own free will-do they embark on excursions into the rough uplands of the World of Change to chart the country and to record the folkways of its savage inhabitants; whence they return with grim tales of horror and frustration.” (Lachmann 1943a, 70)

Even though Lachmann heavily self-identified with the liberal creed, he put the meticulous research of how market forces operate in the real world before ideological musings and clearly instructed those who would like to “defend markets” (as a policy-tool) to first carefully study their workings in every concrete example:

“They will have to emphasize the range and variety of markets and their modes of operation. In each market a different balance of forces can be found, co-ordinating and disco-ordinating, and each such balance will certainly tilt over time. A balanced assessment of the strengths and shortcomings of market forces calls for exactly such a perspective and entails a flexible strategy.”(Lachmann 1988, 274f.)

This displays yet again that it is not the “defense of markets” (as a policy tool) that is the primary aim, but instead a thorough understanding of how market forces operate that Lachmann aimed to attain. Even for pundits who only aimed at promoting the use of markets for ideological reasons, being aware of their strengths as well as the shortcomings is likely to strengthen their case, Lachmann thought.

The synthesis between the Virginia School and German ordoliberalism undertaken in chapter four of the dissertation also highlights similar dynamics. Orderliberalism’s undogmatic, pragmatic approach to liberal economic policy-making is of course well-established (Kolev, Goldschmidt, and Hesse 2019).<sup>3</sup> This also explains how a school of thought often associated with liberal political ideology managed to remain the dominant influence on German economic policy over the past seven decades. In this, ordoliberalism was usually seen as distinct form or interpretation of liberalism, whose unusually high weight placed on what lies “beyond supply and demand” (Röpke [1958] 2009) have little to do with the more straight-forward Anglo-Saxon approaches. Also with respect to this, the analysis provided in the dissertation at hand has displayed that the contrasts between this German-Anglo-Saxon divide had been greatly overstated in the past: Many of the elements that the ordoliberals saw as being “a thousand times more important than the market itself”, i.e. the “borders of the market” (Rüstow 1961, 68) and that consequently shape the evolution of societies, are actually also present in the

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<sup>3</sup> Though it has to be mentioned that in recent years it has become a common pastime to blame ordoliberal ideas for Germany’s uncompromising role during the Eurozone Crisis and similar episodes in recent economic history (Bierbricher 2013, Blyth 2015). Useful insights settings some of these interpretations straight can be found in Dold and Krieger (2021).

“Anglo-Saxon” Virginia approach. As such, the dissertation carves out continuities over supposed discontinuities and contrasts also between these two approaches.

### *1.5.2. Economics is not enough*

One additional linking element between the main protagonists is that all of them viewed the economic approach alone as being insufficient to successfully tackle humanity’s most pressing problems. Rather than zeroing in on the a-contextual, isolating approach of the “pure logic of choice”, Ostrom, Lachmann and Buchanan all enriched their economic analysis with insights from other social sciences.<sup>4</sup> As has been shown above, this is not a distinct feature of these three specific persons, but should rather be seen as a common practice in the three school of thought that the authors belong to – and indeed a core feature of the contextual approach to economics altogether. Especially when it comes to the methods employed (Goldschmidt and Remmele 2005), as well as to the overall methodological underpinnings of a contextual take on economics (Goldschmidt 2006), borders between scientific disciplines – usually thought to be quite inflexible by most economists – become rather murky.

Nowhere is this clearer than in the case of Elinor Ostrom. During her life-long quest to understand the determinants of successful maintenance of common pool resources, she had to abandon the classical tools and techniques that economics employed at the time almost by necessity. The problem was much rather how to adapt research methods to the diverse and at times completely unfamiliar areas of geographic limitation or social life. However, her empirically grounded research approach was perfected in a number of studies on public sector organizations in the United States: her research on police department effectiveness, in the course of which Ostrom actually sat in the back of police cars for weeks at a time to better understand officer behavior and interaction with the public (Ostrom, Parks, and Whitaker 1973, Ostrom and Whitaker 1973, Boettke, Palagashvili, and Lemke 2013).<sup>5</sup> More than anything else,

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<sup>4</sup> This should be least surprising for Elinor Ostrom, who’s background originally lay in political science rather than economics. However, chapter two also demonstrates in which sense Ludwig Lachmann’s focus shifted over the span of his career from a slightly isolating approach principally rooted in the pure logic of choice to a highly contextual economics that took its most important approach from the discipline of sociology. It has additionally been shown how James Buchanan’s approach was actually not only engaged with infusing the logic of economic theory into what previously been the domain of political science, but much rather drew on insights from a variety of the humanities to expand his more basic points into a much more wide-ranging theory of social cooperation that clearly does not carry many isolating elements anymore.

<sup>5</sup> Interestingly, the results of this research showed that police services are performed satisfactorily precisely when officers know the community in which they perform their duties well and, optimally, reside there

the enormous variety and tremendous creativity of the wealth of methods that Ostrom unleashes on social reality becomes apparent in this example: The Bloomington School's research approach is characterized by the fact that, in addition to conventional quantitative methods, it also employs these unusual qualitative approaches to gain insights from corners of the social fabric that are otherwise difficult to access.

Even though less committed to conducting empirical research himself, James Buchanan – as a representative of the Virginia School – repeatedly affronts mainstream economics by combining it with political science and social philosophy.<sup>6</sup> The last element is particularly important, given that Buchanan – guided by his own liberal, contractual social philosophy, does not only aim to describe the political process with the aid of economic models, but at times endeavors to actively change it by offering proposals for effective rule setting on the constitutional level (Vanberg 2020). Hence, Buchanan does not only exceed disciplinary boundaries, but also combines positive and normative science in a way that was, and is, atypical for the economics profession (Brennan and Buchanan 1981). However, it can certainly be argued that his *mélange* of questions relevant for political science with the methods used by economists opened up a host of new possibilities for economics altogether (Wagner 2017).

With Ostrom and Buchanan mixing the realms of the polity with the one of the economy, the Austrian School – as represented by Lachmann – perhaps employs the broadest approach, given that it most explicitly integrates purely non-material variables into the analysis (Storr 2019, Lavoie 2011). Because of this, Lachmann also takes a less well-trodden path with regard to the methods he considers appropriate for economic analysis: Due to the subjectivity and heterogeneity of the factors that motivate individuals to act, it is also difficult for us to describe this with the help of equations or to record it statistically and, on the basis of this, to make forecasts for future developments (Lachmann 1943b). Rather, the goal must be to understand individual behavior in causal-generic terms and to fathom the subjective motivations that drive a person to act, which would traditionally overlap much more with philosophical, anthropological, or historical research paradigms. The aforementioned overlap with the GHS shows itself here yet again. Nowhere is this more prominent than in the discussion of who the actual addressees of economic knowledge really are. For what reason do economists even venture to create economic knowledge in the first place? Whom do they want to understand

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themselves. The quality of their formal training, on the other hand, played no role here and could even have a negative impact on the development of security and crime in the neighborhood in question.

<sup>6</sup> As Shughart and Tollison (2002, 66) put it: “James M. Buchanan is (...) at least an economics department, a philosophy department, and a political science department combined in one person.”

their argument, and which social circumstances shall change as a result? The coming two sections will carve out how all economists featured in the dissertation saw not necessarily the creation of new economic knowledge as the most crucial path to this, but instead chose to focus on the communication of economic ideas in society. In order to drive this point further, I will provide a more extensive overview of F.A. Hayek's theory of social change, which zeros in on the role of intellectuals – his “secondhand dealers in ideas” (Hayek 1949, 417) and their impact on the transmission of economic ideas. I will ultimately drive the point that economists' efforts in economic education – their conveying of economic knowledge to the public – can be seen as being even more important than their actual contributions to economics. I approach the issue by first introducing the concept of “folk economics” and then discussing Hayek's treatment of overcoming a faulty understanding of economic concepts in the population, before then tying his ideas back to the main protagonists of the dissertation.

### *1.5.3. Folk Economics as a problem to be overcome*

Even though all the economists covered in the dissertation held fairly pronounced views about the policies that governments shall or shall not enact, they generally did not emphasize policy-making and the implementation of formal rules very much. Instead, they all stressed the long-run progression of social change and had more trust in efforts that were designed to activate the slow, but steady forces of social evolution than in fast-paced policy making. A prime tool for activating these forces is of course the promotion of economic understanding in a population with the help of economic education. As we will show in chapter four, even the approach of James Buchanan – usually seen as a straightforward “calculus” of finding consent between reasonable and willing subjects, ultimately rests on the ability of these subjects to produce a shared understanding of the task that they face, as well as their willingness to tolerate potential disagreements in the short run in order to benefit from enhanced cooperation in the long term. In other words, the informal norms of a community are a major predictor of whether this enterprise is likely to yield a satisfying harvest. Buchanan himself saw the dissemination of economic ideas as one of the most important influence factors of whether or not his vision would be likely to pay off or not. As such, he is often reported to have quoted Herbert Spencer (Boettke 2020, 1) on the realization that “alien truths can be implanted upon reluctant minds only through constant iteration”. Hence it is clear that economic education and the didactics of economics could potentially help to build greater understanding for constitutionalism and thus increase the likelihood of it ever making an impact in real-world societies.

In the end, all papers included in the dissertation contribute to the discussion about how economic knowledge – after being produced by professional economists – henceforth influences societal discourse about economic matters, and especially also the political discourse. The humbling (well, for economists themselves) truth on the matter seems to be that economist’s direct influence on policy making is negligible (cf. e.g. Hirschman and Popp 2014). Instead, what seems to be driving the economic policy choices of a society is what can be termed ‘public opinion’ (Wlezien and Soroka 2016), which affords a great deal of importance to what Rubin (2003,147) has termed folk economics, or the "intuitive economics of untrained people" (Rubin 2003,147). Rubin’s original formulation (Rubin 2003) is mostly centered on showing how most people's erroneous belief that humans populate a ‘zero sum-world’ leads to an inappropriate aversion to the market economy, or – as in later formulations – “Emporiophobia (Fear of Markets)” (Rubin 2014 ), that might then over time erode the necessary support for a free market order. A more recent exercise on the matter of folk economics is provided by the sociologist Richard Swedberg (Swedberg 2018), who applies it to the case of the economics behind Donald Trump's 2016 presidential campaign. He finds that "Trump and his voters to a large extent thought in parallel ways on key economic issues" (Swedberg 2018, 24) and that those beliefs "were unorthodox, as compared to standard economics, and so were the views of many of his voters" (Swedberg 2018, 24). These findings seem to suggest that economists should focus a little less on advancing the academic imprint of their work, but instead give some thought about how their ideas are actually interpreted by the ultimate addressees of economic science – the sovereign citizens comprising a polity, or whether they are picked up at all. Asking himself – rhetorically – whether citizens should not have the right to remain in a state of ignorance about economic matters if they wish to do so, Swedberg (2018, 26) argues that there are

"(...) areas where it may be positively harmful to remain ignorant? One of these is clearly politics. If you decide to withdraw to the small world of family and friends, Tocqueville famously argues in *Democracy in America*, and to ignore what is happening in the big world of institutions and politics, it becomes easy for unscrupulous politicians to seize power.”

In other words: It is not the same to believe that the world is flat (a conviction that is demonstratively false, but a person holding it will have comparatively little impact on other people, unless the person is a pilot or a cartographer, as Rubin 2019 repeatedly points out) and that demand curves slope upward, or that economic exchange is mutually detrimental. The two

latter examples actually impose potentially significantly large negative externalities on the other participants in an economy because they are – if held by a large enough portion of the voting population – likely to influence political outcomes and thus the institutional framework of a society. And it is precisely with regards to solving this question that all the authors featured in the dissertation converge on economic education being a tremendously important factor to keep folk economic thinking at bay. The introduction now turns to the relevant discussions and will provide a framework for achieving a better dissemination of economic ideas in the general population.

#### *1.5.4. Economic education against folk economics*

All the authors dealt with in the dissertation share the assessment that a faulty interpretation of economic events on the part of large swaths of the population can lead to detrimental consequences for the prosperity of the society in question. Especially the missing appreciation of the role of economic freedom for the smooth working of markets, and its welfare-enhancing effects, was seen as problematic. Thus, an inadequate amount of economic education in a population can be seen as an informal constraint on the economic interaction in that society. In one way or another, the economists featured here all struggled to find the best way to address the problem and insure an adequate dispersion of sound economic knowledge throughout society. In order to achieve this, they favored a variety of techniques: The Ostrom's work is dedicated to carving out how polycentric systems of governance will usually lead to more informed decisions on the part of participants, who – by being more involved in the actual decision making processes – naturally develop a greater interest in its outcomes. Similarly, the solutions envisioned by the Virginia School also favor greater citizen-participation in the rulemaking-process. As is laid out in chapter four, this desideratum is actually less “formalistic” than often assumed, with Buchanan implicitly stressing the informal underpinnings of the constitution making process quite strongly, even though this had thus far largely been ignored in the literature on the Virginia School. Many members of the Austrian School also recognized the vast power of ideas held by a population and public opinion about all matters economic for influencing policy outcomes in that society. Given the heterogeneity of the school (Yaeger 2011) it is difficult to come up with *one* unified approach on the matter: While, for instance, Ludwig Mises stressed the formidable role of economic research per se and its influence on (more enlightened) policy making specifically (Mises 1949, 872-81), Murray Rothbard attributed the insufficient uptake of economic reasoning to power structures in society and



deliberate misinformation on governments (Rothbard 1990). One can also, especially in the works of Friedrich Hayek, find an elaborate theory of the impact of public opinion on economic outcomes. As chapter two will display, Lachmann largely follows his own teacher Hayek, who certainly was the most eminent proponent of the Austrian School of Economics at the time when Lachmann familiarized himself with that approach. As the section has carved out, Hayek is one of the main influences on Lachmann's institutional theory, which is characterized by insisting on the discoordinating as well as on the coordinating features of the institutional order. Like Hayek, Lachmann also saw the disproportionately large influence of informal constraints on formal economic institutions as problematic and hinted at the potentially detrimental effects of "neutral institutions" undermining the structure of a market economy. He attributed the origins of many of these potentially harmful institutions to an inadequate understanding of the workings and prerequisites of the functioning of markets.

His mentor Hayek himself was very early in realizing that improvements in the economic understanding of the public and the effective influencing of the political and legislative process can and will not come about due to economics proper. This realization, was best described in a 1944 speech to the students-union of the LSE:

*"The economist knows that a single error in his field may do more harm than almost all the sciences taken together can do good - even more, that a mistake in the choice of a social order, quite apart from the immediate effect, may profoundly affect the prospects for generations. Even if he believes that he is himself in possession of the full truth - which he believes less the older he grows - he cannot be sure that it will be used. And he cannot even be sure that his own activities will not produce, because they are mishandled by others, the opposite of what he was aiming at."* (Hayek 1944: 35-36, via Nishibe 2018: 73)

Even though the quote is quite clear on its own, I will use the following pages to dwell deeper in Hayek's thinking on the matter. From then I will square the circle and return to the three main protagonists of the dissertation and lay out how Hayek's approach can be integrated into their own oeuvre. Contrary to how it might sound from the passage quoted above, Hayek's thinking is not rooted in the conviction of a general "powerlessness of economic science", but in his conception of how political outcomes are driven by public opinion instead of economic expertise (Hayek 1949). Given Hayek's life-long concern for a largely free-market order and the conviction that other parameters of freedom will be hard to achieve in unfree economies

(Hayek 1939 as well as Hayek [2004] 2006), advancing understanding for how a market economy operates was naturally an important project of his. In this aim, Hayek was – as he himself saw it – fighting against powerful forces: His ideas about social and cultural evolution – most clearly laid out in Hayek [1982] 1998 – display great awareness for the fact that the prerequisites of a modern market economy (among which are universalism, respect for the rule of law, the willingness to direct conflicts to higher authorities, division of labor and the ability to undertake exchanges over wide geographical distances) did not arise out of humanity’s insights into their beneficial results, but rather as an unplanned process that no one really understood, but which was instead driven by the groups having adopted these value sets faring comparatively better. Hence the understanding of a modern market economy to Hayek was not something that comes naturally, and the values needed to implement one are indeed not at all those that humans were exposed to and internalized through most of their history. Instead, particularism, mistrust towards outsiders and a limited range of interaction (hunter-gatherers typically do not live in groups larger than 150 individuals) were the norm throughout most of mankind’s evolution and still form the basis of humanity’s genetic makeup. As such, living in a modern market economy is, according to Hayek, something that needs to be learned consciously, and also something that asks from humans to learn to live in two separate worlds at the same time. While the logic of the small group can still be lived out to a considerable degree in modern, impersonal societies (solely within the realm of family life and friends for instance), people ought to realize that the same logic cannot possibly apply to the numerous impersonal interactions that people have on a daily basis. Rubin’s account of folk economics (Rubin 2003) offers a similar reason for the persistence of economic ignorance in large parts of the population: "(t)he principles of folk economics evolved when our ancestors lived in environments with small societies (25-150 individuals) and little in the way of specialization, division of labor, capital investment, or economic growth.” Thus, when Rubin (2003, 158) carves out the difference between speech and reading as the former being innate while the latter needs to be learned with conscious effort and consequently defines economic knowledge as falling in the same, non-intuitive category as writing, he is basically stating the increased necessity to convey expert knowledge to people who presently hold a folk-views about economic phenomena, as we have just established to having been also on Hayek’s agenda.<sup>7</sup>

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<sup>7</sup> The linkages between Rubin's theories and Hayek's own efforts should become even clearer when one considers that Rubin's original formulation of the concept explicitly links (Rubin 2003, 157) to Hayek's "The Fatal Conceit" (Hayek [1988] 1992). Rubin's analogy (Rubin 2019, 47) between folk economics and flat-earth thinking, and his conviction that the former is substantially more dangerous than the latter, given that someone holding the erroneous belief that the earth is flat will – in case he is not a pilot – be able to act just fine during most instances

While this line of reasoning is common all over Hayek's oeuvre, he never systematically carves out techniques intended to overcome or alleviate the difficulties associated with this evolutionary mismatch. But we can clearly see that Hayek attempted to go beyond economics proper in order to find suitable ways to communicate economic knowledge to the public, which for shall help build the foundations of a free society.

His concept of “secondhand dealers in ideas” (Hayek 1949, 417) for instance, is one way of addressing the issue of the all too small influence of economists on policy making. In the Hayekian framework, politicians normally follow – within bounds – the opinions most commonly held among the voting population. Thus, the usual focus of economists to directly influence policy making might very well be ill-advised, and their more important task actually lie in understanding how public opinion is formed and how they can get access to channels that influence it. With regards to this, Hayek stresses the role of ideas and the way in which they are interpreted in the societal discourse. “Scholars” and “intellectuals” take the center-stage in that discussion. while scholars actively work to develop new solutions to intellectual problems, it is the role of the intellectuals to pick up on the ideas developed by scholars, interpret and simplify them in order to be able to communicate these original ideas to a wider public, hereby framing the problem at hand according to their own beliefs and predispositions. The term “intellectuals” here does not imply the colloquial “person inclined to study and reflection” (Merriam Webster 2021), but is defined by Hayek as person being able to have a “wide range of subjects on which he can readily talk and write, and a position or habits through which he becomes acquainted with new ideas sooner than those to whom he addresses himself.” (Hayek 1949, 372) The group of people consists of “journalists, teachers, ministers, lecturers, publicists, radio commentators, writers of fiction, cartoonists” (Hayek 1949, 372) as well as artists and members of other professional groups who often come to be respected far outside the field of their actual competence, such as lawyers and doctors. Because of their decisive influence on public opinion, “it is the intellectuals (...) who decide what views and opinions are to reach us, which facts are important enough to be told (...), and in what form and from what angle they are to be presented.” (Hayek 1949, 372f) In all matters that are not the immediate expertise of an

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of everyday life. On the contrary, a citizen immersed in folk economic theories will, through his action as a voter in a democracy, impose costs on his fellow men with his economic ignorance. Again then, economic education comes in as a potential antidote to fixed-pie, zero sum thinking also for Rubin.

Furthermore, keeping in mind Hayek's own preoccupation with "our poisoned language" (Hayek [1988] 1992, 106) and the way in which it shapes the evaluation of certain policies on the part of the electorate, Rubin (2019, 52) also points out that modern standard economics frequently uses language that only goes to strengthen the prejudices that laymen already draw from their folk economics (e.g. overly stressing "competition").

individual, it thus depends for “information and instruction on those who make it their job to keep abreast of opinion.” (Hayek 1949, 372) The dissemination-process of ideas is graphically illustrated in illustration 1, whereby new ideas emanate from scholars at the top of the pyramid and then – but only through the mediation of said intellectuals – move down into the opinion of the general public. It is only from there that ideas finally make their way to being able to influence the political process.

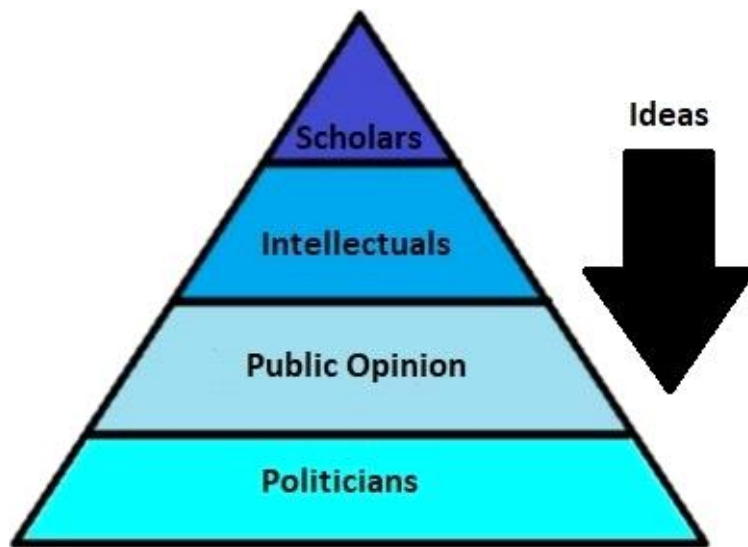


Illustration 1: the dissemination of ideas according to Hayek

The purpose of Hayek’s initial essay was to discuss problems stemming from the fact that most of these overly influential intellectuals would strongly lean towards socialistic political convictions (cf. Hayek 1949, 375f.) – an assessment that we need not necessarily share in order to see value in his general outline of the problem. While two separate interpretations for the furthering of liberal policy solutions<sup>8</sup> can be distilled from Hayek’s original formulation, it is

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<sup>8</sup> Firstly, the more common one, according to which Hayek supposedly urges economists and proponents of a liberal political and economic order alike to not expect the realization of their dreams from entering into politics, but instead asks them to employ their faculties in endeavors that will make the liberal creed more accepted in the general population. This would include the popularization of liberal economic ideas via different forms of art and popular entertainment, such as in the movies. For instance, Ayn Rand’s novels featuring heroes displaying classical liberal convictions have been subsumed under this approach (MyDowell 1982). In some sense, this approach includes the setting up of think tanks and comparable institutions, which is apparently what Hayek had recommended British philanthropist Antony Fisher in a personal conversation as the most viable way to promote the idea of liberty in developed economies, after which Fisher went on to found the London-based Institute for Economic Affairs as a means to achieve that end (Cockett 1996, Muller 1996). Think tanks, it is thought, might be in position to effectively boil down the ideas developed by economic “scholars” so that they can be easily integrated into public opinion, thereby effectively taking the role of Hayek’s intellectuals. Secondly however, one could also interpret Hayek’s take on the matter as an encouragement to thoroughly rethink the ideological foundation of a liberal society and – by focusing on the ideas themselves – fuel the production of economic ideas that will, if you will, “automatically” raise the curiosity of the intellectual class. This interpretation of the path to

clear that Hayek's ideas can contribute to the contemporary discourse on a truly contextual economics.

Firstly, Hayek's take on the matter highlights the important role of often neglected sub-groups for the dissemination of economic ideas. Economists must learn to take the important role of journalists, radio- and tv-commentators and artists in the dissemination of economic ideas into account and not only rely on more traditional forms of passing on economic knowledge, such as having economics taught in schools or informing governmental policy making.

Secondly, and more crucially, economists themselves need to become aware that their scientific insights are not necessarily what ultimately reaches the public as economic knowledge. Before being communicated to non-economists, economic knowledge is filtered, diluted and modified in the hands and minds of the sub-group of intellectuals, who thus have a substantial say in how economic ideas will ultimately be understood and applied. This would seem to call for two behavioral changes on the part of economists: Firstly, what Hayek – referring to the economist's role in shaping the economic order that he inhabits – termed “humility” (Hayek 1979, 7) might also be appropriate in this context: realizing that the insights of one's own research might not at all be what ultimately determines the public's understanding of the subject. The key takeaway for economists from this would be to stress less the need to perform theoretical or applied research in economics, but to inquire more into how economic knowledge – after it is produced – is communicated and distributed in society to make its impact on social and political life. Secondly, this realization also gives clear advice as to how economists should present the findings of their research. If the success of the transfer between economists and non-economists depends on the interpretation of middlemen, it would seem to make sense for economists to actively reduce the need for interpretation of their works by a) presenting their findings in clearer, less complicated fashion and b) actively take part in reaching out to the public about what their work is all about. By doing so, economists would take further steps to lay out a vision for a contextual approach to economics – namely by actively engaging with the ultimate context

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the “liberal Utopia” (Hayek 1949, 237) can also be directly distilled from “The Intellectuals and Socialism”, in which he also explicitly calls for “make[ing] the building of a free society once more an intellectual adventure, a deed of courage. What we lack is (...) a programme which seems neither a mere defense of things as they are nor a diluted kind of socialism, but a truly liberal radicalism which does spare the susceptibilities of the mighty, (...) which is not too severely practical and which does not confine itself to what appears today as politically possible (...) Unless we can make the philosophical foundations of a free society once more a living intellectual issue, and its implementation a task which challenges the ingenuity and imagination of our liveliest minds, the prospects of freedom are indeed dark.” (Hayek 1949, 237) Boettke (2018) has recently carved out how this appeal to thoroughly re-think liberalism on a continuous basis is also a main feature of the Hayekian theory of social change.

under and for which economics is practiced: the sovereign citizens of a free community of equals. The last section of the introduction will now “square the circle” and reflect a bit about the particular interpretation of liberalism that the protagonists of the dissertation espoused, and – in line with Hayek’s theory of social change as just described – which ways of influencing political and social institutions in the direction of their liking.

#### *1.5.5. Moderate, enlightened and socially aware liberalism*

As has been pointed out before, the three papers featured in the dissertation all deal with classical liberal approaches to political economy. Hence it will come as no surprise that the policy conclusions that the authors themselves drew from their own work generally also favored “liberal” solutions to social problems. However, their specific recommendation for policy-making, and even more so, their justifications for a liberal approach to it, vary greatly. This section will briefly review some of the main tenets of the specific embodiment of the three liberalisms examined here and carve out their commonalities as a moderate, enlightened and socially aware liberalism.

For liberals who let themselves be influenced by the work of the Ostroms, this would mean accepting the takeaway that – in the real world – there are only very seldom very simple solutions, and the borders between good and bad, as well as those between the market, the state and civil society, are often blurred. Liberals should - if they do not already do so - base their arguments for a liberal social and political order empirically, identify problems clearly and soberly at the same time and ideally formulate concrete proposals to solve them. From the Ostroms’ point of view, a certain humility in the face of the immense complexity of social reality would be more than appropriate. Hence, their deep understanding of the complexities of all social problems directly leads them to a strict adherence to the principle of moderation in the proposal of policy reforms: The “all or nothing-approach”, which one can often hear from other corners of the “liberal camp” and which sometimes accepts nothing less than the complete abolition of all state activity as an appropriate solution, is very much alien to the Bloomington School. It is much more a matter of carefully researching the social world with a certain dose of self-criticism, issuing recommendations for reform only on the basis of the insights gained and then moving them towards their slow implementation, always with the consent of the population groups concerned waiting.

Consent is also the buzzword one uncovers when trying to distill the policy recommendations put forward by Buchanan's Virginia-approach. Buchanan's contractarian economics is concerned with finding justifications for the existence of the state from a liberal perspective, which he locates in a) governments chiefly acting in their citizens interests and – more importantly – b) them having been formed in response to the demands of the latter. Hence, one could say that the methodological individualism prevalent in Buchanan's economics is complemented by a normative individualism in the application of his insights into policy, which elevates the principle of voluntary consent of the citizenry as the highest principle of legitimization for whether a particular collective action is just or not. The challenge for just policy-making thus becomes on how to find ways to “measure” the degree of (dis-)agreement of the populace with particular policy measures, such as e.g. redistributive elements of welfare states. Buchanan maintained that, in an ideal setting, unanimity would be the only feasible criterion for constitution making, i.e. the act of choosing which rules will structure future decision making on everyday topics in a polity. Even though this desideratum might be considered somewhat unworkable in most societies, the distinction between “choice within rules” and “choice among rules” is still highly illuminating for the policy conclusion to be drawn from Buchanan's thought. Both “The Calculus of Consent” (Buchanan and Tullock [1962] 1999) as well as “The Limits of Liberty” (Buchanan [1975] 2000) explore this question, although from slightly different angles. What unites both takes on the matter is that for Buchanan, societal choice takes place behind a veil of uncertainty, meaning that the individuals agreeing on the – hypothetical – constitution of their future social order have no way of knowing which precise positioning they will be allotted to. This ensures that a social contract is only entered into in order to mutually better the lives of those entering into it, compared to a hypothetical “state of nature”. Two takeaways for the arrangement of an economic order follow from this: Firstly, the “veil of uncertainty”-assumption in Buchanan's conception leads people to preferring sets of institutions that will produce somewhat egalitarian outcomes, or at the very minimum strip away all potential sources of privilege. Secondly, and perhaps more importantly, Buchanan's usage of the conventional economic assumption of basic self-interestedness of human beings necessitates that the social contract, once “signed”, is always vulnerable to being breached by freeriders. This is the point where Buchanan introduces the role of a, at first limited, state to protect the constitutional agreement being destroyed by shortsighted interests of participating individuals. However, he also recognized that the individuals in question might demand services other than the protection of the basic social contract, such as the provision of public goods, which he also found to be possible of being derived contractually from his own

premises. Besides public education financed by taxes, Buchanan also favored a moderate welfare state to decrease economic inequality and increase equal opportunities for all, for which high inheritance taxes were also seen as an adequate measure (Buchanan [1977] 2000). The chief problem for Buchanan then becomes how to “tame” the state (either a minimalistic “nightwatchman” or a public goods-providing “productive” state) from turning into a predatory or potentially even tyrannical “Leviathan”. In order to prevent this, he proposes – in addition to the “cultural” appreciation of liberal institutions carved out in chapter four – a number of constitutional fixes, such as incentive-compatible fiscal rules (Brennan and Buchanan [1980] 2000) or a more rigorous application of federalism (Buchanan 1995). Both proposals can be seen as being “alive and well” in recent politico-economic history, with unequal following of fiscal and constitutional rules being thoroughly discussed as a differentiator between “northern” and “southern” governments during the Eurozone crisis, and “institutional competition” (cf. Wohlgemuth 2007 or Brandi and Wohlgemuth 2006, for instance) often being proposed as a potential fix to governance problems in unions of states as well as in confederacies (Frey and Bohnet 1995).

Compared to the Ostroms and Buchanan, Lachmann remains relatively vague regarding policy recommendations. Even more so: a large part of him felt that, as an economist, offering policy advice should not be his primary task – an aspect in his intellectual edifice (I will explore other aspects of this later) where Max Weber's influence is clearly visible. Lachmann certainly does not offer a comprehensive, closed, liberal edifice of thought, as we know it from Ludwig Mises, for example. Even the economic policy conclusions that can be distilled by conscious effort from his work are not always consistently aimed at reducing state influence. Instead, he put his finger into small, seemingly insignificant wounds in liberal political economy, not seldom urging his fellow economists sympathetic to a liberal economic and political order to rethink their conventional approaches and convictions. Nevertheless, a consistent liberal position, which is primarily aimed at improving the institutional framework of economies, can still be derived from his oeuvre. It mostly helps us to understand what the goal of liberal politics and liberal institutions should be: the enabling of cooperation between individual members of society and its various subgroups. Lachmann shows us how difficult this is actually to achieve and how imperfectly even markets - every liberal's dearest child - operate in the real world.

Summing up, it is easy to see how the three schools of economics featured in the dissertation neatly fit into one coherent, distinct form of liberalism: Firstly, they are all not dogmatic in the sense that they a) do not place opposition to the state as their highest priority and b) also do



make allowances for liberal principles to be (temporarily/conditionally) overturned if particular circumstances necessitate it. This shows itself very strongly, for instance, if one compares the relatively moderate policy conclusion that Lachmann draws from AE when compared to, e.g. Mises or Rothbard. Similarly, the Bloomington School's liberalism would never lend itself to placing any sort of (liberal) dogma over the findings extracted from the real world (in other words: "what works" is to be given priority over what the theorist thinks "will work"), and Buchanan's Virginia School-approach is cognizant of the fact that it is ultimately the sovereign citizens of a polity that get to decide under which rules they want subject their living together. As has been shown further up, these rules do not necessarily have to be the ones that are most consistent with some perfect liberal utopia constructed in an academic's head. These moderated conceptions of liberalism are, in all of the three cases, also accompanied with genuine concern for the welfare of society's weakest members, for whom their works express great empathy and for whose help the liberal solutions they proposed are actually designed. While this cannot be said to be a distinguishing feature of their form of liberalism (after all, a strong conviction for the emancipation of all social classes can be said to have been with liberalism right from its inception, see e.g. Davies 2012 for this point), the accounts of the three schools in question given here certainly demonstrate this tendency most strongly.

However, the perhaps biggest overlap and distinguishing feature between our protagonists is their conviction that – no matter how their specific understanding of the design of a liberal political and economic order looks – it will be impossible to implement it solely with efforts in policymaking. Instead, they were all early practitioners of the recent trend of paying attention to "narratives" (Shiller 2017) or "rhetoric" (McCloskey 1983) in economics, i.e. a growing preoccupation with the processing of social and economic knowledge among the general population, and the resulting ability to sway these perceptions in different directions by presenting the material in a particular way. It has recently been shown how economic outcomes can not only be affected by economists' communication about their ideas, but indeed even more strongly by what laymen think about economic affairs. Exemplary for the discipline are the contributions by McCloskey (2007, 2010, 2016), who argues how the Industrial Revolution and the associated long-term increase in economic output and human wealth are fundamentally related to a change in public attitudes, especially a more positive assessment of entrepreneurship and (self-generated) wealth. Accordingly, her explanation of the enormous increases in wealth since the 18th century is not based on changes in strictly economic factors, but rather on changes in "the habit of the mind" and "the habit of the lip" (de Tocqueville 2002), that is, the way people think and talk about economic and social facts. McCloskey attempts to

illustrate this relationship with, among other things, an analysis of changes in the writing and speaking practices of literates and storytellers, which, she shows, gradually became more permissive of the idea of private property from the beginning of the Industrial Revolution and thus contributed more than any other factor to setting economic development in motion. This also reveals the importance of the way artists and producers of cultural artifacts think about the role of property in an economy: Social facts are not simply passively picked up and received by authors; through their depiction, interpretation, and evaluation of property relations, they also contribute to their shaping and stability. If one follows McCloskey in her findings on linguistic and literary causes of economic development, it is no longer a matter of indifference how, e.g. property rights or the local distribution of incomes or wealth are written about within a language area; future economic development-and thus the most important basis for human progress and social stability-may be threatened by literature that is too critical of property.

Picking up the connection between McCloskey's approach and the one of the economists featured in the dissertation, a brief look of one of McCloskey's most recent contributions – “Why Liberalism works” (McCloskey 2019) – on true liberal values is helpful. There, she argues that “humane liberalism is mainly against ‘policy’” (McCloskey 2019: 8) and thus urges liberals – of course realizing that policy-making, and hence dealing with policy-making on the part of economists is absolutely necessary – to not predominantly focus on that route in order to effect change in their respective societies. The alternative avenue of influencing public opinion might be an especially beneficial enterprise of the characters featured in the dissertation, given that especially their classical liberal leanings have potentially received too little promotion on that front. As McCloskey herself has put it: “The problem for us liberals is that we don't have good songs”<sup>9</sup>, hinting at the fact that the reception of classical liberal ideas in the arts, and thus in an important sphere for its reception on the part of the public, has been miniscule so far. If one contrasts this with the far-reaching treatment that, for instance, socialist utopias have received in artistic works (Egbert 1970), one is tempted to agree with the postulate that more effective influence on the ‘intellectuals’ – Hayek's famous “2<sup>nd</sup> hand dealers in ideas – might provide a more fruitful path to social reform than merely attempting to alter formal laws. This however, is the point where the introduction shall stop and, as a first step, Ludwig Lachmann's wrestling with the forces of economic ignorance and

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<sup>9</sup> Mrs. McCloskey made the following statement in the aftermath of a teaching assignment at the University of Siegen in February 2018 in the presence of the author, remarking that the goal of “us liberals” has to be to rival other strands of political thought in their production of these cultural artifacts. Although I have heard McCloskey make similar statements on a number of occasions, I am unable to find the point elaborated anywhere in print for now.

understanding, as well as their potentially detrimental effects on the institutional structure of societies, shall be explored.

## 2. Order Beyond Equilibrium: Ludwig Lachmann's Ludwig Lachmann's Bridging of Seemingly Irreconcilable Traditions

Throughout his career, the German economist Ludwig M. Lachmann theorized about how economies and societies achieve order within an uncertain world full of heterogeneous agents, heterogeneous production factors, and multilayered subjectivity. This section traces how he began his research agenda by expanding the conventional equilibrium framework of the 1930s to include (potentially diverging) expectations, but gradually abandoned price coordination as the sole source of order in an economy. Instead, he began out to formulate an institutional theory of socially embedded plan coordination, which transcended the traditional division between commerce and community. In this chapter, I illustrate this shift in Lachmann's focus by using two of his neglected German language publications. Additionally, I lay out how Lachmann's effort in the "thinking in orders" tradition was principally rooted in his dissatisfaction with approaches to economics that reduced it to a "pure logic of choice". Lachmann instead conceived of his discipline as being something closer to Max Weber's "socioeconomics", and in this he was strongly influenced by the German Historical School. At the end I try to lay out how, ironically, this tradition which historically positioned itself in stark opposition to the Austrian School, has – through the mediation of Lachmann – taken considerable influence on the recent history of the Austrian School in the US.

### 2.1. Introduction

Lachmann (1906-1990) was somewhat of an outsider among the representatives of the Austrian school (AS). From Carl Menger's 1871 *Principles of Economics* to the 1930s, when Lionel Robbins and Friedrich A. Hayek were building an Austrian-inspired promising department at the London School of Economics, the school gradually went from a position at the very center of the economics profession (Caldwell 1990; Caldwell 2004; Boettke, Coyne, and Newman 2016). A period of near obscurity ensued until Hayek won a Nobel prize in 1974, followed by a modest revival of the AS research program in recent decades (Vaughn 1994; Boettke and Coyne 2015). So why a history of economics paper on a fairly unknown outsider within a school of outsiders? There are at least two distinguishing features of Lachmann's work that make him

intriguing as a figure in the history of economics, a prominent contributor to the Austrian tradition, and as a relevant reference for ongoing research agendas in the vein of the AS.

The first of these features is the highly peculiar intersection of intellectual traditions that Lachmann occupied. He counted himself among the Austrians, but he has also been called the “last member of the German Historical School” (GHS) (Eicholz 2017). This has not been the case merely for the fact he completed his 1930 doctorate in Berlin under Werner Sombart, the head of the youngest generation of the GHS, but also because he was strongly influenced by the “*Verstehende Soziologie*” of Max Weber and the ordoliberalism of Walter Eucken, all of whom can arguably be seen as building – at least to some degree – on the tradition of the GHS (Fritz, Goldschmidt, and Störning 2021; Shionoya 2005).

Lachmann was also Hayek’s closest intellectual ally at LSE during the 1930s and saw himself as continuing Hayek’s research agenda, yet he also acquired a deep familiarity and appreciation for the subjectivist parts of the Keynesian tradition, particularly as captured in the works of John R. Hicks and the Post-Keynesianism of G.L.S Shackle. This seemingly irreconcilable ensemble of influences explains why Lachmann is usually seen as an eccentric character with an unclear (or at least inaccessible) research agenda. Especially his methodological eclecticism, which – as we will show – can be traced back precisely to his early influences in the GHS, has bewildered commentators over the years and relegated his status within AS to one of an “outsider” (Storr 2019, 63). We argue, however, that this wild array of diverse influences can, and is, being put to fruitful use: His ability to reconcile the insights of these seemingly opposing schools of thought demonstrates the usefulness of his peculiar analytic lens. Ironically, as we will show, many of the elements associated with contemporary research practices in the Austrian tradition are directly borrowed from the GHS via the works of Lachmann.

His analytic lens is the second of the features we wish to highlight. Lachmann’s theorizing of economic coordination began by trying to expand the conventional equilibrium framework to include the role played by expectations, and moved gradually to a theory of order beyond equilibrium, as Lachmann broadened his analysis from price coordination to plan coordination, all while acknowledging the role that institutional context and multilayered subjectivism – not merely a subjectivism of wants/preferences, but also of means, expectations, and interpretations – play in plan coordination. In this, he gradually came to abandon the traditional approach to conducting economic research as the “pure logic of choice” and instead ventured to build an integrated socioeconomic approach. This particular analytic lens is what forms the glue between his intellectual influences, making Lachmann’s subjectivism a feature that enables sensible

connections between seemingly irreconcilable intellectual traditions, rather than a nihilistic dead-end that it has sometimes been wrongly portrayed as. But it also occasionally puts him at odds with other, more praxeologically inclined, approaches within the AS.

Lachmann leaves us with an alternative conception of order that does not necessitate equilibrium and an institutional theory that tirelessly calls for investigations not so much into the institutions of society as such, but their interpretation in the minds of its members. In this, Lachmann has opened up completely new avenues for the AS and indeed shaped contemporary research practices in that tradition to a significant degree. Most notable about his approach is the tightrope act between his efforts to successfully contribute to the economic discussion of his time (which entailed advances in theoretical understanding), whilst having been socialized in an environment that promoted gaining insight into the unfolding of real-world processes at the intersection of economics and sociology above anything else. We will begin by revisiting Lachmann's first formative debates on the matter in the Viennese *Zeitschrift für Nationalökonomie*.

## 2.2. Expanding the Notion of Equilibrium

During the 1930s, the *Zeitschrift für Nationalökonomie* (ZfN) represented one of the most vibrant outlets for cutting-edge discussions on subjects of economic theory for German-speaking economists (Klausinger 2015, 287), with Hans Mayer, Friedrich Hayek, Oskar Morgenstern, and Paul Rosenstein-Rodan as frequent contributors, the latter two also serving as long-term editors (Klausinger 2016, 16-18). Furthermore, the journal featured prominent debates about economic coordination with other top-tier contributors such as Oskar Lange or Jan Tinbergen (e.g. Tinbergen 1931; 1936; Lange 1935). Additionally, it served as a “fighting ground” between Hans Mayer and Othmar Spann for supremacy between Spann's “universalism” and Mayer's efforts to keep the legacy of the AS alive, with the latter ultimately succeeding to prevent Spann from being on ZfN's editorial board at its constituting meeting in 1929 (Klausinger 2015, 297). All in all, the ZfN was a highly prestigious journal and was a most promising publication venue for an aspiring economist with an Austrian orientation, and particularly so for one writing on issues of economic coordination. Taking part in this debate was of particular importance for Lachmann who, coming directly from Berlin, perhaps felt the need to emancipate himself from the problems “inherited” from Berlin and the legacy of historicism he had encountered in Werner Sombart's milieu, as we outline in Section 4.

And it is precisely in this medium that Lachmann's lifelong project of explaining how economic order in a society emerges, and of delineating the market process it contains, begins. Our attempt of making sense of Lachmann – a problem that many before us have tackled (e.g. Vaughn 1992; Lewis and Runde 2007; Lewis 2011; Foss and Garzarelli 2007) – is different in the sense that it makes use of two little known contributions in German, specifically Lachmann (1937; 1963), which fill in some perceived gaps in Lachmann's take on markets and institutions, and help us understand the progression of his thought.

We identify the starting point of Lachmann's dealing with the question of expectations and their sufficient integration into economic analysis in Lachmann (1937). "Preiserwartungen und intertemporales Gleichgewicht" or "Price Expectations and Intertemporal Equilibrium", deals with "[...] the doctrine of equilibrium, the core tenet of economic theory" and tries to better integrate the role of expectations into the analysis, "by including the time factor and thereby aligning economic theory more with reality." Having been alerted to the importance of expectations by ZfN's earlier editor Rosenstein-Rodan (Lachmann 1978a, 2), Lachmann thought that without an understanding of expectations, "the further prospects for progress in economic science can be described as rather bleak (Lachmann 1937, 33)",<sup>10</sup> already foreshadowing his conviction that economics, if it wants to have any relevance in the world, should strive to be "realistic". He recognized, however, that the prevalence of expectations that diverge significantly between economic actors can pose grave difficulties for economic theory as such:

A dynamic equilibrium theory, that is, a theory that deals with the changes of equilibrium in time and which describes the process of transition from one equilibrium to the next, apparently becomes impossible, when it is no longer sure that different individuals will react in the same way to the same event. Unfortunately, this is the case as soon as we have expectations to consider. Because no bridge leads from reality to expectations, and a priori nothing can be said in regards to which expectations a certain price movement will give rise to. (Lachmann 1937, 33).

The remainder of Lachmann (1937) then a) shows how market participants can use futures markets to deal with diverging expectations, b) emphasizes what this means for economists, and c) lays out a path for successfully integrating the role of expectations in economic theorizing.

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<sup>10</sup> Unless indicated otherwise, translations from German are mine.

In Lachmann's view, intertemporal markets lead to better aligned expectations about the future because:

[...] everyone can – by buying or selling various futures contracts in an unlimited fashion – express their price expectations in an unrestrained manner, while no one need be concerned with the expectations of others, given that the 'opinion of the market' is objectively and unquestionably represented in the price of futures contracts. (Lachmann 1937, 36).

Realizing that perfect intertemporal markets cannot be assumed in most real-world settings, Lachmann still stressed the somewhat unpredictable nature of future developments in relatively new and not yet well-developed markets (Lachmann 1937, 38), where the notion of equilibrium – and the ability of intertemporal markets to help attain it – must be seen as severely curtailed:

[...] the relative importance of expectations is all the greater the more imperfect the market with regards to intertemporal transactions and the quicker expectations change. It follows that the most difficult problems with expectations are likely to arise where not only there is no intertemporal market, but there is no organized market at all: namely where a new good is created and a market is only just emerging. The question of how new industries can be integrated into the existing production structure without upsetting existing equilibria is therefore one of the most interesting problems of the dynamics of an economy (Lachmann 1937, 45).

Overall, Lachmann's "Preiserwartungen" can be seen as a contribution to a broad German-language debate about the feasibility of economic equilibrium and the necessity of perfect foresight for its attainment. Among the most important authors quoted in the paper is Oskar Morgenstern, whose role as a forerunner of general equilibrium theory is well established (Weintraub 1983; Leonard 2010).

While "Preiserwartungen" clearly calls for an extension of the equilibrium paradigm to also cover the expectations of agents in a more concise way, at this juncture Lachmann does not appear to renounce the idea of a potential market-clearing equilibrium altogether. By 1943, however, he seems to have developed a slightly more "pessimistic" – or shall we say: realistic? – outlook on the potential for market coordination, given subjectively differing and constantly changing expectations, as visible from Lachmann's piece in *Economica*:

In a World of Change no one type of expectation can be relied upon to provide stability. Neither a gullible capital market nor an obstinate one, nor, we may add, any intermediate



variety is in itself a bulwark against crises of every kind [...] To investigate in what conditions what type of expectations is likely to have a stabilizing or destabilizing influence is no doubt one of the next tasks of dynamic theory. We submit that it cannot be successfully tackled unless expectations are made the subject of causal explanation (Lachmann 1943b, 23).

Whereas 1937 in “Preiserwartungen” intermediate markets provided a somewhat predictable force for ensuring (generally sufficient) alignment between potentially conflicting expectations, by 1943 in “The Role of Expectations” it appears that Lachmann grew weary of the claim that these would necessarily act as sufficient vehicles of coordination. We will go on to argue, instead, that just as many other German-speaking economists of his generation, Lachmann shifted from narrow economic problems to broader societal questions throughout the 1930s and into the 1940s. This shift was common among German-speaking economists of the time, notably with Hayek, Walter Eucken and Adolph Löwe, and entailed a re-focusing from (dis)equilibrium issues of the business cycles to theorizing the (dis)order of the economy as embedded in society (Blümle and Goldschmidt 2006a; Dekker 2016). Lachmann’s shift began to appreciate the (dis)coordinating function of the broader institutional order. As we have pointed out, Lachmann’s endeavors in the debate about the role of expectations for the possibility of market clearing can be seen as an effort to emancipate himself from his unwanted heritage in the GHS by shifting into the camp of “pure theory”. As the next section will lay out, this effort ultimately proved to be unsuccessful. Lachmann’s doubts about the feasibility of market clearing voiced in 1943 rise to greater prominence in his institutional theory, where the potentialities for discoordination found in his economic theory become visible to a much larger extent. In section 3 we lay out the taxonomies he employed and the problems in institutional evolution that he described, while we use Section 4 to point out how the influence of the GHS – and specifically the legacy of Max Weber – permeates much of his analysis.

### 2.3. From Equilibrium to Order: Lachmann’s Subjectivist Institutionalism

Despite the complexity and uncertainty of the economic and social world as described by Lachmann, we normally do not observe chaos and disorder in everyday economic life. For Lachmann, it was institutions that render social interactions more predictable and help individuals align their diverging expectations. Thus, “[a]n institution provides means of

orientation to a large number of actors. It enables them to coordinate their actions by means of orientation to a common signpost.” (Lachmann 1970, 49–50).

With respect to this, Lachmann distinguished – when viewing his oeuvre in its totality – between three types of institutions in terms of their relation to the market: external, internal, and neutral institutions. However, his terminology or classification is not found in all of Lachmann’s writings on institutions. In most instances, he only distinguishes between external and internal institutions, treating neutral institutions as a subcategory of internal ones. His “Wirtschaftsordnung und wirtschaftliche Institutionen” (1963), or “Economic Order and Economic Institutions”, will be our starting point for Lachmann’s most nuanced take on institutional structures he deemed to be “neutral”. The piece was published in *ORDO Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft* shortly after Hayek, who joined the the yearbook’s editorial board already when it was founded in 1948, moved from Chicago to Freiburg in 1962.

**External institutions** represent those social structures that are necessary preconditions for markets to even come into existence and without which modern societies, heavily reliant on the division of labor, would not be possible (Lachmann 1940, 49). The most important external institution is the legal framework provided by governments. In his discussion of external institutions, Lachmann’s argument does somewhat resemble the ones brought forward by members of the Freiburg School and other exponents of ordoliberalism – and he does indeed reference Eucken’s *Grundsätze der Wirtschaftspolitik* (“Principles of Economic Policy”, Eucken 1952) on the occasion. And while the connection and influence between Lachmann and the ordoliberals have not yet been studied in detail, in a different article he credits the entire “ORDO school” with having developed an elaborate and useful theory of institutions (Lachmann 1979, 251–53).

**Internal institutions** on the other hand are rules and organizational forms that emerge from the market process itself to fulfill a function or solve a problem that has not been addressed yet. They are, in Lachmann’s own words “creations, not prerequisites, of the market” (1963, 67). He notes stock markets, futures markets, or the insurance industry as examples of institutions of this kind. The most important characteristic of these institutions is the fact that they can emerge when they are needed and that there exists a feedback mechanism which works to deconstruct them again, once their purpose has been fulfilled. That is, there exists an *ex post* calculus that determines their desirability and a process of selection whereby they either endure or are supplanted depending on that calculus. This is very much evident in the case of futures,

stock, and insurance markets, and how they have developed over time. Thus the market process, once it has started to operate, is generally an efficient mechanism for developing institutions to cope with the inherent unpredictability and complexity of modern life, but it gets rid of them again in case they do not fulfill their intended purpose.

Much like a Northian neoinstitutionalist would today, Lachmann noted that: “[...] the market economy is embedded in a framework of legal and other institutions. The quality of the market depends, among other factors, on the quality of this framework (Lachmann 1979, 253).” However, Lachmann’s institutional theory goes beyond what we are used to seeing in neoinstitutional economics. With what Lachmann terms **neutral institutions**, he adds a distinct category missing in most other treatments of institutions, at least within economics. Alike to internal institutions, neutral institutions emerge to overcome certain perceived problems, to set standards for the actions individuals may take, or to facilitate the realization of exchanges in a market economy. The process of their emergence is usually spontaneous and driven from the bottom up, just as in the case of internal institutions. However, the feedback mechanism that would deconstruct them in case they become defunct is absent (or in some way misaligned) in the case of neutral institutions. The prime example Lachmann gives with respect to formal neutral institutions are standardized work contracts, standard terms and conditions, jurisdiction over non-contentious matters, or the establishment of collective bargaining. Those institutions – at least in most societies – emerged spontaneously and the intentions behind their implementation were usually noble ones, he thought. One can also clearly make the case that collective bargaining could be a practice hugely beneficial for the effectiveness of the market process by dramatically lowering transaction costs and potentially increasing social harmony. But it may also be an institution with significant path-dependency and no direct feedback mechanism that would necessarily amend it in case collective bargaining ever leads to adverse outcomes.

Lachmann also considered potential informal manifestations of neutral institutions. He thought they could also be a gateway through which broadly held preferences and moral convictions within a community make their impact on the embodiment of markets. Over time, the convictions and moral preferences of people acting on a market will diffuse on the very structures that make up the market in question. This may be unavoidable, but to him potentially posed grave dangers to the preservation of a functioning market order. Neutral institutions have to conform to societal attitudes, but they need not – particularly so at every point in time – conform to the prerequisites of a market order (Lachmann 1963, 69). Lachmann also uses the concept of “institutional neutrality” to criticize the quantity theory of money. He first

demonstrates how central banks, originally implemented as neutral institutions par excellence, were quickly transformed into external institutions backed by the sheer will and force of governments, that have appropriated vast amounts of compulsory authority, but are themselves still not immune to demands and social pressures emanating from the society in which they operate. Lachmann then goes on to show how the widely shared conviction that “no (nominal) wage may ever fall” can be “traced back to non-economic origins, or an economic problem can be subjugated to an analysis in economic sociology” (Lachmann 1963, 74). The reason for this Lachmann found in the fact that societal perceptions about what is “desirable and socially unbearable” may not at all be analogous to economic and political reality in the community or – in the extreme case – may even be diametrically opposed to it (Lachmann 1963, 76). Through his consistent application of subjectivism, Lachmann is thus driven to observe the bidirectional interplay between economic and cultural/political factors and recognize the potential for friction that lies therein.

While Lachmann does provide a few concrete examples of neutral institutions (labor codes, collective bargaining, broadly held moral convictions that seemingly violate typical rational economic calculus), unfortunately, none of his examples are fleshed out into proper case studies. In this sense, his theory is underdeveloped and likely to leave many a reader of his works without an appreciation of what, if anything, this richer institutional theory adds to the analysis. As such, Lachmann’s framing of the concept of neutral institutions has not made it into the terminology of modern institutional economics, though the issue that he raised, namely the interplay between formal and informal institutions, is still very much at the center of many debates in institutional and development economics (Boettke, Coyne, and Leeson 2008).

In his most comprehensive writing on institutional matters (Lachmann 1971), Lachmann lets go of the concept of neutral institutions, replacing the external-internal-neutral trichotomy with “fundamental” (immutable) and “secondary” (mutable) institutions. While the former closely tracks the “external-category” introduced before and refers to those institutions that enable economic activities in a market economy to get going in the first place (Lachmann puts special emphasis on the legal system), the latter include institutions that evolve freely within the ordering framework of the fundamental ones. He does not, however, distinguish anymore here between secondary institutions with and without proper feedback mechanisms, i. e. between internal and neutral institutions. His emphasis seems to have shifted more toward the importance of change within a relatively permanent institutional order – hence the designation as “mutable” and “immutable” – and to finding the kinds of institutions that will provide for

enough stability in a society so that secondary institutions can pop up and vanish freely around them.

This vision has considerable overlap with the approach of the German ordoliberals, as discussed by Kolev and Köhler in this volume. The numerous references to Eucken and Röpke in Lachmann's 1963 piece in the *ORDO Jahrbuch* could thus be seen as an early "wrestling" with this approach. In the Lachmannian framework, economic and social institutions may – just like for the ordoliberals – not be seen as sterile and somewhat mystical entities that structure or govern human behavior, but rather as social phenomena whose effectiveness – or we may say: influence on economic outcomes – will depend not first and foremost on their design, but more so on how they are perceived by the acting individuals exposed to them (Lachmann 1991, 139ff.). For Lachmann, "an institution is a network of constantly renewable meaningful relations between groups of persons who may not all ascribe the same meaning to the same relation. The task of the student of institutions is to distill such meanings from his observations and to interpret them to his audience." (Lachmann 1991, 137).

Reflecting on Lachmann's institutional economics, we also begin to see in which sense the clearing of an individual market over time – the question that initially bothered him – becomes a problem of secondary importance over the progression of his career. The real factors driving the progression of economies, the forces that ultimately decide whether societies will become richer or poorer, lie – as he realized – at a different level from the one that economic analysis usually zeros in on:

But it is gradually coming to be recognized that growth processes are processes of historical change, that they are prompted by many forces, not all of them economic, and that, whatever may be the best way of studying them, it is impossible to reduce the rich variety of forces in operation to one simple analytical model. In particular, the notion of equilibrium, which economists have long been used to regard as the pivot of their analytical apparatus, can find no application here. (Lachmann 1971, 5).

However, the central concern of Lachmann's endeavors essentially remains the same when dealing with institutional questions or market equilibrium: How to align diverging expectations, given the unknowability of the future, and how to enable necessary changes in the institutional structure over time whilst keeping the overall framework in place. The next section will briefly lay out how this endeavor of his, which stems from his abandonment of the pure logic of choice as the sole foundation of economic analysis, is firmly rooted in his upbringing in the foothills of the German Historical School.

## 2.4. From Berlin to London and Then (Partially) Back to Heidelberg: The Weberian Roots of Lachmann's Institutionalism

We have dealt so far only with Lachmann's path from equilibrium analysis towards institutional economics, but have all but ignored his most comprehensive treatment on the matter, *The Legacy of Max Weber* (1971). Lachmann's connection to the GHS – as already hinted several times – is rooted not only in his early days in Germany and his work under Sombart, but also deeply situated in his appreciation of Weber. A recurring similarity, or rather a shared conviction between him and Weber (as seen by Lachmann himself) lies in the insight that the application of the method of economics will not be enough to solve the most pressing questions about social stability in the face of constant institutional evolution. This probably has to do with Weber's memory being very fresh and influential at the time when Lachmann was writing his doctorate in the late 1920s. On the other hand, the manifold connections between the AS in the 1920s and 30s with Weber must also be acknowledged (Kolev 2020; Boettke and Storr 2002), so there are strong theoretical reasons why Weber's sociology should be extremely congruent with Lachmann's (Austrian) socio-economic queries. We also see this in the way in which Lachmann interprets what other contributors in the Austrian tradition are doing. For instance, he emphasizes in his review of Mises's *Human Action* (Mises 1949) how: “[w]e must never forget that it is the work of Max Weber that is being carried on here (Lachmann 1951, 413).” However, Lachmann's correspondence with Hayek displays that it is not fully clear whether the selection of Weber for this endeavor rests on a conscious choice as him being the best contributor to sociology for these purposes, or rather on Lachmann's unwillingness to acquaint himself with modern sociology:

I am playing with the idea of writing something about the nature of social processes as vehicles of the transmission of knowledge, [...] showing that this is what keeps the world (certainly the Western world) moving.

The trouble is that to do it I should have to learn some sociology first, or at least work my way through a book like Parsons' 'Social System' to learn the jargon of the trade, a task which fails to attract me. ... So I am a bit frightened of sociology. I know my Max Weber, but can one start in 1955 where he left off in 1920?” (Letter to F. A. Hayek, October 10, 1955, F. A. Hayek Papers, Hoover Institution Archives)

The title as well as the content of Lachmann's 1971 book on Weber reveals that he indeed ended up doing just that. However, the book also reveals a whole lot about Lachmann's own methodological underpinnings, as well as some of the sources of his discontent with the Austrian approach to economics. As Eicholz (2017, 230) has pointed out, the "variability of thought" that he wished to uncover with the tools of social science was ultimately the reason why Weber "consistently counted himself as a member of the youngest generation of that tradition [the GHS]". And it is precisely this Lachmannian interest in uncovering the "variability of thought" – and what accepting it means for economic theory and the methodology of the social sciences – that drew him into the scientific edifice of Weber. This Lachmannian insight into the "variability of thought" can also be hypothesized as the prime reason that first drew him into the subjectivist realm of the AS, but then also prompted him to significantly expand upon and push the boundaries of the AS's own understanding of the term. Even though Weber's "method of *interpretation (Verstehen)*" leaves almost no trace on "the science of economics", the "neoclassical formalism" dominant in that field would not permit methodologies that do not resemble the methods used by the natural sciences (Lachmann 1971, 2, italics in the original). Lachmann seemed to lament that a tendency of abstracting too much from social and economic reality could also be found in the work of Carl Menger and was carried forward from there. Lachmann intended to show in which sense "the dissemination of Weberian ideas promises to yield a rich harvest" (Lachmann 1971, 2) also within the Austrian tradition.

It seems that differences concerning the appropriateness of the "pure logic of choice" is what differentiates the Weberian and Lachmannian take from the one prevalent in other conceptions of research in the AS. This clash of conceptions is probably most pronounced between Lachmann and Mises, as the former himself mentions – not uncritically – in the 1978 foreword to Mises's *Epistemological Problems of Economics*:

Mises regarded himself as Menger's true heir, certainly in the field of methodology. Owing to the change in the climate of opinion mentioned, Menger's position in this field had, by the 1920s, become difficult to defend. But Mises did not flinch from his task (Lachmann 1978b, LIV).

In that very foreword, Lachmann also contrasts Mises's approach specifically with Weber's. Though he recognizes that both characters were intent on contributing to the still emerging field of economics, great differences remained:

[...] they were at odds in the way they conceived of the new science. Mises, following Menger, drew a sharp distinction between theory and history and attributed great importance to it. To Weber on the other hand, as to the whole German Historical School, this difference was entirely a matter of degree, and not of kind.

However, the same diverging position on what role the “pure logic of choice”, or the one of “fundamental concepts of the theory of action” – or whether these even exist at all – should play in economics can also be found within the AS, more narrowly defined. We know from Lachmann’s abovementioned letter to Hayek that the former was – in his institutional theory – deliberately building on the latter’s research on the role of knowledge in economics (Hayek 1937; 1945), which in the 1937 “Economics and Knowledge” paper includes a crucial methodological critique of restricting economics merely to the study of “the logic of pure choice.” As Hayek put it:

[...] in the transition from the analysis of the action of an individual to the analysis of the situation in a society the concept [of equilibrium] has undergone an insidious change of meaning [...] There seems to be no possible doubt that these two concepts of “data,” on the one hand, in the sense of the objective real facts, as the observing economist is supposed to know them, and, on the other, in the subjective sense, as things known to the persons whose behavior we try to explain, are really fundamentally different and ought to be kept carefully apart. (Hayek 1937, 39).

This critique applies, of course, not only to the Neo-Walrasian thinkers behind the general equilibrium framework emerging during the 1930s, but also to the praxeology of Mises, the other key Austrian representative at the time. Indeed, this is a flaw that Lachmann notes in his otherwise glowing review of *Human Action* (Lachmann 1951), and Lionel Robbins, in his role of editor of *Economica* where the review was published, wrote in February 1950 in a letter to Lachmann: “I completely agree with you that he [Mises, F/N] commits the major error of identifying the logic of choice with the whole field of economic action” (Howson 2011, 680). In the Lachmannian vision of economics, instead of one acontextual logic, what socially embedded individuals face, are situational logics that may differ from community to community, and market to market. But though Lachmann repeatedly stresses that plans are not made in a vacuum and can significantly differ given the “variability of thought”, his early solution (coordination of expectations through futures markets) is still largely in the realms of the pure logic of choice. It becomes clear at this point how the narrative about Lachmann’s endeavors in equilibrium theory and his later institutional theory converge. While he tried to



emancipate himself from his upbringing in Berlin by engaging in the debates of the day while in London, he soon realized that the particular outlook of the “pure logic of choice” is also not the most fertile ground for groundbreaking research in the social sciences. In the resulting emancipation from both “extreme” poles, Lachmann found a viable role model in Weber. Contrary to many of his “neoliberal contemporaries”, he did not abandon the “Übervater”-like figure (Kolev 2018b) by solely absorbing his writings on epistemology and methodology, and especially he did not leave aside Weber’s sociological contributions – and especially his pioneering efforts at combining economics and sociology in his institutional socioeconomics. Instead of ending up at either of the “extreme” poles of the Misesian pure logic of choice or the pure institutionalism of his time in Berlin, he endeavors to bridge them and aims to practice economic sociology that is undergirded by a prudent theory – a task, which leads him to leave behind both London and Berlin, but pulls him into Max Weber’s Heidelberg.

Some elements on the road to Lachmann’s crowning achievement in institutionalism and “convergence to Heidelberg” as well – his book on Max Weber – have already been discussed. However, besides Weber, there is of course also Sombart’s legacy, which Lachmann never quite managed – or wanted – to shake off. This connection goes back directly to his doctoral training with Sombart, as Eicholz (2017) has demonstrated. Additionally, a nuanced reading of Lachmann will reveal that he did not necessarily see a contradiction between his training in both the AS and the GHS. When writing, once more in the *ORDO Jahrbuch*, about “islands of resistance” against the “triumphal march” (Lachmann 1966, 126) of formalism, he mentions, besides the Freiburg School and the “praxeological school” (with which he associates Mises, Hayek and Röpke), the “rich material in the field of economic history that can be utilized in the development of market economic theory”, singling out the “excellent work of Fritz Redlich” (ibid., 127), who was himself one of the last representatives of the GHS (Poettinger 2018). It seems fair to assume then that Lachmann himself did not see an all too big a difference between the two approaches in the first place. Lachmann’s explicit invoking of the Freiburg School as an “island of resistance” is also instructive in this respect: While its members – and this is also valid for ordoliberalism more broadly – tried to emancipate themselves from their historic German predecessors, it has been shown that they were never fully successful in that pursuit (Fritz, Goldschmidt, and Störing 2021; Schefold 2003). As such, we can now see in which way Lachmann’s gradual invoking of Weber should be seen as an effort to supplement the too pronounced focus on the pure logic of choice in (some conception of) the AS with the more contextual way of thinking to be found in the GHS.

This last point, and Lachmann's bridging position between these two schools of thought, can be strengthened with Lachmann's abovementioned foreword to Mises's *Epistemological Problems of Economics* yet again. In it, Lachmann explicitly denies that the Methodenstreit was a dispute worthy of being seen as such:

For most Austrian and German economists of the 1920s the Methodenstreit was a quarrel of the past, a most unhappy affair best forgotten. How could sensible people doubt that theory and history were both equally legitimate forms of the pursuit of knowledge? Since both protagonists in the dispute, Menger and Schmoller, appeared to accept this, it was hard to see what the violent quarrel was about (Lachmann 1978b, LVIII).

He contrasts this position to that of Mises who "took an altogether different view. For him, the Methodenstreit was by no means over (ibid.)." Going back to Menger's quest of conceptualizing economics as a science uncovering "exact laws" (laws which require no experience to confirm or disconfirm them) through deduction, he carves out how Mises saw himself as Menger's "true heir" (ibid., LIX) who was determined to uphold this position on the methodology of economics even in times when it had gotten difficult to defend. Even though Lachmann coats his criticism for the Misesian position in praise and attributes whatever shortcoming he points out to the tough environment of the last years of the Weimar Republic ["It was not a good time for subtlety" (ibid., LVIII)], there is no doubt that at least part of him thought the book was somewhat redundant at this point and that not much could be gained by reviving methodological quarrels of that past that had perhaps never deserved quite as much attention to begin with. The fact that Mises's book in question has a second, more recent foreword (Hülsmann 2003) that develops a distinctly different – much more glorifying – view of the relevance of Mises's book, allows us to use the following section to dwell further on how Lachmann's particular outlook has shaped contemporary research practice in the AS.

## 2.5. Order vs. Equilibrium in the Recent History of the AS

It is uncontested that Lachmann's ideas have significantly influenced the AS's recent history and its contemporary research practices. To illustrate this, we can start right at the South Royalton Conference in 1974, which is often described as a major kick-off point of the Austrian revival. Ludwig Lachmann was – together with Israel Kirzner and Murray Rothbard – one of

the keynote speakers at the event. Kirzner – who can doubtlessly be described as one of the major forces of this revival himself – singles out Lachmann’s contribution:

The participation of Ludwig Lachmann [...] was particularly important. A senior respected scholar who had studied and written under Hayek during the ‘thirties, Lachmann introduced young Misesians to a perspective on Austrians economic thought which opened their eyes to the precise location of the battlefield of ideas in which subjectivists such as the Austrians must wrestle with the mainstream orthodoxy. (Kirzner 2015, 229).

In other words: The “young Misesians” Kirzner is referring to were introduced to a conception of the AS that had not incorporated all the richness that, Kirzner thought, his own tradition had to offer. The “Misesian” character of the re-emerging AS during the 1970s very likely refers to most young Austrians of the time having been introduced to the tradition by Rothbard’s *Man, Economy and State* (1962, for its influence see Boettke 2010). It is interesting to bear in mind that Kirzner, even though he also emphasized that Hayek had taken up the subjectivist approach from Mises, in this context singles out Lachmann having studied under Hayek, thus implicitly linking the former’s richer conception of Austrian economics that goes beyond the pure logic of choice to Hayek’s departure from it during the 1930s and contrasting it with the Rothbard-fueled approach of the “Misesians”.

This particularly strong influence of Lachmann’s ideas on AE certainly has not decreased in more recent years. Indeed, it has been argued, for instance, that Lachmann has played a dominant role in inspiring the “second Austrian revival of the new millennium” (Gloria 2019, 2) and that “we [Austrian Economists] are all Lachmannians now (Storr 2019, 65).” This second Austrian revival has inspired unparalleled research activity in that tradition, which also – more so than ever – aims at an empirical investigation of economic reality where the subjectivist perspective and the focus on genuinely *understanding* economic phenomena yields great advantages, such as the intersection of economic action and culture (e.g. Lavoie and Chamlee-Wright 2001; Chamlee-Wright and Storr 2010). Accepting that Lachmann was so instrumental in inspiring this shift, our paper provides evidence that some key characteristics of this shift derive from a tradition that the Austrians were historically in opposition to.

While Lachmann’s self-description as an Austrian and his employing of analytical tools rooted in the AS is without question, we have clearly shown how he regularly went beyond the “pure logic of choice” that the AS is sometimes associated with. We have argued that the way in which he re-interprets AE is not necessarily surprising. Tracing the progression of Lachmann’s thought and uncovering the influences of Hayek, Weber and the GHS more broadly, it seems evident that

a tendency of trying to move away from the pure logic of choice is not something that is unique to Lachmann only, but can indeed be located – in some degree – in many contributors to that tradition. While it has historically been portrayed that Austrians initially developed their positions in opposition to the GHS, attempting to carve out universal laws of human action (Mises 1929; 1949) via economics as a praxeological science, realizing Lachmann’s important role in the 21<sup>st</sup> century revival of research practice in the AS makes one wonder whether it is not precisely the “anti-praxeological flavor” inserted by Lachmann that makes the AS thrive in recent times. Bearing in mind, again, that the role of the Methodenstreit was somewhat exaggerated (Häuser 1988), and the concept of subjectivism in economics – so dear to Lachmann’s own heart – originally a conception flowing out of the (older) GHS (Streissler 1990), one wonders whether the AS would not benefit from accepting this unsuspected complementarity with the GHS a bit more. To the extent that Lachmann has accentuated the two recent AS developments, the “hermeneutical turn” and the “empirical turn”, and pushed for a real *understanding*, as opposed to mere explaining, of economic phenomena, he might well have demonstrated that these two supposedly incompatible schools of thought actually are compatible.

It is insightful to now note that the pessimistic view that Lachmann had about markets clearing in all potential cases, which then also transcended into the realm of institutional evolution, can both be explained with recourse to his background in the GHS, which compelled him to view both processes from a holistic point of view and dissuaded him from accepting solutions that were merely rooted in formal logic but had no evident backing in observed reality, driving home – again – the oft-repeated Lachmannian plea for a “realistic” economics. Also this element can be readily connect to recent proceedings within the AS: Boettke’s plea for a more realistic, plausible AS that engages in “intrinsically interesting” research programs, comes out of the same camp (Boettke 2019, 5). Interestingly, what Boettke advises economics to develop is “an anchor in the world” and offers an “educational proposal that [...] would be a re-evaluation of the history of economic thought (as theory) and economic history (as empirical touchstone)” (Boettke 1996, 34). Boettke contends that Austrians “have failed to fully come to terms with (their) neoclassical heritage and (their) heterodox critique (thereof).” Interestingly, he then adds that:

[...] perhaps, when contemporary Austrians do come to grips with these currently uncomfortable aspects of their thought, the promise of *Hans Mayer* (1932, p. 149) that the way to scientific enlightenment in economics is along ‘the road on *which the great system-builders of the ‘older’ German historical school meet up with the founders of the ‘Austrian School’ will be fulfilled and a new political economy will be forged* that

simultaneously satisfies our humanistic desire to understand ourselves, our scientific impulse to know the underlying forces at work, and our humanitarian belief that philosophical understanding and scientific knowledge can be employed in concert with one another to improve the human condition. (Boettke 1996, 35, *our italics*).

The explicit invoking of Hans Mayer – and his reference to the (older) GHS – is yet another testimony to the significant overlap between the two traditions we have been dealing with here. Thus, we again find that Lachmann’s take on economic life, which was shaped, apart from his focus on subjectivism, by a resistance to formalism as well as the demand for a solid grounding of ideas in economic reality, is not only characteristically Austrian. It can also be said that many of the elements that characterize this Lachmannian conception of “Austrianism” are entirely compatible with the approach of the GHS, as it was practiced historically. This is the reason for Lachmann’s invoking of Weber as a bridge between these two traditions. Our findings thus further strengthen the idea that the significance of the *Methodenstreit* between the GHS and the AS was largely overstated (Streissler 1990) and that the two opposing schools share considerable portions of their outlooks. As Braun, writing about members of the (older) GHS foreshadowing Mises’s argument about the impossibility of economic calculation in socialism, has recently put it: “Austrian economists would be wise to forget the old animosities and to rediscover the contributions of their former adversaries in the *Methodenstreit*.” (Braun 2016, 126).

At this juncture, it is time to return again to contemporary practice in the AS and Lachmann’s role therein. We have stated that Lachmann’s eclecticism in terms of methods and his attention to the non-economic aspects of social life are to be found at the forefront of contemporary research practice in AE. However, it should be noted that there still are two diverging strands within AE at this moment. While the Lachmannian account presented here, and the contemporary research conducted in that tradition, clearly employs a broad view on the subject matter of economics and tries to integrate institutional and cultural influence factors into its analysis, there is also another strand of the Austrian tradition that does not endorse this approach. A substantial divide exists between the empirically oriented approach stemming largely from George Mason University and the more “praxeological” interpretation of AE, which is upheld for instance by a group of scholars affiliated with the Mises Institute in Auburn, Alabama. Several of the “young Misesians” whom we have referenced from Kirzner 2015 earlier on were largely influenced directly by Rothbard and have continued the development of AE largely along praxeological lines. In this pursuit, they have not seldom drawn sharp lines

between their interpretation of AE, which rests solely on Misesian praxeology, and other approaches, especially the Lachmannian one. Consider Rothbard on the matter:

The problem is this: a lot of younger Austrians [. . .] have given up basic Misesian praxeology, that is: that Austrian theory is deduced from a few general axioms implicit in the existence of human action, and that therefore the economic method is fundamentally different from the methods of the physical sciences [. . .]. Many Austrians [. . .] are anti-praxeological, and hence anti-Misesian, and they are trying to preserve fashionable methodological unity of the sciences [. . .] by being mainstreamers who simply talk about “disequilibrium,” time, and “market process.” [. . .] The key is praxeology and these people have given it up. (Rothbard 1982, as quoted in Salerno 2002, 124).

Lachmann and “Lachmannia” – the “disease” befalling Austrians dabbling too much with Lachmann’s works – were seen by Rothbard as contributing the most to this “unfortunate” development befalling the reemerging AS:

I am convinced that Mises would have considered Lachmann (an institutionalist, nihilist, and Keynesian) an “anti-economist,” and he would have been right. Lachmann is not an Austrian at all. Back to Mises! (Rothbard 1977, as quoted in Salerno 2002, 121).

Irrespective of the answer to the question of whether Lachmann is, in fact, an Austrian or rather the last member of the GHS, or both, as we are inclined to believe, it goes without saying that the Lachmann-infused, empirically oriented approach practiced at George Mason University has indeed developed into a “progressive research program in the social sciences” (Boettke and Coyne 2015). It achieved this also by actively attempting to join forces with other approaches in the “mainline” of economic thought, such as the Virginia and the Bloomington Schools (Boettke, Coyne, and Newman 2016). In contrast, the Auburn approach has shown a tendency to self-isolate and actively shield itself from outside influences. Thus the Lachmannian view of how economics should be practiced is at the heart of most recent developments within the contemporary AS, whereas the purely praxeological approach associated with Auburn has sunk into academic obscurity.

## 2.5. Conclusion

We have traced the evolution of Ludwig Lachmann’s thought from the 1930s to the 1970s and have shown how his initial preoccupation with the possibility of integrating the notion of

(diverging) expectations in equilibrium analysis was replaced over time with much greater attention to the overall institutional order of societies. Radical subjectivism and diverging expectations – the two realities that brought Lachmann to doubt that equilibrating tendencies will always be able to ensure the proper functioning of goods markets – also made him hesitant to develop an all too optimistic outlook on the potential of institutions to order the economic activities of societies. Employing less well-known writings of Lachmann in German, notably Lachmann (1937; 1963), has helped us shed new light on his gradual shift from equilibrium to order and illuminate on how and why this shift came about. Additionally, we have demonstrated how through this shift away from the “pure logic of choice”, dominant in much of neoclassical economics and at least one branch of the AS, gave way to a Lachmannian institutional economics that took subjectivism, expectations, and the adapting potential of the institutional setup seriously, ultimately seeing its goal not anymore in the perfect clearing of markets, but rather in understanding human action in a socially embedded setting, and in devising an institutional economic order that fits these prerequisites. In this endeavor, Lachmann’s outlook was deeply rooted in the approach of the German Historical School, both in the legacies of Weber and Sombart. Lachmann attempted to link the Austrian approach with the acceptance of the “variability of thought” of agents in his economic analysis, starting a precarious tightrope act between the praxeological tradition in the Austrian School and the methodological eclecticism that he tried to inject herein. Our paper affirms that this tightrope act was possible and has indeed demonstrated a potential avenue for a different understanding of the Austrian tradition itself, especially in its modern, empirically oriented variant which has been influenced by Lachmann to a considerable degree. Recognizing how this account of the recent history of the school differs from the more praxeological interpretations would seem to lead to a more nuanced and balanced self-interpretation of the Austrian tradition: namely, one that does not shield itself from outside influences, but actively reaches out to adjacent research programs for building a richer conception of what economics is, and what it ought to accomplish in the real world. The next chapter will build on this vision and demonstrate, using the work of Elinor and Vincent Ostrom, how a focus on this “real world-orientation” manifests itself in people’s interpretations about which goods and services shall be deemed “public”.

### 3. Social services as impure public goods: Ostromian lessons for their provision in contemporary welfare states

The chapter provides a novel way of thinking about social service provision by inserting social services in the typology of goods. While approaches to understanding social services as consisting of public goods already exist, the paper attempts to understand them as common pool resources (CPRs) or impure public goods. The chapter argues that, while excludability from social service provision is not accepted in most societies for political reasons, rivalry of consumption still holds and manifests itself mostly through non-price rationing mechanisms. After having defined social services as impure public goods, the paper draws on Elinor Ostrom's design principles for the successful and sustainable use of common pool resources. By applying those principles to questions of social services, it identifies problems with their provision in contemporary welfare states. While some of Ostrom's design principles might be seen as fulfilled with regards to social service provision, especially conflict resolution mechanisms, monitoring and sanctioning as well citizens' ability to self-organize to provide for the social services of their liking must be seen as severely curtailed. The chapter ends by arguing for more decentralized and participatory mechanisms in order to improve policy outcomes. These would call for a greater citizen participation in the design and provision of social services and more plurality in the institutional structures used for their financing. Additionally, citizens shall be enabled and encouraged to, as far as possible, devise their own solutions to social problems.

#### 3.1. Introduction and Research Questions

Welfare states<sup>11</sup> presently are – and have been so almost since their inception – exposed to a variety of criticisms that cast doubt on their long term efficacy to solve, or at least ameliorate, social problems. Despite high (and growing) rates of spending<sup>12</sup>, ever-expanding scope of welfare state programs<sup>13</sup> and high support among the general population of western countries

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<sup>11</sup> Defined as mechanisms to "enhance the welfare of people who (a) are weak and vulnerable, largely by providing social care, (b) are poor, largely through redistributive income transfers, or (c) are neither vulnerable nor poor, by organizing cash benefits to privies insurance and consumption smoothing, and by providing medical insurance and school education. " (Barr 2012, 7).

<sup>12</sup> For data for Europe see Eurostat 2018, for the U.S. OECD 2018.

<sup>13</sup> Especially the expansion of regulatory practices is notable here (Hollcombe and Boudreaux 2015).



(for instance Mau 2001), most welfare states continually fall short of achieving their ultimate goals: the abolition, or –as some argue – merely even the reduction, of poverty and inequality (Wagner [1998] 2019, 95f). Welfare state reform thus seems to be an ever-topical issue – a fact that is well reflected in a growing literature on the problems of over-expanding social problems and the various difficulties of downsizing or reforming existing welfare states. (Jensen, Arndt, and Lee 2018) While advocates of programs and measures of the welfare state often describe those as inadequate and demand an expansion of the various practise, there are of course a certain number of critics of the modern welfare state who would rather advocate a reduction of social policy and a withdrawal of the state from this area in order to achieve better policy-outcomes. It need not be said that these debates have a tendency to easily turn from academic debates on economic policy into fully (day-to-day) political debates. Questions of the latter kind are not dealt with here.

I nevertheless plan to add to the various debates, not by offering concrete policy-advice on how welfare states should be reformed, but by discussing the nature of some of the goods provided in welfare states in the light of the familiar typology of private, club- and public goods as well as common pool-resources, whom I will oftentimes also refer to as impure public goods. With respect to this, we do not deal with the welfare state in its entirety, but focus on the provision of social services. These comprise services such as child- or elderly-care, active labour market policies, re-integration services for former convicts or drug addicts, help for migrants and debt counselling – all services that aim to alleviate or solve perceived social problems. Further down, a more concise definition and a precise demarcation from other elements of modern welfare states will be provided. I also wish to point out that this chapter will explicitly not deal with other, more commonly known aspects of the welfare state such as redistributive programs or social insurance. While discussing the nature of those welfare state programs might also be valuable, I omit such endeavours here and wish to concentrate my efforts solely on social services.

The paper does not give concrete policy advice, but aims to improve outcomes by providing a clear framework for thinking about the goods being "exchanged" on "markets" for social services. Throughout the paper, I will be building the argument that social services should be considered as having similar properties – and thus also problems with respect to their provision and use – as common pool resources. With respect to this, the work of Elinor Ostrom in particular will be of paramount importance. This should also allow conclusions to be drawn as to which policy responses are appropriate in relation to potential reforms of the provision of

social services. For reasons of better intelligibility, I will occasionally illustrate certain points by examples from the elderly- and childcare sector in Germany.<sup>14</sup>

In order to set the stage for the further line of argumentation, the next section briefly introduces the concept of the typology of goods and reviews literature that attempts to understand social services as public goods. Then I lay out in which sense the public-goods theory about social services is deficient and build my own account of viewing social services as common pool resources by demonstrating their non-excludability (given contemporary value-systems in many western welfare states) and rivalry of consumption. In order to do this, I make use of the public attitudes literature originating from welfare state research and theories as well as empirical evidence about non-price rationing mechanisms. I then discuss Elinor Ostrom's writings about making common pool resource systems sustainable and resilient and apply her insights on the matter of social services. The following section discusses how accepting the common pool nature of social services might lead to improved policy outcomes and highlight a few potential real world implications. The last section concludes.

### 3.2. Social Services & The Typology of Goods

Systematising and classifying the nature of the goods traded on markets is a very foundational practice in economics. Only by thinking clearly about which characteristics the goods exchanged on various markets have will one be able to offer coherent explanations of the processes unfolding on various markets. For this reason, the most common way of classifying goods is briefly discussed here. Furthermore, a short account of contemporary social services provision is given and the particularities of these services are highlighted. In order to make the point of this paper more understandable, it will also be necessary to refer to one further way of interpreting the types of goods that exist on markets for social goods: That of social services as a public good.

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<sup>14</sup> These sectors represent typical examples of social services and perfectly capture the intricate relationships between public opinion, financing needs, private service provision and public financing that is the topic of this paper. However, I would not want to be misunderstood in as much as the framework for understanding social services developed in this essay should just as much be valid for other types of social services and should also apply in other places than Germany. It just so happens that I am most familiar with these aspects of the German market for social services and hence chose to use these areas for my illustrations. Given the local character of many of the debates about social services, it was unavoidable to cite some sources in German in order to illustrate some points. I hope that this does not cause the reader too much inconvenience.

### *3.2.1. The Typology of Goods*

The most familiar attempt to classify goods is according to the two dimensions of excludability and rivalry of consumption. Rivalry here refers to whether the consumption of a good or service by one party necessarily diminishes the ability of other parties to consume the same good or service, while excludability points to how easy it is to preclude non-contributors from the consumption of the good or service. Combining these two dimensions, the standard account describes four distinct types of goods emerging from this dichotomy: private goods, club goods, allemande goods (also referred to as common pool resources or impure public goods) as well as public goods.<sup>15</sup> It also needs to be pointed out that the classification of goods into these four categories is obviously not a fixed scheme, but much rather takes place along a continuum, in which a single good or service can seldom be assigned unconditionally to any category, but much rather display these characteristics varying in degree only (Aligica and Boettke 2009, 40 as well as Ostrom 1965).

With respect to this, private goods are defined by both excludability and rivalry of consumption and comprise the vast majority of goods and services that individuals typically consume on a daily basis. With club goods exclusion can easily be conducted, while rivalry typically is not a strong property of club goods, especially with regards to the marginal user/consumer of the good. In case of severe congestion, rivalry can still re-emerge for these kinds of goods, e.g. on a highway during rush hour. Pure public goods refer to goods that are both non-excludable and non-rivalrous, in which case the relevant literature frequently states the necessity of governmental intervention in order to supply the good in question, given that providers of a good can typically not charge or exclude potential consumers once the good is provided. National defence or measures taken to improve air quality serve as standard examples here. Common pool resources or impure public goods are also deemed mostly non-excludable, but suffer from the additional problem that their consumption must largely be seen as rivalrous. High sea fishing grounds or irrigation systems (as an example of a man-made CPR) constitute most common examples. Overuse is often thought to be a recurrent problem of CPRs, a topic that will be dealt with in detail in the following chapter.

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<sup>15</sup> My account skips the complexity of the process necessary to arrive at the classification of these four types of goods. Originally, it was customary to only distinguish between private and public goods (cf. the original dichotomy by Samuelson, 1954), with Buchanan 1965 firstly bringing club goods into the discussion. Ostrom and Ostrom [1977] 2002 then was instrumental in broadening the classification by introducing "common pool resources" or impure public goods into the discussion. By "doubling the types of goods" (Ostrom 2010, 412) social science thus had a more powerful analytical toolkit at hand.

### 3.2.2. *Social Services*

Given that the paper will apply the typology of goods onto the provision of social services, this section attempts to give a brief overview over the definition and the provision of social services in contemporary western welfare states. Social services may be defined as services that attempt to overcome or ameliorate social problems, to offer help in situations of distress suffered by individuals, groups or communities or try to circumvent them by preventive measures (Cremer, Goldschmidt, and Höfer 2013, 7; Weyrich 2011; Bäcker et al. 2010, 505). The fields generally counted as falling within the domain of social services are: child and youth welfare services, family assistance, help for elderly persons, health services, labour market activation policies, help for persons with disabilities, help for people with migratory background and help in difficult situations such as drug addiction, indebtedness or homelessness. In that sense, social services comprise both services that are highly specific to particular and rare problems but also certain services that most people will consume at some point or another in their lives (Cremer, Goldschmidt, and Höfer 2013, 10). Social Services have to be distinguished from other, more general elements of welfare states, such as redistributive transfers or forced insurance schemes. While many users of social services also obtain transfer payments (e.g. in the case of acute poverty or temporary unemployment), these transfer- or insurance-related measures need to be distinguished from 'active' attempts to reintegrate them on the labour market via labour market policies, the latter of which clearly falls into the realm of social services. We also can distinguish social services from other programs of the welfare state by referring to the service-characteristics of the former – while social insurance or social security-programs entail the transfer of some resources from one group to another, social services are concrete, observable services performed for a person. Only the financing of these services is, under conditions of many jurisdictions – relegated to the welfare state and its institutions (Le Grand 1991; 2007). Economically, social services are interesting for a couple of reasons: Firstly, the areas which social services pertain to usually have highly emotional backdrops and the success of their provision means a lot in terms of the future life-chances of the consumers of these services. Unlike the goods and services traded in conventional markets, social services thus have a strong tendency to not only be evaluated in terms of the supply and demand-framework characteristic of usual economic analysis, but also for all sorts of normative, institutional and cultural aspects to enter the analysis (Cremer, Goldschmidt, and Höfer 2013, for a detailed application of the principles at work in the health sector Arrow 1963). Among these, as we shall see later in more detail, a general tendency not to accept the exclusion of non-paying individuals from access to the services in question will be one of the most important particularities here. Therefore,

questions of social services perfectly lend themselves to be viewed not only from an economic angle but to bring interdisciplinary perspectives to the scene as well. Moreover, this also means that 'contextual' approaches to economics will generally be in a better position to explain the processes unfolding on these markets and to come up with policy-advice concerning their design than the usual 'isolating' approach (Goldschmidt, Grimmer-Solem, and Zweynert 2016). Secondly, and for our purpose perhaps even more importantly, the provision of social services usually takes place not only on ordinary markets, but in complicated and diverse arrangements that span wide varieties of provisions such as quasi-markets (Bartlett and Le Grand 1993, for a critique of service-provision via quasi-markets see Boettke, Coyne, and Leeson 2011), public-private partnerships (Esping-Andersen 1996), heavily regulated markets as well as genuine markets. The provision of social services is, at least in western welfare states, seldom completely exempt of government interference, but can – and oftentimes is – still be facilitated via market mechanisms (Shera 1996; Blöching 2008).<sup>16</sup> Only the financing of the services in question is oftentimes relegated to government, while the provision can be taken over by public-private partnerships, non-profit organization or even for-profit companies, leading to complex interrelationships between consumers, providers and government institutions (Tynkkynen, Keskimäki, and Lehto 2013). All the particularities of these markets make social services a highly interesting arena for economic inquiry. However, the complexity of the services involved and the multiple entities involved in their provision have also led to quite differing views about the nature of the goods involved. The following two paragraphs review two of the most prominent attempts at interpretation: social services as public goods and as club goods.

### *3.2.3. Social services as public goods*

The notion of social services as "public goods" is not only relevant from the perspective of theoretical economics. Also in public discourse the idea of the services provided in welfare states as goods with public character has a certain significance, even though this use is not dealt with here.<sup>17</sup> However, attempts are also being made within economic theory to classify the

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<sup>16</sup> See also the Ostromian point that "the production of goods and services needs to be distinguished from their provision at public expense" (Ostrom, Tiebout, and Warren 1961, 36).

<sup>17</sup> These are statements according to which certain goods or services - mostly provided by state institutions - have a public character because their adequate provision is in the "public interest". Typical services of this kind are, for example, the provision of public transport, infrastructure or schooling. For an example of this practice, cf. Kratzwald 2018. Leaving aside question about how difficult it can be to come up even with an approximation of that the "public interest" would be, we do not consider this type of literature here due to the improper use of the term "public good". It bears notice however that a better understanding of what and should be considered as public good is certainly also among the secondary aims of the paper.

welfare state as a collection of goods with public character. Here the fundamental private nature is not disputed by many, but it is pointed out that non-excludability is a very strong political postulate, which should not be ignored in the formation of economic theory. Since public opinion has an extremely strong effect on the design of social policy, and in most places the exclusion of the genuinely needy from access to social services is regarded as undesirable, the exclusion principle must ultimately be regarded as inapplicable for social services. Cremer, Goldschmidt, and Höfer 2013 for instance formulate an approach of that sort building on Musgrave's (1959) theory of merit goods, thereby defining social services as goods that might, if demand for them would be left entirely to people operating in private market, not be demanded in an amount optimal for overall societal welfare. Just like people might not provide their children with a socially optimal amount of education (a classic example of a merit good-inspired market failure situation), they might also not see the need to save for their own care after having reached old age. Similarly, a person just released from prison or a refugee recently embarked in a country will seldom have the resources necessary to purchase (re-)integrative services, or an alcoholic on withdrawal – given the particularities of his condition – will perhaps find it difficult to finance the necessary medicinal and psychological treatment herself. Cremer, Goldschmidt, and Höfer 2013 argue that, because many people in contemporary welfare democracies would implicitly agree with the non-exclusion of potential non-payers from these merit goods, the classification of social services in the typology of goods yields surprising results: While they actually agree with the proposition that many social services actually are private goods along the dimensions of excludability and rivalry of the goods in question, they hold that both aspects – and hence the privateness of social services – are deliberately repealed: By not accepting the exclusion principle for non-contributors, societies would regularly actively choose to transform social services from private into public goods (Cremer, Goldschmidt, and Höfer 2013, 63-67). By providing access to social services (either via their provision directly by state institutions or via quasi-market mechanisms such as vouchers or personal budgets), it shall be insured that an adequate consumption of the goods in question takes place, thereby also satisfying the societal demand for non-excludability of these services.

However, in their attempt to classify social services they do not pay adequate attention to the second dimension of public goods, namely the non-rivalry of consumption. The authors do not go to great length to confirm their point: it is simply assumed that, because excludability cannot be assumed to be operating in any meaningful way for these goods, that the ascription of 'public goods' is justified. Just because political action is used to render excludability unnecessary it does not automatically follow that scarcity per se – and thus rivalry in consumption – is

abolished together with it, as will be shown further down. However, in the notion of social services as public goods this aspect is not considered in any meaningful way.

### 3.3. Social services as impure public goods

Not much has been written on the topic of social services as common pool resources – the closest parallels are found in a (modest) literature attempting to apply the commons-literature on redistributive programs on the welfare state. With regards to this, Thomson 1996 discusses welfare state failure in New Zealand and bleak prospects for the maintenance of current provision-levels in the future, ends up finding the reason for the persistent underfunding in the common-like nature of social policy-arrangement and propose shifts in the incentive structures to minimize the problem. Jakee and Turner 2002 apply a similar reasoning onto the welfare budgets needed to keep welfare states going, the proverbial "fiscal commons", but also discuss behavioural difficulties associated with boundedly rational human actions in CPR-situations. The analogy between social services and common pool resources is not a perfect one, but it is certainly conceivable that similar forces are operating in the two domains. The following sections discuss reasons for why the provision of social services can be assumed – under conditions of many welfare states in advanced economies – to be non-excludable and rivalrous. Special emphasis will hereby be paid to distinguish between the services themselves, the claims / rights to access them on the part of the citizenry and the budgets that fund them.

#### 3.3.1. *Non-Excludability*

The discussion of the approach of Cremer, Goldschmidt, and Höfer 2013 in a previous chapter has already briefly indicated why non-excludability can be assumed for access to many social services. The findings are by no means based on the inherent properties of social services, but exclusively on the social valuation and social attribution of these goods by the majority of members of society. In other words, the classification of goods is not independent of what and how people think about them.<sup>18</sup> If people strongly believe in non-excludability, then a certain

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<sup>18</sup> Interestingly enough, one could with respect to this, refer to similarities in my approach to subjectivist approaches to economics in general and in particular to the Austrian school. Consider for instance Carl Menger 1871 on the nature of value: "Value is thus nothing inherent in goods, no property of them, nor an independent thing existing by itself. It is a judgment economizing men make about the importance of the goods at their disposal for the maintenance of their live and well-being." (Menger [1871] 1976, 120f.) While the analogy must of course

degree of non-excludability must probably be assumed to be real and will lead to real world consequences.<sup>19</sup> This also shows Ostroms' insight that the nature of goods is usually not an "ontological given", but that "institutional arrangements have an effect on the degree of choice and accordingly on the way the nature of goods is perceived and their production organized (Ostrom 1965, 80 in Aligica and Boettke 2009, 40) Similarly, Vincent Ostrom also hints at<sup>20</sup> "the basic presupposition (...) that human beings, to some significant degree, create their own social reality. Order in human societies is constituted by concepts and beliefs that human beings share and hold in common with one another. Customs, laws, or rules more generally, are used to order relationships with one another and with events of the world in which live. Seen from this perspective, human beings are the "artificers" who create their own social reality (...)" (Ostrom [1973] 2008, xxvi).

This insight can in a certain sense also be transferred to social services whose non-excludability decisively does not originate from the goods themselves, but merely from the attribution by social valuations. This strong degree of non-excludability for social services can best be illustrated by some opinion polls (Svallfors 2010). Given that social services are subsumed as a part of welfare states more generally, the opinion polls listed here will oftentimes refer to welfare states broadly speaking. With respect to this, it is not difficult to show that the welfare state as an institution is virtually undisputed in most places.<sup>21</sup> In no country is the welfare state

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remain somewhat imperfect and this subjectivist strand is by now firmly accepted in all of economics while thinking about social services in a similar way must seem rather obscure to many at this point, the quote is intended to illustrate how many "facts" that we as human beings experience on a daily basis are rooted in influencing forces completely unknown to us. Just like the task of the subjectivist economist can be seen as identifying the forces that propel prices to move up and down in line with changing valuations and knowledge on the part of market participants (Hayek 1937, 1945), my task can be seen as uncovering societal valuations of the need for a non-exclusionary social service-provision and elaborating on the consequences that seem to follow from this.

<sup>19</sup> This finding also reminds of the famous theorem ascribed to the American sociologist William Isaac Thomas: "If men define situations as real, they are real in their consequences." (Thomas 1928) As such, "the definition of a situation" (Thomas 2002: 104) will have vast influence on the outcomes that can be expected from what is sometimes seen as an objective manifestation of the situation. Just like the fairy Tinker Bell in the play "Peter Pan" is brought back from death by the sheer belief of the audience, so social services can be rendered non-excludable if enough members of a polity do indeed interpret the matter to be like this. (For illustrations of the "Tinkerbelleffect" in other domains of the social sciences see Paris 1997 and Stewart 2004.)

<sup>20</sup> He does this writing about the German tradition of "Ordnungsökonomik", for which's support he was quite well known. (Aligica et al. 2017)

<sup>21</sup> Cf. For instance Busemeyer and Neimanns 2017, even though it is also clear here that the approval of individual programmes of the welfare state can fluctuate considerably due to the social positioning.



itself open to discussion. However, there are naturally individual areas of welfare states which, in relative terms, have less approval in some places, such as highly progressive taxation or extreme redistribution mechanisms (Busemeyer and Garritzmann 2017b).

Shifting the focus to areas that resemble social services to a larger degree, we find that public attitudes about education spending among citizens of the European Union are such that spending cuts for universities are much more likely to be accepted than those for elementary education (Busemeyer and Garritzmann 2017a, 384) - which can be interpreted as a non-excludability declaration for basic school education, while the same cannot be maintained for tertiary education – clearly a state of affairs that is reflected also on the policy-level in most countries. Furthermore, Mischke 2014 explains the evolution of family policies in Europe and finds that changing family models and societal valuations about what constitutes a "proper" family have been the main drivers of the resulting policy changes. Kananen, Taylor-Gooby, and Larsen 2006 show that even in times of general expenditure cuts for social policy purposes it is possible to open up completely new fields of social support, as long as the social demand for it is large enough. The findings remain consistent when the matter is viewed from a much wider angle: Busemeyer, Goerres, and Weschle 2009 compare a large number of welfare states around the globe and conclude that cultural attitudes are everywhere a reliable predictor of the scope and extent of social programs. Likewise, Goerres and Tepe 2010 find that attitudes towards childcare in contemporary OECD-countries are decisively not formed according to self-interest and personal gain, but instead almost exclusively on the basis of general social norms and cultural convictions, thereby suggesting that non-excludability might in fact be assumed for other social services as well.

While this is of course not an exhaustive description of the factors influencing the progression of social policies and other factors do certainly play an important role, it nevertheless underlines the distinct importance of public attitudes on the provision of social services. We thus think that by presenting evidence for the strong cultural determination of social policies, the criterion of non-excludability can be accepted for social services provided in modern societies. Besides the opinion polls cited, the intended aims of many organizations providing social services underscore this particular interpretation.<sup>22</sup> All in all, accepting the non-exclusionary nature of social service provision already shows why the club good-approach presented earlier shall not be used to classify social services. In the next paragraph, I turn to the question of whether rivalry

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<sup>22</sup> See for instance the organizational motto of "Caritas", the most important provider of social services in Germany: "Not sehen und handeln!" – "When you see poverty, act upon it!" (Caritas 2019)

of consumption shall also be considered an important characteristic of social services, thereby demonstrating that also the public good-narrative is afflicted with severe problems.

### *3.3.2. Rivalry of Consumption / Subtractability of Use*

The public goods-approach presented earlier considers the provision of social services to be non-rivalrous. This means that, although the underlying goods and services are in principle scarce and their provision is often associated with a considerable effort, their transfer to the care of the welfare state miraculously renders unimportant any consideration of rivalry, even scarcity in principle. The issue is not even discussed in detail and it is apparently simply assumed that the obligation on the part of state authorities not to allow the exclusion principle to be applied will, as it were, also – without much effort – render the problem of underlying scarcity obsolete. We would like to reject this idea here and explain that rivalry in consumption is a fundamental characteristic of social services. One illustration can be found in the health sector, where - especially in social democratic states that offer their citizenry "universal" health care without imposing costs directly at the moment of consumption - the official insistence on the principle of non-exclusion leads to the use of alternative, often non-price rationing mechanisms. (Parish 1981) When exclusion is not possible on monetary terms, overcrowding of the relevant providing institutions (such as doctor's practices, hospitals or care homes) not being able to cope with the inflow of patients/people in need of care will be prevented by alternative mechanisms. Examples are the use of personal contacts, relationships or the giving or promising of personal gifts to decision-makers in the bureaucracies concerned (Iversen and Siciliani 2012, Frech III and Lee 1987, Alderman 1987). This category also includes recourse to private offers to address the problem at hand (Breyer 1995). For some social services, the rivalry of consumption is not even limited to the underlying budget and the raising of the necessary funds, but simply to the real shortage of skilled labour that could provide the services demanded in the first place. Examples of this are the prevailing shortage of skilled care- and nursing-workers in Germany despite repeated efforts to attract additional manpower from abroad (Deutsche Welle 2018), and the shortage of kindergarten- and day care-facilities for children, where the practice of not applying the exclusion principle clearly meets reality.<sup>23</sup> Overall, it can therefore be seen that in addition to strong tendencies towards non-excludability for social services, a certain rivalry in consumption must also be assumed. While this rivalry is not permitted to manifest itself in the allocation of goods according to willingness to pay, it still shows up in the

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<sup>23</sup> Even though the central government guarantees access to day-care services for every child below three, in practice there are around 200,000 day care spots missing (Deutsche Welle 2016).

alternative, non-price rationing mechanisms described and thus entail consequences for the optimal provision of social services. I would argue that it is this characteristic that chiefly distinguishes the public good-approach from the common-pool-approach presented and advocated here. It explains why the most influential characterizations of social services as public goods continually, and even more so policy-implementations built up on it, continuously fall short in reality: Even though many people might believe that their fellow citizens ought not to be excluded from social services, it does not follow that access to those is abundant.

### *3.3.3. Social services as impure public goods*

It is worth pondering where exactly the elements of non-excludability and rivalry for social service provision stem from. The notion that goods can change their nature due to interpretation of the actors involved or via societal pressures will not hold for, for instance, fisheries: if large amounts of people were to develop the conviction that high sea fishing grounds are in fact excludable, this would not change anything about the fact that those would remain CPRs. However, what seems to change the situation with respect to social services becomes apparent when we divide the good "social services" in three components: a) the good itself, namely the physical provision of social services, which could still be best described as a private good; b) the claim/right to it, which is derived from political action guaranteeing the financing of various social services for everyone and is ultimately rooted in the societal conviction that exclusion with respect to social services is not desirable; and finally c) the public budgets that fund the provision of social services, from which exclusion is made impossible by the claims/rights discussed under b), but which nevertheless are vulnerable to depletion, rivalry and subtractability of use.<sup>24</sup>

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<sup>24</sup> The insight that the same resource can be classified as multiple types of goods does not originate with me, but has – for instance – clearly been worked out for groundwater basins by Elinor Ostrom (Tarko 2017, 79ff. as well as Gibson et al. 2005), where the quantity of water can be seen as a common pool resource, whereas the quality of the water stock displays public goods-character.

		<b>Rivalry of Consumption</b>	
		<b>Yes</b>	<b>No</b>
<p><b>Exclusion possible?</b></p> <p><b>Yes</b></p> <p><b>No</b></p> <p><i>**Intended public good shifts to allmende good due to existing rivalry.</i></p> <p><i>*Exclusion is not desired, attempt to transform into public good.</i></p>	<b>Yes</b>	<p><b>Private Goods</b></p> <p>Food, Housing</p>	<p><b>Toll/Club Goods</b></p> <p>Cable-TV, Highways, Databases</p>
	<b>No</b>	<p><b>Common Pool Resources</b></p> <p>High Sea Fishin Grounds, Grazing Meadows</p>	<p><b>Public Goods</b></p> <p>Public Security, Defense, Flooding Protection, Improving Air Quality</p>

Illustration 2: Social services shifting from public- to allemande good due to rivalry of consumption existing despite societal non-acceptance of exclusion

Illustration 2 summarizes the account presented here: the originally private good of social services is attempted to be transformed into a public good by the acceptance of universal claims onto those services but ultimately bounces "back" to a common pool resource due to the need to exclude (either groups of people from access altogether or everyone from certain aspects of social services) in order to remain within the realm of the budget allocated for their provision or, more generally, not to engage in non-justifiable spending for social services. Hence we can describe the dilemma of the provision of social services in modern welfare states as one of a continuous oscillating movement between the one of public and impure public goods: While the transformation of an initially private good or service to a public good is intended to be facilitated in welfare states, the transformation falls short of its objective and has the intended public goods swinging back to the level of a common pool resource. It is with respect to this that the not so frequently used, but highly accurate term of an "impure public good" shows its full beauty and descriptive force – while we would perhaps like social service-provision to be treated as a public good, (fiscal) reality thwarts our plans and renders the potential public good impure. The next section will briefly state the main properties of common pool resources or impure public goods and, drawing mostly on the contributions of Elinor Ostrom, suggest institutional arrangements for their sustainable usage.

### 3.4. Common Pool Resources, their durability and the Samaritan's Dilemma

As this chapter aims to define social services as impure public goods, this section will briefly introduce, building mostly on the work of Elinor Ostrom, ways in which their governance can best be facilitated. Because of their characteristics, the incentives for their overuse are ever present: Given that it is hard to exclude potential appropriators from using a CPR and their consumption is generally rivalrous, these resources are prone to the problem of overuse and – in the worst case – complete depletion of the resource. Typically, common pool resources goods are thought of consisting of a stock of the resource in question, which in turn provides a limited amount of harvestable output, a so called flow variable. While the flow of a CPR can be extracted and made usable to human consumption without problems, the stock will have to remain intact in order to also supply future users of the resources with adequate flows suitable for consumption (Ostrom [1990] 2017, 30). Because of their potentially fragile nature and the incentives present for their overuse, CPRs have been (and still quite often are) often seen as being subjected to the "tragedy of the commons" (Hardin 1968), according to which common pool resources will necessarily and without exemption be overused. The overuse of CPRs in the natural world has a clear parallel with respect to our example of social service provision under conditions of socially non-accepted exclusion of non-contributors: the Samaritan's Dilemma. Introduced by Buchanan (1975), it models the interaction between a potential donor (the Samaritan) and a prospective recipient alongside the dimensions of "Work / No Work" (recipient) and "Donate / Not Donate" on the part of the Samaritan. While the latter would prefer the potential recipient to work and thus to be independent of his aid, his utility function might be shaped in such a way as to always prefer to donate if the relevant alternative is the recipient potentially suffering in the absence of help. If the recipient is aware of the Samaritan's preference, the situation lends itself to being exploited by recipients who prefer a steady inflow of Samaritan aid at the cost of no work to a (potentially higher) income derived from labour markets.<sup>25</sup> The stock-flow discussion thus also has a clear analogy in the realm of social service provision. In the sense that the budget available for social service provision can be kept in check and "Samaritans" are not discouraged by an ever-rising number of needy recipients, the "stock" of a budget suitable for alleviating the social problems of the genuinely needy will be preserved.

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<sup>25</sup> On this, also see the Ostroms on the free-rider problem (Ostrom and Ostrom [1977] 2002, 81).

While the Samaritan's dilemma, in its initial formulation, is strictly theoretical, it has been found to be operating to some degree in real life-situations (Ostrom 2011, Raschky and Schwindt 2009, Pedersen 2001). Even though it seems as if the problems raised by the Samaritan's dilemma mostly pertain to redistributive programs of the welfare state, also the provision of social services can be affected by Samaritans being overly generous, thereby being taken advantage of by unnecessarily high numbers of needy recipients. The following discussion of Elinor Ostrom's design principles will thus always have to be viewed as responses to overcoming the tragedy of the commons and preventing society-wide Samaritan's dilemmas (Ostrom 1996). Naturally, E. Ostrom writes solely about ways in which the tragedy of the commons when she deals with physical CPRs and reserves discussions of the Samaritan's dilemma to policy-problems occurring in development (Gibson et al. 2005). However, there clearly seems to be a parallel between these two dilemmas, as this paper implicitly tries to show, in the non-excludability of access to a natural resource and the Samaritan's reluctance to stop supporting a needy recipient.

#### *3.4.1. Ostrom on common pool resources*

Originally, policy-makers were thought to be confined to two options for overcoming the problem of overused CPRs: either the privatization of the resource in question, or alternatively heavy governmental involvement in the form of regulation or even the socialization of the resource system in question. Elinor Ostrom's work was crucial in breaking up this notion and bringing into discussion alternative ways in which CPRs could be made more durable. By highlighting that the "tragedy of the commons" and other overly pessimistic theories such as the prisoner's dilemma (Dawes 1973) or Olson's "logic of collective action" (Olson 1965) ultimately rest on severely undercomplex hypothesis about human action and motivation. By rejecting all too simple models of self interest and the gloomy predictions drawn from them, Ostrom attempted to base the study of CPRs on a different and more solid footing. In order to do that she refused to draw far ranging policy conclusions from "models as metaphors" (Ostrom [1990] 2017, 24) all too easily and instead advocated and actively pursued the empirical investigation of CPRs existing in the real world. The CPRs examined by her range from fisheries in Sri Lanka, Nova Scotia and Turkey to grazing grounds in the Swiss mountains, groundwater basins in California to irrigations systems in southern Spain and the Philippines. Ostrom's insight suggest that the supposed "tragedy of the commons" might not be unavoidable after all: the problems that result from the combination of subtractability of use and rivalry of consumption can, under certain conditions, indeed be overcome and do not subject users of

CPRs to eternal struggles and chronic overuse of the common pool resource they wish to use. Having studied CPRs worldwide, Ostrom felt confident to formulate "a set of seven design principles that characterize all of these robust CPR institutions", which would "help (...) to account for the success of these institutions in sustaining the CPRs and gaining the compliance of generation after generation of appropriators to the rules in use." (Ostrom [1990] 2017, 89-90). According to Ostrom, the seven design principles necessary for this were (Ostrom [1990] 2017, 90):

- 1) Clearly defined boundaries of the CPR
- 2) Congruence between appropriation and provision rules and local conditions
- 3) Collective-choice arrangements to modify the rules
- 4) Monitoring of appropriators
- 5) Graduated sanctions in case of rule-breaking
- 6) Conflict-resolution mechanisms
- 7) Minimal recognition of rights to organize on the part of governments

For CPRs that are not autonomous on their own, but are embedded in larger systems (such as financing- and provision-mechanisms for certain services in welfare states, which are themselves embedded in the larger structure of a government), she added the criterion of 8) "nested enterprises", which should allow for the implementation of the other design principles in this more complex structure on many layers. (Ostrom [1990] 2017, 103f.) This would, in our case, pertain to a federal structure for the provision of social services or to agencies active in the financing and provision of social services to hold independence of the federal government. The next section will apply these design principles onto the matter of social service provision in welfare states and inquire which ones can be seen as being fulfilled and with respect to which policy changes might be called for.

### 3.5. Improving social policy by realizing its common-pool nature

For Elinor as well as for Vincent Ostrom, clear demarcation of types of goods was not an end in itself, but a prerequisite for establishing coherent policy prescriptions (Aligica and Boettke 2009, 116). While they have over their careers engaged in numerous attempts to study in detail the nature of various goods and resources, their attention has scarcely been put onto matters of social policies more generally. However, it is not the case that these matters were altogether

unimportant to them: V. Ostrom's work on the meaning of democracy and the vulnerability of democracies clearly states a country's policy choices with respect to social policies can have long-lasting effects on economic prosperity and – perhaps even more importantly – the long-term viability of free social orders (Ostrom [1997] 2009). He placed special emphasis on the cultural effects of overarching welfare policies and stressed the importance and significant meaning of citizens coming together voluntarily in order to discuss, vote on and craft the socio-political institutions of their society. By relegating questions of poor relief, health care, provision for old age – and presumably also social services – to central bureaucracies and not taking responsibility for their own affairs, societies run the risk of long-term social decay and the neglect of their political institutions as well as their moral imaginations. (Ostrom [1997] 2009) In that regard, the project undertaken here of contextualizing the nature of social services within the typology of goods can be seen as a valuable – and highly relevant – exercise. Given that, in an Ostromian framework, the purpose of social science is – in the last respect – always the application of scientific insights onto real-world problems and the finding of solutions to social problems, the preceding discussion shall in the following be made fruitful to concrete policy advice. In order to do this, I will discuss Elinor Ostrom's design principles presented above and their applicability will be at the center of the discussion. The Bloomington School's ultimate task of "free[ing] our institutional and political imagination" (Aligica and Boettke 2009, 141) would certainly find few areas of social reality as needy of this modification as the welfare state.

### *3.5.1. Solutions to problems of social service provision*

Because neither "government intervention" nor "privatization" – as the historically most widely applied ways of trying to overcome the tragedy of the commons – promise much success for a satisfactory reform of social service provision, a close look at the approach of using Elinor Ostrom's design principles considerable merit here. Thus, the postulate that the CPR that is the provision and financing of social services could be preserved and its operation improved by the invoking of Elinor Ostrom's design principles and their application onto the matter will occupy us for the remainder of the chapter. The ultimate goal would be to offer practical solution for making presently existing welfare states sustainable, resilient (Tarko 2017, 103-37) and more responsive to the people they are deemed to be serving (Aligica 2016). Thus, the following paragraphs will apply these principles onto the provision of social services, ask whether the Ostromian conditions for successful provision are met, discuss potential problems for the provision of social services and offer some tentative suggestions for remedies. I will start with



two design principles that I see as being mostly in place with respect to the provision of social services and then shift the discussion to those where I find considerable deviations from Ostrom's principles.

*3.5.2. Boundaries of access to social services:* It is not difficult to define at a given moment the social services that can be obtained in a welfare state. More important will be, however, the question of how these boundaries change over time. To give an example: While the question of state provision or financing of care services was not even raised 50 years ago, it is common practice today - at least in European welfare states. This same effect can be shown to exist for many other areas of social service provision. This means that the problem of the boundaries of state involvement in welfare states is not a static but a dynamic one. The same informal-cultural mechanisms that influence the exclusion criterion of social services at a given point in time also have a major impact on the areas to which the said exclusion criterion may no longer be applied in the future. A clear boundary or definitive criterion for what constitutes a "legitimate" provision of a given social service will thus be hard to get hold off, at least over longer periods of time. In the short run however, it is absolutely no problem to define where access to a social service begins or ends and, given that I would conclude that this design principle does not pose a severe obstacle to social service provision in welfare states.

*3.5.3. Congruence between appropriation and provision rules and local conditions:* With regard to this design principle, the greatest relevance can probably be seen in correctly determining the carrying capacity (Jakee and Turner 2002, 496), i.e. the sustainable financing of the corresponding programmes. Jakee and Turner see two different problems with regard to this: First, the financing of social services is subject to "soft budget constraints" (Kornai 1986, 3), which is why the financing of social services was and is not always tied to budgetary limits (for the recent instances of this with regards to nursing care insurance in Germany, see Aertzblatt 2018). Here, however, demographic change processes could lead to a "hardening" of the budget constraint in the not too distant future. Moreover, it must be assumed that in many Western welfare states the upper threshold of the possible corridor for tax rates might already have been reached and that resistance can be expected in the event of future increases in taxes to finance social services. Similar considerations can also be made in some places with regard to the possibilities for further government debt. Secondly, Jakee and Turner (2002, 497) point out that in many places the inflows and outflows into the fiscal commons of social service systems have reached such a scale and complexity that neither politicians nor policy experts - not to mention the users of the services - can get a good overview of the extent of the underlying CPR. The overview becomes even more difficult if future developments - for example to

estimate future funding requirements for the financing of care services - are also to be taken into account. However problematic these outlooks seem to be, I would still argue that they underlying problems can potentially be resolved. In the case of care-insurance in Germany for instance, the demographic outlook automatically leads to rising rates on the part of contributors to the budget (BPB 2014); while this might not be a perfect adaption to the challenges ahead, it still demonstrates that congruence between appropriation and provision rules and the particularities social service provision in welfare states can be facilitated.

Thus far, I have suggested that some design principles might be – at least partially – fulfilled with regards to social service provision. I will now shift to those where I see greater potential for them not being fulfilled and where consequently a less than optimal and potentially unsustainable management of the underlying CPR needs to be feared. It will become apparent that this pertains mostly to those design principles that pertain to the ways in which the collective choice about the organization of the CPR are made and how the procedures within it are to be monitored and administered.

*3.5.4. Collective Choice Arrangements & Conflict Resolution Mechanisms:* While in democratic welfare states a certain civic participation can be localized through participation in elections, it must nevertheless be stated that the influence of the individual citizen on the design of concrete policy-measures is likely to be relatively small. This is due to the sizeable political distance to the decision-making centers for social policy matters, as well as to the vastly larger group sizes that contemporary welfare states cater to. A rather simple takeaway to solve this problem would be to split the respective supply systems into smaller geographical units. (Sellers and Lindström 2015) However, this is decisively not the direction in which contemporary social service provision seems to be moving; much rather, international organizations such as the ILO, the UN and – in the European context – the EU are attempting to come up with and implement principles for social policies to be unified over jurisdictions and its administration centralized (Holden 2017, Kelly 2011, ILO Global Flagship Program 2019). Thus, one would have to predict that also the future realization of this particular design principle does not seem all too likely at this point. The same criticism would hold for conflict-resolution mechanisms, which – according to Ostrom ([1990] 2017, 100) – should be available rapidly and at low cost to appropriators. While, again, the political arena of modern welfare states facilitates some function of this design-principle, it is of course a far cry from the potential that relatively small and somewhat homogeneous groups of appropriators can have to solve conflict in the CPRs described by E. Ostrom.

*Monitoring and Sanctioning:* Similar conclusions can be drawn with regard to effective monitoring. While social security systems can easily be designed in such a way that corresponding violations of the directives can be identified and sanctioned, the difficulty is probably more in ensuring that a) violations of the rules are defined so precisely that they can also be proven in daily practice, b) monitoring-techniques that span entire societies can be developed and c) the members of society responsible for monitoring - with regard to social services these are politicians and bureaucrats - have a sufficient interest in enforcing the sanctions. Jakee and Turner (2002, 499-502) point to the difficulty of the first point and, with regard to the last one, show with Buchanan 1967 that this desired behaviour cannot be easily assumed. While I do not wish to belittle the public-choice problems that questions of the welfare state are inherently confronted with<sup>26</sup> and the difficulties of properly defining the rules in a complex welfare state, I would still posit that the difficulties of effective monitoring discussed under b) pose the greatest challenge in this regard. While the mechanisms used to monitor the behaviour of a small-scale community concentrated in a relatively limited geographic area can easily be facilitated by the appropriators themselves, extending the scope of the impure public good in questions to millions and millions of people necessarily requires monitoring to be delegated to agents that might not have the same interest and ability to effectively pursue their tasks.

*3.5.5. Minimal recognition of rights to organize:* Correspondingly, I would also state a less than perfect congruity between this design principle and the reality of social service provision. While it is certainly possible – in most cases<sup>27</sup> – for individuals to make their own arrangements for certain social services (if they can afford to), it is under most conditions not possible for them to correspondingly withdraw from the financing mechanisms for the collective provision of these services for other members of society. Thus, even though the formal recognition of citizen's rights to self-organize to provide social service is mostly not curtailed, the prevailing financial incentives make it unlikely that these rights will be acted upon by the majority of the populace – by making the opt-out option with regards to social services undesirable, welfare states practically make this design principle of the Ostromian account not fulfilled.

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<sup>26</sup> For, in my opinion, still the best overview on the matter, see Wagner [1998] 2019.

<sup>27</sup> Note that for e.g. education, which is not included in most definition of social services but whose provision mechanism are similar under conditions of most western welfare states, some countries do not even allow citizens to withdraw their children from state-run or certified schools, thereby rendering home-schooling illegal (for an overview of the situation regarding this in Germany, see Deutsche Welle 2019).

Summing up, we can see that, while the design principles that pertain to the definition of the boundaries of CPR and the appropriation rules can be seen as fulfilled for social service provision, it is rather those design principles that deal with the importance of collective choice mechanisms, monitoring, sanctioning and rights to self-organization that must be seen as found wanting. It is thus apparent that the takeaway from this realization lies in an appeal to strengthening those areas in which the Ostromian design principles seem to apply the least. While I am not going to engage in concrete policy proposals and even a thorough discussion of potential responses to the mismatch between the design principles and the reality of social service provision is beyond the scope of this paper, the following lines shall play with some ideas of how service provision can be made more robust vis-à-vis the described shortcomings. Interestingly, potential remedies for the shortcomings in the application of the design principles can be found in other works of Elinor and Vincent Ostrom. Especially their insights about the polycentric nature of – apart from a manifold of other social phenomena – what they came to call "the public economy" can serve as a useful starting point here. Realizing that "(t)he public economy need not be an exclusive government monopoly" (Ostrom and Ostrom [1977] 2002, 75), the Ostroms set the base for a polycentric view on service provision (also see Ostrom [1972] 2002). While social service provision, as I have previously laid out, is already being financed and provided in a way not completely foreign to the "public economy"-approach developed by the Ostroms, the pendulum could still be shifted further away from governments with respect to social service provision. The characteristics of polycentric systems, namely that "there exist many decision-making centres, formally independent of each other" (Ostrom 1991, 223), is certainly an idea that could potentially be fruitfully applied to social service provision as well. Or, as Elinor Ostrom had put it in her Nobel Prize Speech: "Moving away from the presumption that the government must solve all common-pool resource problems while recognizing the important role of governments is a big step forward" (Ostrom 2010, 197). The big step with respect to social service provision would be to realize that governments, while they might continue to be important players in the financing of social services, ought to realize that their capacities to manage and oversee social security system in complex modern societies in necessarily limited. Similarly, Ostromian insights from the Metropolitan Governance Debate can be applied to for social services might also be defined very differently: The most striking finding of E. Ostrom's investigations with respect to this surely is the insight that higher degrees of "professionalization" on the part of service providers do not necessarily lead to greater satisfaction for service users. This effect was most pronounced with the provision of policing services, for which increased specialization actually lead to worse results. Police officers, who

might have gotten excellent training and were well equipped in terms of their technical capacities but had no grounding in or relation to the community they were serving in produced worse results (Ostrom, Parks, and Whittaker 1978, Boettke, Palagashvili, and Lemke 2013). Consequently, professionalism and the optimal background for effective provision would also need to be viewed in a differentiated way with regards to social services. While it is certainly important that providers of social services be professional in the sense that they are able to perform their tasks well, perhaps not enough attention is being paid to the inherently human element of social service provision and the fact that it might be more important to stress those elements than insisting on ever greater specialization and professionalization in those fields. All in all, what has been said leads to the conclusion that the remedy to the deviations observed between the design principles and social service provision could be remedied by taking steps towards a more participatory welfare state (Delsen 2016), that would attempt to search for polycentric solutions not only for the provision of social services, but for a host of other welfare policies as well. Additionally, the role of community and localized service provision could be strengthened.

### 3.6. Conclusion

I have tried to show in this chapter that social service provision in modern welfare states has characteristics that resemble a common pool resource or an impure public good. The contrary definition and practical treatment of social services as "public goods" regularly leads to problems. In particular, the assumption that in the provision of social services - after their financing and guarantee of provision by state institutions - the rivalry in consumption can be ignored must be regarded as mistaken – rivalry of consumption still manifests itself, although perhaps along different avenues than merely prices. At the same time, the problem of the principle of exclusion being inapplicable because of social and cultural beliefs about social services must also be accepted - non-paying, but needy persons cannot simply be excluded from access to care, health or education. Having demonstrated this impure public good-character of social services, the chapter then applied Ostrom's design principles for sustainable CPRs onto matters of social service provision and found that mostly design principles that speak to the self-organisational, monitoring- collective-choice-capacities of the "appropriators" (i.e. service users and taxpayers) seem not to be fulfilled.

In my view, two major takeaways follow from what was discussed here: First of all, it would be important - both for the economists analysing and for the politicians making decisions about

the provision of social services - to assess the nature of social service provision correctly. If the fundamental nature of social services as goods, whose properties are very similar to those of CPRs, is correctly recognised, the effects of economic and social policy decisions in this respect will be better assessed. As for practical proposals, the chapter has argued that a more participatory version of the welfare state and social service provision within it would help to remedy some of the shortcomings associated with it. While I have refrained from discussing concrete policy-responses to narrowly defined real-world problems<sup>28</sup>, I have challenged the reader to re-think policy-responses to social service provision along Ostromian lines. These would call for a greater citizen participation in the design and provision of social services and more plurality in the institutional structures used for their financing. Additionally, citizens shall be enabled and encouraged to, as far as possible, devise their own solutions to social problems. While these proposals certainly do not serve as a panacea (Ostrom, Janssen, and Anderies 2007) against problems experienced with social service provision, I would hope that the thoughts laid out here could serve as the starting point for further inquiries into the nature of the goods and services offered in welfare states. The next, and final, chapter of the dissertation explores a similar, albeit more conceptional approach to the problem of adapting social policies to the social norms prevalent in a society. I will discuss how the ordoliberal Freiburg School tackled these questions and ended up concluding that a liberalism worthy of its name will always have to be contextual, meaning that it should take into account the preferences for social organization prevalent in any given society, even if those may – prima facie – seem to conflict with the program of classical liberalism, as it has historically been understood. Interestingly, the section will also point out how this conception of a “contextual liberalism” also underlies the approach of the constitutional economics of the Virginia School

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<sup>28</sup> The Ostroms themselves would probably have liked my chapter more had I done this!

## 4. Contextual Liberalism: The ordoliberal approach to private vices and public benefits

This chapter highlights the various sources that shaped the genesis of ordoliberalism. In the wake of the emerging project of *neoliberalism*, ordoliberals created a theory that contains a bundle of claims, which constitute the attempt to merge liberalism and its contextual embedding into a social philosophy that meets the requirements of both – economy *and* society. They were concerned with a new and properly interpreted liberalism. Not because they did not share the basic assumption of classical liberalism that individual self-interested action is the necessary driving force in advancing economic and social progress, but because they realized that individual action requires an embedding into a social and moral order to deliver public benefits. This insight proves to be the significant difference between ordoliberals of neoliberal facon and the exponents of classical liberalism: Namely that the market economy operates based on prerequisites which it cannot itself guarantee. Regarding their very own historical context, this must be seen in light of their concern for the reconstruction of Western societies after the end of the totalitarian Nazi regime. The purpose of ordoliberalism has always been the “consciously shaped” economic order which manifests itself as *humane* and as *functional*. Moreover, if one understands ordoliberalism as contextual liberalism, it can also be significant for today’s discourse. In order to achieve this aspiration, ordoliberalism adopts a contextual approach. In particular, linkages can be drawn here to Constitutional Political Economy, which – as will be shown – also grounds its definition of liberalism, and even more so the way to implementing liberal policies in a society, in the convictions and moral codes of the local population. The interaction of the dicussed perspectives offer promising benefits for both “thinking-in-orders” traditions.

### 4.1. Introduction

To grasp what constitutes the specificity of ordoliberalism, it may prove helpful to contrast renowned thinkers, both of which are understandably icons of liberalism: Bernard Mandeville and Friedrich Hayek. In his commemoration of Mandeville in 1966, Hayek assesses the Dutchman’s achievement to be grounded in being the first to explain that “in the complex order of society the results of men’s actions were very different from what they had intended, and that the individuals, in pursuing their own ends, whether selfish or altruistic, produced useful

results for others“ (Hayek 1978, 253). In this sense, it was Mandeville who established this important element of liberal theory, namely “the twin ideas of evolution and the spontaneous formation of an order” (ibid., 250).

Yet when one examines the texts of ordoliberal scholars, one quickly discerns that – contrary to Hayek – classical liberal thinkers like Mandeville and Adam Smith hardly play a significant role, and if they are mentioned in passing they are generally regarded critically. It would be mistaken, however, to suggest that ordoliberals failed to understand classical liberalism. Slightly in contrast to the usual perspectives in the predominant literature (Horn 2019; see also Tribe 2008) they were far more concerned in their contestation of liberal thinkers like Mandeville and Smith with the concern that their ideas unintentionally led to a development in which individuals’ actions were removed from their social settings and respective context. To formulate it differently: ordoliberals did not deny that individual action based on self-interest was the necessary driving force of market and societal forces; but they detected that an excessive focus on individual action and the positive effects that such action brings about for society were inflated, thereby overlooking the necessary embedding of individual action in a societal and moral order. Yet such an order is indispensable for ordoliberals to ensure that individual action does indeed serve the benefit of the public.

Unlike for Mandeville where even individual vices confer public benefits, ordoliberals require the presence of public benefits in terms of a societal order *ex ante* so that individual action can be assumed to function in a desirable way. Thus, ordoliberals seek to invert the perspective of classical liberalism: Only an order which embeds the individual sufficiently can secure the liberty of both society and the individual durably. In all other cases, the degeneration of society and a development which is antithetical to the intention of classical liberals – i.e. the Wealth of Nations – would ensue. Alexander Rüstow, a progenitor of ordoliberalism, got to the heart of the matter in formulating the following:

“Adam Smith and his school of economic liberalism no longer depreciated egoism as ‘vice’ – as had Mandeville in his puritanical asceticism – but rather identified it as the real motive force of the market economy; they viewed it as altogether legitimate, and sanctified it because of its highly beneficent effects – a development that also contributed to the ‘transvaluation of values’ that was to culminate in the nineteenth century.” (Rüstow [1980] 2014, 477)

In light of this focus on values, virtues and collective welfare, the ordoliberals extended their economic analysis far beyond “economics proper” into what can be called the (societal)



environment under which economic activity takes place. They anchored their specific concept of liberalism in societal notions of norms and justice – in short: in its context.

We shall proceed as follows: In the second section we briefly introduce the ordoliberal school of thought and delve into the philosophical foundations of ordoliberalism. To understand its genesis correctly, it is important to realize that the ordoliberal tradition has no genuine roots in “classical liberalism” as such. Nonetheless, ordoliberals have always seen themselves as “true” liberals and were willingly engaged in the early- and mid-twentieth century project of a redefinition of liberal principles. It is not a surprise that the *ordoliberals* see a primacy of order before freedom. Moreover, for them liberalism is much more than an economic conception. In the third section we illustrate the connection ordoliberals established between liberty and dignity. We argue that irrespective of the detailed experiences during the dark time of Nazism, the threat of the Nazi-regime had profound influences on the ordoliberals, instilled a stronger desire for freedom in them, and demonstrated the necessity to come up with societal arrangements that would oppose totalitarian developments in the future. Section four illustrates the ordoliberals specific grasp of political economy. By focusing on the contextual sphere, it becomes clear why they can certainly be seen as successors of the German Historical School (GHS). We will demonstrate how the ordoliberal research program can be connected to Constitutional Political Economy (CPE), especially with regard to thinking in rules and orders enabling freedom and of common interest to all members of a society. Based on such a re-interpretation of ordoliberalism, impulses for the current debate on liberalism can be drawn. The fifth section concludes.

## 4.2. The philosophical foundations of ordoliberalism – a liberalism without liberal roots?

With all its peculiarities, ordoliberalism is commonly regarded as the German variety of neoliberalism (Bilger 1964; Riha 1986; Barry 1989; Kolev 2015; Biebricher 2017). Ordoliberalism mostly dates back to an interdisciplinary research group of economists and legal scholars, the so-called *Freiburger Schule* (Freiburg School). It was founded at the University of Freiburg in the nineteen-thirties by the economist Walter Eucken (1881–1950) and the two jurists Franz Böhm (1895–1977) and Hans Großmann-Doerth (1894–1944). As the name implies, ordoliberalism emphasizes the necessity of the establishment of an economic *order* above all, which must be created and maintained by the state as a legal framework in order to guarantee a free, prosperous and humane society. In contrast to other liberal currents, this

characteristic shapes ordoliberalism as a school of thought and was heralded by further important scholars beyond the Freiburg School: namely, Alexander Rüstow (1885–1963), Wilhelm Röpke (1899–1966), Alfred Müller-Armack (1901–1978) and Ludwig Erhard (1897–1977).

It is indisputable that the ordoliberal thinkers around Eucken always considered themselves to be true liberals, but their characteristic emphasis on the idea of order and the prominent role that the state has to play in it is not the only aberration from classical liberalism's roots. The incompatibility was quite obvious as early as in 1938 at the *Colloque Walter Lippmann*. The participation of Alexander Rüstow and Wilhelm Röpke was formative in the sense that it forced them to discuss and further confront their differences with regards to economic policy and liberal foundations (Reinholdt and Audier 2018). In general, the ordoliberal thinkers were chiefly concerned with a *new* and properly interpreted liberalism; hence it is not surprising that the creation of the term *neoliberalism* is supposedly attributed to Rüstow during the Colloque (Mirowski and Plehwe 2009, 12–13).

The ordoliberals criticized classical liberalism for failing to provide a sufficient response to the cultural and social problems of modern mass societies. They had the impression that classical liberalism tended to decontextualize the individual, the economic processes, and itself represented a decontextualized perspective on society. It was the end of totalitarianism at the end of WWII, in particular, which led ordoliberals to consider freedom to be an integral and practical project. The contradiction between the perception of living in times of cultural and social crisis and at the same time the undiminished liberal conviction that this crisis could not be overcome without the market economy and economic competition could be seen as *differentia specifica* of ordoliberalism to the other (neo-)liberal schools of thought, especially to those of the classical Anglo-Saxon tradition (Kolev and Goldschmidt 2020, 215–216).

In order to differentiate themselves from the latter, they applied the term *paleoliberalism* to distinguish antiquated liberalism from what they sought to develop (Rüstow 1961). As Horn (2019) has argued, they have not always bothered to dig as deep into Smith's works to fully appreciate the nuances of his positions. One can argue à la Horn, but our point is a different proposition: It is not so much a misinterpretation by the ordoliberals that leads to a different assessment of the classics, but rather the assessment that the focus on individual behavior (quite in the sense of the Enlightenment), which was understandable in the eighteenth century, neglects the necessary and obviously embedding of individuals in society. Furthermore, the ordoliberal approach does not refer to a "liberal" philosophical underpinning. Instead, their philosophical influences can be found in German idealism, for Eucken especially in the person

of Edmund Husserl (Goldschmidt 2013; Goldschmidt and Rauchenschwandtner 2018) and Immanuel Kant (Klump and Wörsdörfer 2009; Audier 2013) as well as – in the case of Rüstow in particular – the Greek classics (Rüstow 1952).

#### 4.2.1. *A reverse perspective on liberalism: Order first, followed by individual freedom*

The German variety of neoliberalism did not wish to separate itself from the “liberal family”, but was willingly engaged in the early- and mid-twentieth century project of a redefinition of liberal ideas and the search for institutions that would enable societies to preserve economic and civil liberties over time (Kolev, Goldschmidt, and Hesse 2019a). The important role of ordoliberalism during the *Colloque Walter Lippmann* or later on in the *Mont Pèlerin Society* seem to confirm this assessment. Nevertheless, the ordoliberal thinkers were drawn to their liberal convictions in somewhat different ways, focusing on diverging strategies for achieving their vision of an ordered and at the same time free society. Ordoliberalism does not emphasize as much the process of free exchange as the essence of liberalism inasmuch as it focuses on the interaction of free individuals within a legal order. Within this legal framework, the individual is free in the sense that rules guard its freedom and expand its scope for action while the economic order ensures efficient economic performance.<sup>29</sup> The main argument that led the ordoliberals to this conviction was

“the question of private power in a free society. It necessarily leads to the question of how an order of the free economy is constituted. From there one arrives at the question of what types and possibilities there are at all, what role power plays in them, both the power of the government and the power of private individuals and private groups, and what disturbances of order occur when a different distribution of power develops within the state and society than that which is in conformity with the respective economic system.” (Böhm 1957, 99).

In this sense it becomes obvious that “free order is a task” (Eucken [1952] 2004, 360) and not something that will be propped up by spontaneous forces: “The ‘invisible hand’ does not easily create forms in which individual interest and overall interest are coordinated” (ibid.). This they

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<sup>29</sup> As Ludwig Erhard (at this time Minister of the Economy) wrote in 1949 in a letter to the first Chancellor of the Federal Republic of Germany Konrad Adenauer: “The Social Market Economy means much more than a return to liberalistic forms of economy; it does not mean a *laissez-faire*, but a very alert, sensitive economic governance which leaves the principle of freedom untouched, indeed highlights it more strongly and more emphatically than the abuses of a past capitalist system.” (Erhard [1949] 2019, 203; all quotations from German sources are translated into English by the authors).

perceived to be the decisive difference of their approach to classical liberalism. It is not the pursuit of individual interests and competition per se that leads to advantageous economic and societal outcome; on the contrary, competition itself is to be understood as a task (Miksch 1937) which can only be realized and preserved through an adequate order and thus serves the interests of the individual. The ordoliberals do not deny that self-interested individual action is the necessary driving force of economic and social progress, but they are concerned that the sole reliance on the action of the individual overlooks its necessary integration into a social and moral order. For them, however, this order is indispensable, to ensure that individual actions really do best serve the common interest. In this conviction they rely on the incentivizing effect of a properly set institutional framework which sets the “rules of the game” for each individual. In preserving the formal side of these rules, they see the primary task of social and economic policy – interpreted as *Ordnungspolitik*.

“They [i.e. the Classics] have failed to appreciate the degree to which socio-cultural achievements have been important for the development of mechanisms of ordering, believing instead that it would suffice to remove privileges, to establish the freedom of trade, and to refrain from state intervention to create a politico-social framework which enables leaving everything else to ‘nature’” (Böhm 1950, 52).

And still this is not to be understood as a reproach of the Classics. Only historical development highlighted, the ordoliberals argued, that an ordering of the economy was necessary to guarantee its functioning – experiences classical liberals had not had when they formulated their politico-economic proposals. Thus, the novelty of neoliberalism in ordoliberal fashion was to “refine the market economy to a competitive order and to realize it in the economic-social cultural sphere of ORDO“ (ibid.). For ordoliberals, the idea of freedom (literally) comes second to the notion of a well-ordered society, but this is certainly not to be understood as a devaluation of freedom: In ordoliberalism – unlike in other liberalisms – it is order that makes freedom possible in the first place. On this basis, one might be induced to believe that the idea of liberty does not in itself have excessive value for the ordoliberals,<sup>30</sup> but this tension vanishes disappears if one comprehends that their concept of liberalism is deeply rooted in their cultural values.

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<sup>30</sup> Eucken summarizes this in his *Grundsätze der Wirtschaftspolitik* (Principles of Economic Policy): “The principles outlined here are sometimes called ‘liberal’ or ‘neoliberal’. But this term is often tendentious and not apt. [...] The liberals of the nineteenth century were mostly supporters of a policy of laissez-faire. They were based on a great tradition; but some of them were epigones. On the whole, the liberalism of that time is only a branch of the great tree of European culture which has been based on freedom ever since it existed, and which was threatened or decayed only when freedom decayed. The new historical context makes it necessary – and it is precisely this

#### 4.2.2. Liberalism as a cultural ideal

The idea of (classical) liberalism is often associated by ordoliberals with the conception of laissez-faire and “manchesterism”, which, as immanent features of the economic system, are seen as causing undesirable social phenomena such as impoverishment and economic inequality and are therefore downright counterproductive to the attainment of human flourishing. According to Rüstow, the great demerit of “manchester liberalism” is that it “could not stop the degeneration of the market economy” (Rüstow 1949, 131). The insistence on a “weak state” (Rüstow 1942, 275) ultimately led to the fact that the actual economic policy prerequisites of a market economy – a “pure efficiency competition” for performance (ibid., 274) – could no longer be regarded as given. As a solution to the real economic problems that existed in the mid-twentieth century, ordoliberals had in mind a “Third Way” that openly addressed the grievances of the market economy and attempted to renew liberalism in such a way that it “takes into account the demands of socialism” (Rüstow 1949, 131; see also Röpke [1944] 1979, 52). In other words: There is no doubt that the ordoliberals share the goal of classical liberalism – a free society of sovereign individuals. From the perspective of the ordoliberals, however, the strong focus on individual self-interest and the underestimation of processes of economic power have not drawn sufficient attention to the legal and cultural preconditions for achieving a successful liberalism.

In this regard, classical liberalism seemed to them to suffer from an “emptiness of the senses”. Nobody made this point better than Röpke who charged classical liberalism with “economism”, only aiming at “stimulating performance” while neglecting the crucially important non-economic aspects of human existence (Röpke [1958] 2009, 136). Ordoliberalism, on the other hand, claims that the market economy “must be embedded in a higher overall context which cannot be based on supply and demand, free prices and competition” (Röpke [1958] 2009, 131). Rüstow also extensively deals with “liberal criticism of liberalism” (Tönnies 2009, 159) and contrasts it with his own vision of a more contextual version. Furthermore, classical liberalism could be found guilty of *Soziologieblindheit* (blindness for sociology) (Rüstow [1950a] 2001, 61) and correspondingly the overlooking of institutional prerequisites and regulative forces of a market economy (ibid., 90–112).

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idea that has forced us to do so – to avert the massive threat to freedom posed by new, positive means.” (Eucken [1952] 2004, 374–375)

Accordingly, Röpke writes in *Civitas humana*: “The liberalism which we reach could be characterized as sociological, and against it the weapons which have been forged against the old, purely economic liberalism remain blunt” (Röpke [1944] 1979, 51).

Against this backdrop it is obvious how ordoliberalism’s criticism leads away from an economic view and locates the true problem of liberalism in another place, namely on a level that lies, in the words of Röpke, “beyond supply and demand” (Röpke [1958] 2009). The surrounding institutions or – as they themselves called it – the “border of the market” which represents “the actual domain of the humane, [and is] a hundred times more important than the market. The market itself merely has a serving function” (Rüstow 1961, 68). In a similar vein, Eucken criticizes classical economics’ – implied in this is the ever-present connection with classical liberalism – failure to explain events in the real world by abstracting too much from them:

“We can appreciate the efforts of the classics to discover a rational natural order by studying the diversity of economic institutions, but all the same they did not satisfactorily explain economic life as it actually was. Their analytical powers were applied essentially to the *one* case which they considered ‘natural’, the system of free competition in all markets [...] We know that the classical economists did not feel this divergence between theory and reality so strongly, because they were mainly concerned to look for the “natural”, rational and workable economic system, but we, if we wish to understand economic reality, cannot tolerate it.” (Eucken [1940a] 1950, 49)

In Röpke’s dichotomy of *fleeting* [vergänglich] and *lasting* [unvergänglich] liberalism (Röpke 1947a, 12) ordoliberalism’s unique view on the liberal order and its issues with classical liberalism become most evident: A distinction must be made, he thought, between liberalism as the political and social movement of the nineteenth century and *true, imperishable* liberalism. The economic and socio-political liberalism of this time was actually a transient liberalism that did not do justice to the “cultural ideal” (ibid., 1) which should inform lasting liberalism (see also Goldschmidt and Dörr 2018).

### 4.3. The fight for freedom in response to the tyranny of the Nazi dictatorship

We have shown in the past section that ordoliberalism puts the idea of order before the idea of freedom as a desideratum for a well-functioning society. Additionally, its members criticized economists advocating for a *laissez faire* approach to economic policy and, at times, actively tried to distance themselves from belonging to the “camp” of paleoliberalism. At the same time,

it can be shown that – despite the criticism of classical liberalism – the real freedom of each individual is essential for ordoliberals, and this became increasingly important over the years. While it is clear that a significant liberal outlook existed with many ordoliberals prior to 1933, we make the case that the first-hand experiences with the thoroughly illiberal regime of National Socialism from 1933 to 1945 sensitized ordoliberals to the necessity of liberal political and economic institutions and the value of freedom as such. The issue can be illustrated with the ordoliberals’ publication history: While their early writings were clearly centered on narrow economic questions such as business cycles and capital theory (Röpke 1929), trade theory (Rüstow 1925) or detailed descriptions of various business segments (Eucken 1914, 1921), which then turned into questions about the good economic order (e.g. Eucken [1938a] 2005, [1940] 1950), their scope and aim changed further in the late nineteen-thirties and -forties and increasingly links economic questions to matters of political organization and social philosophy.<sup>31</sup> The very concept of “freedom” and clear statements about the desirability of its maintenance can be found from this point onwards. The practical experiences with a very concrete loss of freedom led to a deeper reflection about the prerequisites of an economic and social order that would prevent such constrictions reliably in the future. To achieve this aim required extending the realm of analysis from merely economic topics to broader issues, as is evident from the titles of their publications at the time – *The Social Crisis of our time* (Röpke 1947b), *Civitas humana* (Röpke [1944] 1979) or *Freedom and domination – a historical critique of contemporary civilization* (Rüstow [1980] 2014)<sup>32</sup> do not sound like titles of economics textbooks, and that certainly is not what they were.

This change of appreciation for a *liberal* social and economic order can be directly linked to experiences with the Third Reich. Naturally, the experiences of the proponents of ordoliberalism during that time period differed sharply depending on their relationships with the regime. In the case of Alfred Müller-Armack or Ludwig Erhard, for instance, their relationship to National Socialism is not always entirely clear, especially in the earlier years, even though they generally distanced themselves from being active in politics during those years.

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<sup>31</sup> Blümle and Goldschmidt (2006a) argue that the rise of dictatorship in Germany also taught ordoliberals that attempting to solve small, technical problems of economic life might not be the proper domain. While these technical problems faced difficulty in isolated analysis, a well-ordered overall economic order was useful to address these issues.

<sup>32</sup> This book is a condensed, translated version of Rüstow’s three-volume *Ortsbestimmung der Gegenwart* (Rüstow 1950b, 1952, 1957) edited by his son, Dankwart A. Rustow.

For others, most notably Alexander Rüstow and Wilhelm Röpke, the coming to power of the Nazis impeded freedom in a very concrete sense: It forced them into exile. In both cases, the experience of National Socialism triggered deep reflection about the cultural prerequisites of free societies and instilled the conviction in them that economics alone was not sufficient to prevent disasters like the Nazi regime in the future. The issue at hand was viewed to be a cultural malaise which required that solutions to the problem were also to be found on the level of social and cultural influences (as exemplified in the second section). In the case of Röpke, for instance, many of the sentiments he expressed during his exile in Istanbul and later in Geneva can be detected in the collection of essays *Against the Tide* [Gegen die Brandung]. It not only demonstrated Röpke's initial reaction to the difficulties of the Weimar Republic and "Brown Totalitarianism", but also reveals how the experiences of those years informed his later attempts to help (re)-construct an economic and social order that would not succumb to the same type of totalitarian seduction again in the future (see Röpke 1969). While Röpke's writings in the early nineteen-thirties are already permeated with pessimism about the future, the dire outlook (among which totalitarian tendencies were clearly included) is always seen as a consequence of faulty economic policies, especially with regards to money and trade (Röpke 1929, see also Eucken 1923). Shortly after the takeover of the National Socialists, we do already find much broader criticisms of the current state of affairs and its political climate "[...] that prepares itself to reforest the garden of culture and transform it back to the old primeval jungle" (Röpke [1933] 2009, 68).

The case of the Freiburg School is perhaps even more instructive in this respect, especially given the characterization of the ordoliberal's liberalism of one as a "cultural ideal", as has been laid out in the second section.<sup>33</sup> Franz Böhm and Walter Eucken, for instance, both raised in homes in which Christian faith played a prominent role, were active in all three of the so-called "Freiburg Circles", which aimed at reflecting on the role of the believing citizen in the face of an evidently unjust political order during the times of the Third Reich. Ultimately, they were part of actively promoting the overthrow of the Nazi regime.<sup>34</sup> For our purposes, the activities

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<sup>33</sup> Research about the important role of Freiburg economists in the resistance has of course been conducted almost exhaustively in recent times (Rieter and Schmolz 1999; Rütger 2002; Goldschmidt 2005, 2011; Maier 2014; Dathe 2018). Our aim is not to contribute to actual historical research about the so-called Freiburg Circles (see below), but rather to carve out in which sense the ordoliberal's commitment in the resistance against the Nazi regime contributed their increased appreciation of freedom as a value to be actively pursued.

<sup>34</sup> Three Freiburg Circles must be distinguished: The *Freiburg Council* (First Freiburg Circle), the *Bonhoeffer Kreis* (Second Freiburg Circle) and the *Arbeitsgemeinschaft von Beckerath* (Working Group von Beckerath, Third



in and contributions to the so-called Freiburg Bonhoeffer Circle is a perfect way of illustrating the connections of the resistance against the Nazi regime and the development of ordoliberalism. The Bonhoeffer-Circle was created at the behest of the Berlin pastor Dietrich Bonhoeffer (1906–1945) and was also heavily influenced by the ideas of the Confessing Church. The Circle produced a clandestine paper titled “Politische Gemeinschaftsordnung: Ein Versuch zur Selbstbestimmung des christlichen Gewissens in den politischen Nöten unserer Zeit” (Political and Communal Order: An Attempt at Self-Determination of the Christian Conscience in Our Politically Difficult Times), which dealt with questions of how Christians ought to act in the Third Reich. More importantly, it also featured an essay written by Eucken and his two Freiburg colleagues Constantin von Dietze and Adolf Lampe, included in the appendix of the document, which deals with the “Wirtschafts- and Sozialordnung” (Economic and Social Order) to be implemented after the war had ended. The appendix proposes an economic order for the post-war area that does not only focus on material aspects, but also offers “the strongest resistance possible to the power of evil” (Dietze, Eucken, and Lampe [1943] 2008, 100). Throughout the text, the authors stress the ethical and religious pillars of a future economic order, at the heart of which stood the individual human as a free and moral being. They motivate their endeavor in the following way, which clearly demonstrates the strong religious underpinnings of the project:

“Our work is primarily concerned with the overall order of economic life, rather than with the duties and commandments which, according to Christian teaching, apply to the behaviour of the individual in economic life. As much as we are imbued with the fact that the observance of the eternal basic demands of individual economic ethics founded on Christian values is of utmost importance for healthy economic and social conditions, we think that we should not deal with them in detail here.

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Freiburg Circle). A detailed description of the members of the Freiburg School in all three circles can be found in Goldschmidt (2005). In this paper we will mostly use the Second Freiburg Circle for purposes of illustration. The first Freiburg Circle, the so-called Freiburg Council, was founded after the events of the “Reichskristallnacht” (Night of Broken Glas). The members, all of who had strong ties to Christianity, wrestled with the question of what their role vis-à-vis the Nazi-regime should be.

The Third Freiburg Circle was a working group on economics as part of the working group “Klasse IV der Akademie für deutsches Recht” (Class IV of the Academy for German Law), in which many of the Freiburg economists came together – with other leading German economic thinkers of the time – to discuss questions of economic policy. The reports of these meetings played an important role later on within the scientific advisory body of the federal ministry of economics under the first federal minister of the economy in the newly founded Federal Republic of Germany, Ludwig Erhard (Grossekettler 2005; Klump 2005). Indeed, many of Erhard’s advisors had belonged to the working group.

For the Christian foundation of individual economic ethics, everything that is contained in the commandments of love for God and love for one's neighbour (Matth. 22, 40) seems to us to have been worked out sufficiently clearly. On the other hand, it is a particularly urgent task to give a Christian foundation to the foundations of social-economic ethics, especially according to the Protestant understanding. What has been done for this so far is not enough and therefore has not found general approval." (ibid., 99)

As such, the appendix also offers very concrete practical guidance for economic policy: The discussion of the promotion of competition and the avoidance of monopoly – characteristic for ordoliberalism – is found there, along with an extensive treatment of the role of the state on the matter, given the necessity of embedding the economic order of a society in a safe and stable legal framework. In that sense it is no surprise that the appendix has been described as “containing the essence of ordoliberal thinking” (Horn 1996), and its content neatly illustrates that the ordoliberal's conception of liberalism is indeed rooted in strong ethical and cultural underpinnings. However, the ordoliberals' membership in the resistance also carried with it immediate practical consequences that placed their lives in severe danger. After the failed assassination attempt on Hitler on July 20<sup>th</sup> 1944, the endeavors of the Bonhoeffer-Circle became known and its members frequent targets of police questionings and SS-investigations. Some of its members, for instance Constantin von Dietze and Adolf Lampe, were sentenced to death, but the verdicts were not carried out (Goldschmidt 2011).

Thus, the Freiburg School's program for economic policy ultimately also became – as Eucken later described it – a “program for freedom” (Eucken [1952] 2004, 370). With its opposition to Nazi ideology, it becomes clear as to why it evolved into a positive program for real individual freedom. The threatening loss of freedom spurred the development of an economic and social order that could defy power and coercion. As Michel Foucault wrote about the ordoliberals:

“But I think we can say that Nazism was, in a way, the epistemological and political ‘road to Damascus’ for the Freiburg School. That is to say, Nazism enabled them to define what I would call the field of adversity that they had to define and cross in order to reach their objective” (Foucault 2010, 106; see Goldschmidt and Rauchenschwandtner 2018).

Their practical experiences with unfreedom during that time, and the constraints that they had to suffer because of that, also sensitized the ordoliberals towards appreciating freedom as a value in itself. This does not imply that a school of thought similar to ordoliberalism would not have emerged without these experiences, but it does suggest that its focus on individual freedom and the necessity of searching for an economic and political order that would limit the

activities of the state and render a reappearance of a Nazi-like regime impossible would have been far less pronounced without their crucial experience of National Socialism.

## 4.4. Ordoliberalism as contextual liberalism

### *4.4.1. The historical foundations of ordoliberalism's contextual approach*

Having seen how the historical context of their times helped instill their particular appreciation of freedom in them, we now turn to how the ordoliberals integrated the broader context under which economic activity takes place into their thinking. In order to do this, it is necessary to first take one step back: One of the strongest influencing factors of early ordoliberalism was undoubtedly the German Historical School of Political Economy, although ordoliberal thinkers around Eucken tried to distance themselves from this origin (e.g., Eucken 1938b; 1940b). And indeed, at first glance, discontinuities with the program of the GHS can be identified at various levels: e.g., with regard to the methodological approach, to the epistemological position, or to the agenda relating to economic policy, particularly with regard to competition policy implications (Eucken 1940b, 489). It is therefore not surprising that some corresponding works consider ordoliberalism to fall into an Anglo-Saxon tradition rather than an offspring of the GHS (e.g., Sally 1996; Vanberg 2004; Goldschmidt and Berndt 2005; Köhler and Kolev 2013). Nevertheless, even if this interpretation were correct, ordoliberalism can only be fully grasped in its connection to the heritage of the GHS (Scheffold 1995; 2003; Peukert 2000; Goldschmidt 2002; Broyer 2006). Moreover, at second glance, a further examination of this heritage reveals continuities, that even the early ordoliberals may not have fully recognized or perhaps did not wish to acknowledge.

It is often overlooked that the founders of the (older) GHS stood firmly on the ground of German political liberalism of their time. Even so, they had a dispassionate confidence in the blessing of state intervention to remedy social problems (Bruch 1985, 138). But to justify obvious deviations like this from the liberal doctrine of classical economics in their own country, they developed a pronounced historical awareness within their political economy – a relativist economic approach which took the context and specificity of time, place and culture into account. This contextual – or rather sociological – understanding of political economy is also strongly reflected in ordoliberal theory, and it is not coincidental that this tradition of economic thought originated in Germany in the middle of the nineteenth century (Goldschmidt,

Grimmer-Solem, and Zweynert 2016, 3–6): Compared to England or France, the onset of industrialization was a relatively late development, so Germany was one of the first latecomers in Europe to carry out catch-up development. The isolating theory of classical economics in the wake of David Ricardo implicitly presupposed what Germany – like most other societies – had not yet sufficiently achieved.<sup>35</sup>

Following this interpretation, one can distinguish explicitly between contextual economic approaches, which concern the interaction between the economic order and other societal orders, and isolating economics, which focuses on the processes within the economic order (Goldschmidt, Grimmer-Solem, and Zweynert 2016; see also Kolev, Goldschmidt, and Zweynert 2019b). This classification does not imply a static relationship between contextual and isolating economics, but rather that their interrelationship varies or should vary as economic reality changes (Kolev, Goldschmidt, and Zweynert 2019b, 648). Hence, contextual economics is first and foremost research of transition; it has its comparative advantage in understanding profound structural changes (ibid., 649). However, given their own historical context in nineteenth century Germany – in the midst of a major societal transformation and an increasing integration into the world economy (Rieter and Zweynert 2006) – it appears reasonable that the research program of the GHS was almost exclusively devoted to contextual economics.

This applies in particular to the works of Gustav Schmoller (1838–1917), the *spiritus rector* of the younger GHS. Central to his approach is the economy *in its entirety* – i.e. that economy and society (and each of their interdependent components) are conceptually integrated (Shionoya 2006).

“The term ‘economics’, adopted by the Americans and partly by the English, instead of political economy [Volkswirtschaftslehre] [...] seems to me even more impractical, because it also wants to eliminate the people, the society, the social side of the economic process by using the economy as a mere material process” (Schmoller 1911, 429).

Schmoller’s contextual concept can best be described as historico-ethical political economy (Nau 2000). It is the attempt to move beyond pure economics, because for Schmoller political economy “can only be a science if it expands to a societal doctrine [Gesellschaftslehre] and to the extent to which it does so. Its entire starting point must no longer be the individual and one’s technical production, but rather society and its historical development, its narratives must be inquiries into the societal manifestations of economic life” (Schmoller 1882, 1382).

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<sup>35</sup> From the perspective of the history of economic thought this certainly does not apply to the beginnings of classical political economy. Especially the system of Adam Smith was still firmly concerned with understanding economic processes in their societal embeddedness (Evensky 2005).

Methodologically, Schmoller's approach was primarily derived empirically by individual studies of economic history in which institutions constitute the tangible object of research. He preferred to "first explain the development of the individual economic institutions" (Schmoller [1908] 1978, 120) in order to embed it in specific overall economic and societal contexts. Even though the later ordoliberals rejected the allegedly anti-theoretical method of Schmoller in their effort to overcome the predominant historicism after the decline of the GHS – quite tellingly they refer to themselves as "Ricardians" in this respect (Janssen 2009a, 34–50; Köster 2011, 222–233) – they clearly share its genuinely contextual approach.<sup>36</sup> Eucken's *specific holism* (Zweynert 2007), according to which it is necessary to concentrate first on the analysis of the suborders in order to be able to comprehend the overall order, is remarkably similar to Schmoller's institutional approach. Considering this, it is not surprising that Eucken on the other hand also rejects classical economics with quite a *schmollerian* argument: It failed to him "not simply because of defects in its theoretical system, but mainly because its theoretical solutions did not fit the existing historical variety of economic life" (Eucken [1940a] 1950, 48).

Consequently, the ordoliberals sought to distance themselves to a certain extent from both the (contextual) German Historical School *and* (the seemingly isolating) classical economics. At the same time Eucken explicitly identified the questions about economic processes *and* those about economic order as the two main subjects of political economy (Eucken [1938a] 2005). What appears to be a contradiction yet makes sense when condensed to the fundamental notion of isolating and contextual economics in general.

The early ordoliberals had the claim to emancipate themselves from their predecessors who in their eyes had failed by exaggerating the historicist method (Böhm, Eucken, Großmann-Doerth [1936] 2008, 38; Eucken 1938b, 207). Their aim was to overcome the "ruins of the Historical School" (Janssen 2009b, 104) by providing its guiding questions with an epistemologically solid foundation (Gander, Goldschmidt, and Dathe 2009) and by reconnecting German political economy to the modern international mainstream of economic science in favor of a more (neo-)classical theoretical approach. But in the end, the successors to the GHS rather tried to offer a new perspective and a new theoretical background (Schefold 1994, 222). Therefore, one could say that ordoliberal thinkers wished to pursue modern economics, but also sought to include contextual thinking into their analysis. They attempted a new form of deductive abstraction, but wanted to remain grounded in the real world. According

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<sup>36</sup> Schmoller never ruled out the possibility that an economic theory is possible under realistic basic assumptions. The almost ubiquitous accusation of Schmoller's hostile attitude to economic theory to emerge at a later point therefore needs to be put into perspective (Plumpe 1999, 262).

to Alfred Müller-Armack “we are not entitled to view economic development in isolation. It is deeply connected to general intellectual history, which we thus have to address as such” (Müller-Armack [1949] 1981, 539).

In other words, the economic approach of ordoliberalism tries to bridge isolating and contextual economics without being bogged down by the inherited burdens of the respective approaches. Condensed to the notion of a contextual approach, ordoliberalism can certainly be understood as the most recent GHS (Schefold 1995; 2003; Peukert 2000). The ordoliberals not only maintained the great emphasis on social policy (Blümle and Goldschmidt 2006b) or the conviction that the prerequisite to guarantee a free, prosperous and humane economic and social order has to be a strong and assertive state.<sup>37</sup> Their strong ethical-normative convictions and their appeal to include cultural values in economic analysis (already discussed in the previous section) are broadly to a considerable extent rooted in the rich legacy of the GHS’s intellectual endowment (Häuser 1994). In particular, this seems the case with regard to their attitude on value judgements. According to Eucken, above all, economics was tasked with “find[ing] an effective and lasting system, which does justice to the dignity of man” (Eucken [1940a] 1950, 314). His scientific aim was a *functional* and *humane* order of the economy (ibid.; see also Eucken [1952] 2004, 14).

Probably the most important contextual domain within the scientific agenda of ordoliberalism is the issue of social cohesion in modern market societies. This ethical line of thought on the contextual interaction of markets and social order is deeply anchored in German economic thinking (Priddat 1995, 310). Schmoller used to compare the economy to the mechanical gears of a clock driven by egoism and quantitative relations which must be regulated by ethics and law in order to achieve a prosperous outcome (Schmoller 1875, 86). Insisting on the need for an institutional framing of the economic order, he suggests that it is not a “natural product”, but rather that it is most of all the outcome of “respective moral views on what is right and justice in the relationship of the various social classes” (Schmoller 1874, 337). In his 1894 essay “The Idea of Justice in Political Economy”, he expounds that social stability derives from subjective perception of social conditions based on certain predominant mental models rather than from objective economic indicators alone (Schmoller [1894] 2016).

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<sup>37</sup> The ordoliberals uses the term “strong state” not in the sense of an authoritarian or totalitarian state. For them it is a state which, by operating with general rules as opposed to establishing privileges, is above private interests and is not subject to being captured by these (Eucken 1952 [2004], pp. 327–332). The misinterpretation of the term “strong state” is a permanent irritation on the part of critics of ordoliberalism (e.g. Mirowski and Plehwe 2009; Bonefeld 2017; Innset 2020).

In the view of ordoliberalism (e.g., Röpke [1956] 1981, 448) one could read Schmoller as follows: The market economy operates based on prerequisites which it cannot itself guarantee.

This holistic view of the interdependent relationship between the economic order and other societal orders and the recognition that the economic reality is continually evolving and driven by changes in the social environment makes ordoliberalism still and particularly relevant for the twenty-first century (see Zweynert, Kolev, and Goldschmidt 2016). The new societal fragility is characterized by an entanglement of factors that stem from the economic, legal, political or even religious domains (Kolev 2018a, 86). For if ordoliberalism is not simply considered as a merely (neoliberal) approach to economic policy, but as approach to a rather sociological and therefore contextual understanding of political economy, its unabated scientific value becomes apparent (Kolev, Goldschmidt, and Zweynert 2019b, 655). If current economic research aims to provide explanations for economic processes in the real world it has to deal with the same questions that drove the early ordoliberalism of the nineteen-thirties and -forties. As we will show in the next section, such contextual ordoliberalism can also enhance contemporary liberal approaches.

#### *4.4.2. Contextual liberalism and CPE*

While isolating economics has its merits in times when the interrelation between various societal orders is fairly stable, it does not do justice to recent changes in (economic) reality. However, it is these problems where contextual approaches have their comparative advantage. This is where ordoliberalism can reveal its significance, but in order to do so it is (again) necessary to reconnect with current economic discourse to achieve mutual enhancement between suitable isolating *and* contextual approaches. Even more importantly, because in the past the search for integration in Anglo-Saxon academia was pursued sporadically at best (Feld and Köhler 2016).

The linkage between ordoliberalism and the research program of Constitutional Political Economy pioneered by the extensive work of James M. Buchanan appears to be most suitable in this respect. How close these two approaches are in their very own “thinking-in-orders” tradition is, of course, already well established by the detailed examinations of Vanberg (1988) and Leipold (1990). Both – the exponents of ordoliberalism and CPE – share the essential conviction that a sound liberal society needs a well-defined legal framework which sets the

rules for individual actions; especially with regard to the issue of power in a market economy.<sup>38</sup> In contrast to classical liberalism, they consider mere reliance on the rationality of action by single individuals to be insufficient. Instead they plead for an effective design of a superior (constitutional) order – which defines the “rules of the game” – as a prerequisite for self-interested actions to serve the common interest.

Like ordoliberalism, Buchanan’s work is clearly directed to the entangled interfaces between the political and societal order on the one hand and the economic order on the other (see Wagner 2017; 2018a). With his approach of combining ordoliberal thought with the works of Buchanan, Vanberg has already shown how the Virginia School can revitalize ordoliberalism, e.g. by providing a more realistic concept of the functional and performance capability of politics in a democracy (see Vanberg 1997; 1999; 2014; 2015). The essential distinction between “choices over rules” and “choices within rules” has become a central element of modern “*Ordnungsökonomik*” (economics of order). Picking up on this, Kolev (2018a) has recently outlined how the ordoliberal tradition can benefit from Buchanan’s comprehensive contributions to the fields of CPE and Public Choice to promote a research program of “*New Economics of Order*” (see Zweynert, Kolev, and Goldschmidt 2016). We suggest that such a synthesis would certainly also be a great asset in terms of *contextual liberalism*.

Moreover, in this respect CPE could certainly benefit from ordoliberal insights as well. It has been argued that Buchanan’s notion of a functional CPE is no adequate way of insuring the self-set goal of facilitating the construction and sustainability of a free and liberal society (Haeffele and Storr 2018, 113). Buchanan’s project would ultimately have very little to say precisely in those cases where it should be most needed – in societies filled with unreasonable and heterogeneous actors, i.e. most real-world societies. Similarly, Goldschmidt (2006, 181) asks what the “culturally and socially transmitted conditions [are] that make an agreement between citizens possible” concluding that CPE severely falls severely short of a conception of economics as a cultural science.

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<sup>38</sup> With regard to their normative convictions, the founders of both approaches pleaded for an active shaping of the institutional (respectively constitutional) order, but they had different emphases: Eucken was primarily concerned with the active shaping of a competitive order which was intended to prevent private concentrations of power in the form of cartels, monopolies etc. (see Eucken [1952] 2004, 241–324). In contrast, Buchanan’s considerations are primarily aimed at limiting the power of the state, either through finding the appropriate framework for people to agree on which responsibilities they want to delegate to government (Brennan and Buchanan [1985] 2000) or through exposing governments to competitive pressures themselves (Sinn 1992, 187).



To develop concrete constitutional rules (based on the unanimity rule), Buchanan stresses the rationality of the individual and its accountability to society. In claiming, furthermore, a cultural environment that sustains this self-imposed order, ordoliberalists take a further decisive step. To them, methodological individualism and individual rationality is too indeterminate; they require a cultural (and thus contextual) embedding. Although it did not find much consideration in his theory, Buchanan seemed to be aware of this particular shortcoming of this approach. It is easy to show that “Virginia-style” CPE is not completely blind on that issue. Indeed, some of Buchanan’s work on moral orders and moral community (Buchanan [1981] 2001) can actually be interpreted in a similar vein: While moral community can serve to facilitate and maintain agreement among a small and relatively homogenous society because “individual members of the group identify with a collective unit” and do not “conceive themselves to be independent, isolated individuals” (ibid., 188), they create issues for governmentability in larger societies. To the contrary, a moral order – defined as conditions under which “participants in social interaction treat each other as moral reciprocals, but do so without any sense of shared loyalties to a group or community” (ibid., 189) – was seen as a much more preferable form of underpinning a contractarian political order. Precisely because “each person treats other persons with moral indifference, but at the same time respects their equal freedoms with his own” (ibid.), the prospects for peaceful cooperation and exchange are greatly magnified in a moral order.

However, the great challenge associated with this was how to overcome the problem that “it is not rational to participate actively in any discussion of constitutional change or to become informed about constitutional alternatives” (Buchanan [1989] 1999, 371). In other words, treating other members of a society as moral equals imposes a cost on citizens – a cost, that they will be much more likely to bear in the presence of some – as Buchanan called it – “Madisonian vision” (ibid., 372), namely “some ethical precept that transcends rational interest for the individual” (ibid., 371) prevalent among the population. Without what Buchanan called a “*heritage of experience* that embodies some understanding of the central logic of effective constitutionalism, any implementation of constitutional democracy will be difficult to achieve” (Buchanan [1986] 2001, 234; own emphasis). Indeed, Buchanan acknowledges that, historically speaking, large parts of human evolution and progress could be described as a gradual extension of mutual respect between persons from the original setting of tribal communities to much more inclusive forms of organization (Buchanan 1983, 205). While Buchanan thought that religions had historically been at the forefront of granting a status of morality including to (former) outsiders, letting go completely of distinctions between in- and

outsiders of course rarely happened. Nevertheless, Buchanan mentions “humanism, considered as a great religion” (Buchanan 1983, 205) as one such attempt to extend inclusiveness of traditional moral communities to humanity as one giant group, which could thus serve as the basis for an all-encompassing moral order, which would in turn make agreement between diverse groups of people much easier.

It is worth noting that CPE also does not seek solutions to perceived policy problems exclusively within the domain of trying to change formal institutions: *The Reason of Rules* (Brennan and Buchanan [1985] 2000) – by most accounts the most comprehensive account of CPE – ends with a section that calls for “a new civic religion” (ibid., 165). CPE will not, as Brennan and Buchanan stress in abundantly clear terms, be successful by “proffering advice to this or that government or politician in office” (ibid., 167), but indeed only by the gradual advancement of constitutional understanding on the part of a population. Once “the relationships between individual utility functions and the socioeconomic-legal-political-cultural setting within which evaluations are made” (Buchanan 1991, 186) are understood, Buchanan thought, it opens up the possibility to “invest [...] in the promulgation of moral norms” (ibid.), revealing a further contextual sphere of the CPE-project. While these ideas are usually presented as “side notes”, their presence shows that the contextual sphere is at least partially present in Virginia-style CPE, implying the possibility of broadening its scope to a CCPE – a Contextual Constitutional Political Economy – at some point.

While the ordoliberal tradition is generally more concerned with the properties and characteristics of the non-economic preconditions they deem necessary for the implementation of a functional market and societal order, its hinted presence within CPE highlights one further overlap between the approaches of Freiburg and Virginia, which favors a fruitful collaboration in the search for adequate rules to promote human flourishing under the header of a “contextual liberalism”.

## 4.5. Conclusion

Not unlike Friedrich Hayek, James Buchanan also sees Bernard Mandeville as “one of the first social philosophers to demonstrate that the result emerging from interaction of many persons need not to be those intended or planned by any one person or group of persons.” Instead: “Under some situations [...] qualities of private individual behavior that might seem vicious or self-seeking may be precisely those required to produce desirable social results when persons interact in a complex environment.” (Buchanan [1970] 2001, 302) To what extent private

interests produce public goods depends largely – on this matter ordoliberalism and CPE concur – on the corresponding environment, i.e. on the rules of the game. In which sense classical political economy actually acknowledged it (Buchanan’s interpretation) or only merely presupposed this environment unknowingly (the ordoliberal interpretation) is a dispute that will have to be settled by historians of economic thought.

However, with the emerging project of neoliberalism in the late nineteen-thirties, it became the ordoliberals’ aim to restore a properly interpreted liberalism. Not because they did not share the liberal basic assumption of classical liberalism that individual self-interested action is the necessary driving force in economic and social progress, but because they realized that individual actions require an embedding into a social and moral order to unfold public benefits. To have experienced this insight proves to be the significant difference between the *ordoliberals* of neoliberal stance and the exponents of classical liberalism. It became their profound conviction that without a proper “spiritual-moral bracket” (Röpke [1958] 2009, 160) neither society nor its wealth-serving market economy are viable. Thus, the purpose of ordoliberalism has always been the “consciously shaped” (Eucken [1940a] 1950, 314) economic order which manifests itself as *humane* and as *functional*. The crucial insight of the ordoliberals that such an order can only thrive on the soil of a liberal society was reinforced by their own experiences of totalitarian oppression during the years of the Nazi regime. That is the reason why freedom turned into a real project for them.

Moreover, this real project of freedom and the pronounced reception of contextual factors is key in understanding the relatively strong influence that ordoliberalism managed to exert on policy making in post-WWII Germany. While ordoliberal ideas were not heavily debated in international academia, their reception in policy making did directly help to construct the main pillars of the German model of the Social Market Economy (see Hesse 2010). If one contrasts this with the relatively modest impact that CPE was able to exert on practical policy making in most places,<sup>39</sup> one is tempted to conclude that the ordoliberal approach has proven to be more fruitful in some respect.<sup>40</sup> We suggest this can be partially explained by the more contextual

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<sup>39</sup> Richard E. Wagner – one of Buchanan’s most influential students himself – even suggests that Buchanan’s political economy must be seen as a “failed effort to square the circle” (Wagner 2018b, 9), given that he – whilst being interested in the continuously ongoing “game” of societal rule-making – could, on an analytical level, “never escape the hold of closed-form theorizing” (*ibid.*).

<sup>40</sup> This should not be interpreted as a criticism of CPE, the aim of which’s does not lie precisely in the direct influence on policy making. However, it is also proper to mention, that even Buchanan himself was aware of a

perspective it employs, which leads to it never losing sight of the ultimate goal of its efforts: A humane and self-determined life for as many people as possible. To achieve this, the ordoliberals have always been willing to recognize that reality is more important than principles. While Buchanan would probably not have disagreed with this premise concerning the political process itself,<sup>41</sup> ordoliberalism is more proactive in realizing the (sometimes messy) heterogeneity of contemporary societies and the corresponding need for compromise and reciprocal discourse already present at the theoretical level, thereby suggesting one key area in which CPE could actually benefit from the ordoliberal approach in order to gain more relevance in the political arena itself. If CPE as a traditional “thinking-in-orders” approach is – according to Gaus (2018) – also “not a completed artifice to be admired and defended, but an ongoing project, constantly refining its assumptions and analysis” (ibid., 139), the same can be said for ordoliberalism. These approaches can benefit from mutual interaction based on their particular insights and thereby make valuable contribution to current socio-economic discourse.

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“basic indeterminacy” (Buchanan 1987, 249) of CPE; even though he did see it as a necessary, and not even detrimental, feature of this approach.

<sup>41</sup> For a comprehensive summary of Buchanan’s conception of democracy see Thrasher (2019).

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