German "*Ordnungstheorie*"

From the Perspective of the New Institutional Economics[*] [a]

by

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Abstract: German "*Ordnungstheorie*" (~ system theory, *ordo* theory) relates essentially to Walter Eucken (Freiburg) who attempted to strike a balance between the economics of the German Historic School, still relevant in Germany of the 1930s, and its opposing neoclassical analysis. The paper starts, therefore, with a brief description of Eucken's morphological approach, his "isolated abstraction," as an analytic method that is focusing on a precise description of the institutional framework of the analysed economy with only vague assumptions on human wants, behaviour, behavioural constraints etc. Its considerations may be loosely compared with the strategic reasoning of lawmakers who are primarily interested in the general consequences of their draft bills and not in (theoretically or econometrically established) predictions of their effective functioning. Marginal analysis is abandoned and replaced by general behavioural assumptions such as "…all normal men everywhere and at all times act in accordance with the economic principle." Target of Eucken's *Ordnungspolitik* (*ordo* policy) is to minimize (measurable market) power instead of striving for (immeasurable) Pareto efficiency. Eucken's morphology, his ideal typical description and ordering of institutional frameworks by way of "isolating abstraction," may be seen as a predecessor of Williamson's formation and use of "efficient governance structures." Eucken's questioning of the regulative ability of *laissez faire* anticipates (instinctively) the consequences of Olson's logic of collective actions. Eucken, together with the other members of the Freiburg school, demand from the state the establishment and guarantee of an economic constitution of a free market economy based on David Hume's principles of natural law: private property, freedom of contract and personal liability. This paper continues with a neoinstitutional discussion of Eucken's *ordo-liberal* principles of *Ordnungspolitik*, which served as basis of the West German *Wirtschaftswunder* after the currency reform of 1948. It ends with a critique of Eucken's deliberations and some reflections on Douglass North's "adaptive efficiency" as another substitute for the empty concept of "Pareto efficiency".

JEL: B25, B31, B52, L16, L22.

Ordnungstheorie (~ system theory, *ordo* theory) and New Institutional Economics have opposing objectives: The objective of *Ordnungstheorie* is the "…scientific understanding of real economic life"[2], given the institutional framework (economic system or "order") within which economic life happens, while the objective of the New Institutional Economics[3] is the eco-

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[2] Eucken (1950, 221)
[3] The term "New Institutional Economics" was introduced by Williamson (1975) and became a standard (or banner) under which a diverse group of economists assembled, who shared one common intellectual ground not only that institutions matter (as in what became "constitutional economics") but that the determinants of institu-

nomic analysis of the institutional framework of the economy itself (its "order"). That is, in spite of their different objectives, the two approaches have one common point of interest: the institutional framework of economic life. For that reason it may be of interest to neoinstitutionalists to have a closer look at German *Ordnungstheorie*.

A warning in advance: To translate Eucken's thoughts into to-day's economic language - and do him justice – is the task of a historian of economic thought, which we are not. We discuss therefore in this paper Eucken's theory *as we see it*.

1. Introductory remarks

German "*Ordnungstheorie,*" together with its application as "*Ordnungspolitik,*" relate essentially to WALTER EUCKEN (1940) and his criticism of the at his time in Germany still relevant economics of the Historic School of Gustav Schmoller (1900) and its consequences, viz., the infamous *Methodenstreit* between the German Historic School and the Austrian Theoretical School of economics as represented by the work of Carl Menger (1883). Eucken assumes an intermediate position between German historic and Austrian theoretic approach. This is one reason why Eucken's *Foundations of Economics* is so tedious to read for modern economists. Another reason is that Eucken belonged to the at that time large group of German "verbal" economists, who were either hostile or strongly reserved to the application of mathematical methods in economics (at that time largely differential calculus) because mathematics would belong to the natural sciences while economics is a humane discipline (see Stackelberg 1948, X). Still, Eucken applies some concepts of "mathematical" economics such as demand and supply curves, Cournot's monopoly theory, Stackelberg's oligopoly theory, the concept of marginal costs. But he uses no utility function, no marginal value theory, and no Pareto optimality, i.e., Eucken keeps clear of value theory, the prevailing economic theory of his time.[4]

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tions can be analyzed with the aid of economic theory – taking into account transaction costs, incomplete foresight and bounded rationality. A different (at first sight possibly more obvious) way to deal with *Ordnungstheorie* is in terms of Buchanan's (1987) "Constitutional Economics" as illustrated by Vanberg (1988, 2005).

[4] That culminated in Hicks (1939).

Instead, he suggests using a mix of historic and theoretical analysis that he calls **morphological** approach (Eucken 1940, 1950, 293). In the subsequent German literature the term *Ordnungstheorie* established itself. This method describes an economy from aspects of its outside appearance, viz., from its type of economic system or "order" (like "centralized economy" or "exchange economy"), as well as from aspects of form and structure of its internal organization (like its market forms or type of monetary systems). The morphological approach is to be seen in contrast to a "physiological" explanation of economic life, i. e., the explanation of functional issues (as does neoclassical microeconomics or Keynesian macroeconomics). Its aim is to explain - or predict - the consequences of the general organizational structure of an economic system, not to explain - or predict - the actual level or development of specific economic magnitudes such as interest rates, commodity prices, unemployment etc.. Thus, for the morphological approach suffice very general information on human wants, behaviour, knowledge, constraints etc. It may be compared with the strategic reasoning of lawmakers who are interested in the general consequences of the draft bills they are voting on and not in (theoretically or econometrically established) predictions of their detailed functioning

Correspondingly, Eucken proceeds in general terms. He describes an economy as a *system* of actors whose actions "… are always based on an economic plan."[5] Economics behavioural assumptions are only briefly mentioned, such as that "…all normal men everywhere and at all times act in accordance with the economic principle." (Eucken 1950, 293). How actors proceed in detail depends on "spiritual and intellectual characteristics of individual men in different periods, classes or nations" (loc. cit. 294). Human actions are constrained by the givens ("data"). Eucken apparently disagreed with the unhistoric methodology of "pure economic theory," i.e., its mathematical method of constrained individual utility maximization. Hence, he does not use the concept of Pareto-optimality to assess economic systems or "orders." In-

[5] Eucken (1950, 117 f.).

stead, Eucken applies the concept of **economic power,**[6] which became an object of dispute between adherents of the Marginal Utility School ("pure economic theory") and the Historical School in the early 1900s.[7] Its issue was, how to explain income distribution: by the "natural laws" of marginal utility analysis or by means of the social concept of "power". However, Eucken does not deal with distributional aspects. He refers to the general aspect of *human freedom*, viz., that power confronts men and politics with the dilemma that

> the possession of power provokes arbitrary actions, endangers the freedom of other people, and destroys mature and good institutions. Nevertheless, without the possession of power there can be no social life; for there must be *authority* – in the state and in a firm. (Eucken 1952b, 38)

Eucken continues that economic power would reach its maximum concentration in the *totally centralised economy*[8] and its minimum in an *exchange economy*,[9] to wit, under conditions of perfect competition on all markets.[10] But in this context "economic power" is merely a specific type of power, viz., "market power;" or more precisely: the power to admit/exclude someone to/from a market and to make/take prices.[11] Of course, Eucken disapproves of centralized economies.[12] He opts for an exchange economy with perfect competition, i.e., a market economy with an entirely functioning price mechanism. To achieve such an economy, economic life would have to be controlled by an appropriate norm system or "order" whose development must not be left to *laissez faire* but should be designed and enforced by the state

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[6] Which has many facets. Eucken's attempts to clarify it: 1950, 263 and Note 59.

[7] Debated was the relevance or usefulness of marginal productivity theory for the explanation of real world income distribution. Böhm-Bawerk (1914) defended in a well-known paper Austrian marginal utility theory against Stolzmann (1909) who argued that it is power alone that determines the distribution of income.

[8] "…in the central authority, which alone formulates economic plans and controls the actions of all the members of the community, who for their part are left without power or freedom." (Eucken 1950, 265).

[9] Eucken (1950, 269).

[10] That is probably what Eucken (1950, 205) calls "complete general equilibrium" or the "static state of the Lausanne School", i.e., what we now call "general equilibrium."

[11] Schmoller (1906) vividly illustrates this aspect of economic power.

[12] As for the "centrally administered" economy, "…because of the size of the community and the number of goods to be valued, it is impossible to express the values of goods in quantitative terms….[and] as history shows, economic calculation, and therewith any precision in the control of the economy, encounters the greatest difficulties." (Eucken, 1950, 119, 120) "Men have experienced the extraordinary disadvantages that are related with centralised planning." Eucken (1952a, 118 f.).

in accordance with a catalogue of constitutional norms. This catalogue has been suggested by Eucken (1952a), in apparent accordance with the other members of the Freiburg School like Böhm. He argued that what matters is the quality of the design of the constitution or order of the economy and its defence by the force of law (Böhm 1937, 106).

We'll describe first Eucken's conceptions of *Ordnungstheorie* and *Ordnungspolitik* as we see them and then continue with a neoinstitutional discussion of his views. Some analytic remarks and inferences are following. An afterword concludes this paper.

2. On Eucken's *Foundations of Economics*

The German *Methodenstreit* reached in Germany into the 1930s. An important topic was Schmoller's demand that before one starts to draw general conclusions from a set of underlying assumptions these have to pass the test that they truly are the crucial causes of the economic phenomena in question (Schmoller 1883, 245). That would be the „stricter" (*strengere*) form of science (Schmoller 1894, 538). All other forms of theorizing would be „premature" and should be avoided.

By contrast, Eucken argues:

> The theoretical questions do not come at the end of our science, and the theoretical propositions, which we have to seek, are not simply a distillation of experience. (Eucken 1950, 40 f.).

The economic process goes on always and everywhere within the framework of a historically given economic system (or order) (Eucken 1950, 80). However, his theoretical approach – a morphological approach - differs crucially from that of neoclassical economics (marginal utility approach). It demands a precise description of the "outside" appearance of an economic system or order (Eucken 1950, 89). For this purpose, he suggests to apply the concept of an "ideal type" in the following sense:

> The individual features of an individual phenomenon…are extracted and ideal types built up out of them. …The method of "isolating" abstraction or of abstraction of the distinguishing or significant characteristics[13] starts from the individual fact. (Eucken 1950, 107) [14]

Such ideal types "are … to be used as 'models' on the basis of which theoretical propositions can be worked out. (1950, 233).

Note that Eucken's ideal types differ from Weber's who describes his ideal type as a thought up "Utopia," which is "…to be contrasted and compared with actual economic conditions."[15] Against this, Eucken's morphological ideal types are got the other way round - from the actual economic world - to help us understand it. In fact, they would be completely indispensable "…for an understanding of the structure of actual economic systems, that is for one of the central problems economics has to solve." They finally "…help us to understand both the nature of different economic systems and that of the economic process, that is, the whole field of economic reality." (loc. cit. 173) Thus, "…the knowledge of the different kinds of systems (of *Wirtschaftsordnungen*) is the first step towards knowledge of economic reality." (Eucken 1950, 90)

> Eucken's "ideal types" might be seen as "clinical cases": A special real world case is assigned to its respective ideal case (or "ideal type") – the sum of its outstanding properties – like that of the market forms of monopoly, duopoly or perfect competition etc...[16] Williamson (1985, 79) proceeds in a similar fashion by use of his types of efficient *governance structures* such as "unified governance", "bilateral governance" etc.

As mentioned above, Eucken distinguishes two extreme cases of ideal types: the *centrally directed economy* and the *exchange economy*. Between them are numerous types of mixed economic systems, so that we have a whole catalogue of *morphological schemes* of different

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[13] By applying "the method of ‚isolating' abstraction, or of abstraction of the distinguishing or significant characteristics" that starts from the individual fact - in contrast to the "generalizing" abstraction with which the constructors of "stages" or "styles" of development work (Eucken 1950, 107). [*"Pointierend hervorhebende" oder "isolierende" Abstraktion*" (Eucken 1947, 114)].

[14] A good summary of Eucken's views on these matters provides Schmidtchen (1984, 57 f.).

[15] See, e.g., Weber (1968, 6).

[16] See Eucken's list of "forms of market" (1950, 158).

ideal types of economic systems with numerous different features. Of particular interest for us is the general system of an exchange economy, described by Eucken as an open or closed system[17] of interrelated markets of various forms,[18] combined with some monetary system (1950, 156 ff.).

Eucken's ideal types of an exchange economy are determined by
(i) a set of *"data"* that comprise individual needs, the stock of already produced goods, land and natural resources, technical knowledge, legal and social organization; [19]
(ii) a set of *empirical rules* or "laws," [20] of which Eucken lists Gossen's First Law, the law of diminishing returns, and the law of productivity of "roundabout" production; and
(iii) the presence of *"risk."*[21]

Of particular interest for the neoinstitutionalist are Eucken's comments on the "datum" of legal and social organization. It is here where Eucken's *Ordnungstheorie* and the New Institutional Economics overlap. Eucken is convinced "…that the modern industrialized world does not of itself produce an effective economic system, but requires certain controlling constitutional principles as a foundation" that are to be issued and guaranteed by the state." (loc. cit. 315) [22] Legal thought and practice would to an increasing extent have the task of co-operating with economists in the design and implementation of the norms of this economic constitution. Beyond question, Eucken's morphological theory tends more into a "historic-legal" direction

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[17] "Supply and demand are 'open' if every individual or group has access to the market as supplier or demander, and if each individual can supply or demand whatever quantity he thinks fit." (loc. cit. 134)
[18] Such as competition, oligopoly, monopoly either on supply or demand side or both, with open or closed markets (loc. cit.158).
[19] Eucken (loc. cit.178 ff.)
[20] loc. cit. (loc. cit.186 ff.)
[21] Loc. cit. 198 ff.; Eucken mentions at the sidelines Knight (1921), thus his term of "risk" might have included „Knightian" uncertainty.
[22] According to Hutchison (1979, 433) there are two modes of arguments for free markets:
a "Smithian" and a "Ricardian." The latter would be also followed by some "neoclassical." It is derived from an abstract, purely economic model of competitive equilibrium…", while the Smith mode is formulated in much broader terms, "…comprehending the political and social order, and especially the legal foundations and framework of the economic order." The ideas of Eucken's *Ordnungstheorie* and *Ordnungspolitik* follow this Smithian mode.

than into one of “pure economic theory” that became neoclassical microeconomics.

Unsurprisingly, Eucken’s ideas attracted the interest of German legal scholars. Thus, Eucken and two law professors at his University of Freiburg, viz., Franz Böhm and Hans Großmann-Doerth, established in 1936 a series of publications entitled *Ordnung der Wirtschaft*. The series was opened by Böhm (1937)[23] with a paper on “The Design of Economic Order as Historic Task and Law Creating Achievement.” In contrast to Hitler’s actually practiced policy, Böhm argued that the economic constitution in force at that time [1937] would still provide for a free market economy, and continues

> That implies our responsibility to restore the normative character of the constitution of a free market in its highest possible purity and to do the utmost to restore the normative character of a free market constitution in best possible purity and to do one’s utmost to encounter (oppose) the cult of soft law (*Kult des Faktischen*), even in cases where markets are still free, to help win the economic constitutional way of thinking (Böhm 1937, 71).

He supports the idea of a liberal economic constitution understood as a legally protected system of competitive markets. His paper is an outspoken attack on fascist corporatism that was increasingly practiced in Germany of that time. Böhm, Eucken, Großmann-Doerth together with another Freiburg economist, Leonhard Miksch (1937), became known as the founders of the Freiburg School of economic thought – whose ideas were soon dubbed ‘*Ordoliberalism*’. It is to be seen as a counter movement against the widespread German centralist, anti-bourgeois and anti-liberal trends of the time between the wars and thereafter.[24]

3. On Eucken’s “Principles of Economic Policy”

Given Eucken’s reservations towards pure economic theory (marginal utility theory) and maintenance of his interest in historic-legal characteristics, “efficiency” (like Pareto-

[23] The first issue appeared behind issues 2 and 3.
[24] On the intellectual movements of the 1920th and 1930th see, e.g., Kiesel (2007, Vierter Teil).

efficiency) of economic systems is not his problem (a welcome attitude from the perspective of the NIE). Instead, he is interested in the social issue of the control of power through price competition. Therefore, and not for efficiency reasons, Eucken favours the market form of perfect competition. To work properly, competition requires an **economic constitution (**“order”) whose formation cannot be left to *laissez-faire*. Rather, design and administration of the economic constitution is the task of economic policy or „*Ordnungspolitik*“ by the state. However, the state should not intervene in the economic process itself.[25]

We continue with a description and discussion of the basic norms or “**constituent principles**” that, according to Eucken, should characterize the economic constitution of an exchange economy. His constituent principles lean on the main features of the classical liberal state. They are listed in his posthumously published *Grundsätze der Wirtschaftspolitik* (‚*Principles of Economic Policy’*), and read briefly as follows (own translation):

(1) The basic principle of the economic constitution and economic policy consists in the **creation of a viable price mechanism** (Eucken 1952a. 255). “That is the strategic point.” For this reason economic policy has to aim for the development of the market form of perfect competition (ibid.) in which “… the supplier or demander takes the ‘anonymous’ market price …” as a datum (Eucken, 1950, 139).[26] Different from, e.g., Keynes, Eucken is convinced that competitive pricing unfailingly leads to market equilibrium (1950, 252, 254).[27]

Proper functioning of the competitive price mechanism demands the realization of the following six constitutional principles.

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[25] See Eucken (1950, 314, 1952a, 336); similarly Eucken (1952b, 95f.): “The state should influence the *forms* of economy, but not itself direct the economic process. […] State planning of forms – Yes; state planning and control of the economic process – No!” The latter would distort relative prices and lead to misallocation of resources (see Eucken 1952a, 287).

[26] In the real world it is not the exact number of suppliers or demanders that determines the market form of perfect competition but “it is the economic plans that decide.” (Eucken 1950, 140)

[27] Concluded from what Eucken (1950, 523) calls „method of variations“ – an equivalent to what is called now “comparative static.”

(2) The principle of **stable money**, to guarantee the functioning of the price mechanism of an economy and thereby the equalization of [market] power.[28] For this purpose Eucken demands the introduction of absolutely strict money supply rules, viz.,

[1] To give the central bank direct control of the quantity of *demand deposits*, Eucken advocates application of the "100 Per Cent Money Plan,"[29] i.e. a banking rule that demands in its pure form that the full amount of each depositor's funds are held in reserve as central bank money.

[2] To avoid the discretionary supply of central bank money ("cash"), Eucken supports a commodity standard in form of the "Graham Plan."[30] He argues, a currency order that leaves a free hand to monetary policy makers, would give them more credit than they are up to (Eucken, 1952a. 257).

(3) The principle of **open markets** or freedom of trade**,** to help avoid monopolistic practices and achieve, or guarantee the existence of, competitive markets. Neither public nor private barriers to trade shall be allowed (264 ff.[31]).

(4) The principle of **private property**, as basic means to achieve an economically allocation of resources by means of self-interest. Eucken views private property as precondition of a competitive economic system. (274) Under perfect competition economic power would be equally distributed among all private owners of firms, and private property of use for both, owners and non-owners (274).

(5) The principle of **freedom of contract**, to allow the economic allocation of privately owned resources under conditions of a competitive market system. However, there is a

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[28] Eucken (1952a, 255) speaks of the „primacy of currency policy."

[29] See Simons (1934). However, what becomes of financing business firms through bank loans? (see Hart 1953, 439).

[30] Graham (1937), Hart (1953, 442). The Graham Plan tries to answer the problem of price fluctuations of one single money good by using instead a bundle of money goods whose price fluctuations tend to offset each other. Milton Friedman provides a critical discussion of this and other forms of commodity standards. He concludes: "In every important respect the commodity-reserve currency is technically inferior to the fiat currency." Friedman (1953, 249):

[31] At the high time of German hyperinflation Eucken (1923, 80), unsurprisingly, advocated the gold standard.

hitch: freedom of contract would include also the right to conclude monopolistic agreements such as cartels, which should not be granted (275 ff.).

(6) The principle of **personal liability**, to achieve promising capital investments. Eucken underlines also its property to hamper mergers or other restraints of competition. The escalating limitation of personal liability would have opposite effects (destroys the social control mechanism of selfish actors). Eucken is concerned over these developments (281).

(7) The principle of **constancy of economic policy,** to facilitate long term planning under conditions of a competitive economic order (286 f.). Eucken demands regularity of economic policy "… in order that a satisfactory investment activity is getting started. Besides, no competition order (*Wettbewerbsordnung*) would work without such regularity." (loc. cit., 288)

Eucken (1952a, 289) emphasizes the interdependence of his constitutional principles. Only together they are able to serve their common purpose, viz., to control the economic process through competitive pricing. Thus, if all constitutional principles would be realized but one, say "private property" or "open markets", the control function of the price mechanism (with its power reducing effects) would no more work.

Eucken concedes that his constitutional principles require balanced interventions by *Ordnungspolitik*. To this end he suggests a set of **regulating principles** of his *Ordnungspolitik* regarding the passage of anti trust laws, of income redistributing tax laws, of laws to curb or avoid external costs (1952a, 292 ff.).

<u>Summing up</u>: Different from Keynes, Eucken follows the classical proposition that competitive pricing balances supply and demand. He is convinced that power reaches its minimum concentration in competitive market equilibrium. To achieve this aim an appropriate economic constitution or "order" is required. Different from libertarian economists, Eucken does

not believe in the spontaneous or *laissez faire* development of such an appropriate system or "order". Therefore, the economic constitution has to be established and guaranteed by the state according to above listed constitutional principles. Eucken is convinced that competitive pricing does always lead to stable market equilibria. "There is no tenable economic basis for the view expressed by, among others, Keynes and Pigou that after a static state has been disturbed a new static state *cannot* again be reached." (1950, 254; emphasis in the original).[32] Rather, markets are destabilized by monopolies and oligopolies, i.e. on the strength of economic power, and by the creation of money by commercial banks (money supply determined by credit demand) that would have a particularly harmful effect on employment (1952b, 67). This being so, economic policy should concentrate on *Ordnungspolitik*, i.e., the development of an economic system ("order") that is conducive to market equilibrium. The essential aim of economic and social policy should be to *construct a framework for everyday functioning of the economy*, and not to attempt sole control of the economy by means of central planning. (Eucken 1952b, 67, emphasis added).

4. Eucken's Approach Seen through NIE Glasses

Opposed to neoclassical economics or macroeconomics, whose object of research is the *process* (the functioning) of economic activities within a given, loosely described institutional framework, Eucken's object of research is the institutional framework or "order" itself, within which the economic process proceeds. While neoclassical microeconomists or Keynesian resp. neoclassical macroeconomists model economies functionally, as systems of structural equations (target functions and its constraints such as production functions, utility functions

[32] Eucken apparently did not attach any great importance to the at his time debated phenomenon of the hog cycle (Hanau 1927).

etc.) or behavioral equations (consumptions functions, investment functions, etc.[33]) suggests Eucken to model economies "morphologically" by assigning observed institutional structures to their respective ideal types (1950, 223).[34] Insofar Eucken assumes an institutional economic point of view. We ask: what can be said about Eucken's approach from aspects of NIE? To answer this question, we'll discuss in the following his above listed constitutional principles.

(1.) Central target of economic policy is for Eucken the creation of a **viable price system** in a **system of perfectly competitive markets**, in which "…economic power disappear[s] completely" (1950, 269).[35] As one recalls, this is for Eucken **(**1952a, 254) the basic principle of **economic constitutional law.** In this context, Eucken gives priority to fighting economic power (not to achieve efficiency), because "…the possession of power destroys mature and good institutions" (1952b, 38) and it contradicts the cardinal principle of the constitutional state, viz., to safeguard individual rights and liberties against violations by fellow citizens on the one hand and the state on the other (1952b, 39). Perfect competition would be the economic constitutional answer to the problem of economic power.

Eucken is aware of the argument that – at least under neoclassical conditions - "perfect competition" is compatible with extremely different distributions of individual wealth (Eucken 1950, 269). He replies that individual wealth or firm size matter only if the actor or the firm, in consequence of size, "…has certain markets partially or entirely under its control; that is, where it is not subject to competitive conditions but to some other form of market." (1950, 270), i.e., if he has some degree of "market power".

However, as is known since the debate on Coase (1937), Eucken's problems of market power (in neoclassical jargon: of "monopolistic inefficiencies") occur

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[33] Some early versions where represented in the shape of circulating fluids - called by Coddington (1976, 1264) "hydraulic Keynesianism."
[34] By referring an observed real case to its corresponding specific ideal type.
[35] … or, as Stigler (1968, 181) states, in which power is "utterly dispersed" and all resources are efficiently allocated – the latter remark is not used by Eucken (1950).

strictly speaking only under conditions of positive transaction costs, imperfect foresight and bounded rationality - not under conditions of neoclassical models. Therefore, from the perspective of NIE, neoclassical microeconomics in its pure form may be a misleading basis of competition theory and policy. It could be used in a hybrid form, partly neoclassical, partly neoinstitutional (as in contract theory), but that is an unpleasant mix of high precision and vagueness.[36] As opposed to this, Eucken's dispensation with rigorous microeconomics and use of his morphological approach relieves him from the requirement to exactly define and model the reduction or equalization of "power" through "perfect competition."[37] His distrust in *laissez faire* and his argument that the state would have to design, establish and administer a proper **economic constitution** is supported by Olson (1965) in his logic of collective action.[38]

Another important reason for collective design and administration of market organizations in a world of positive transaction cost is the need of protective measures against market collapse as a

[36] Furubotn and Richter (2005, 512): In some areas, such as contract theory, neoclassic modelling and kind of NIE modelling is mixed. It would be extreme to say that such "… hybrid models have nothing to offer and cannot contribute anything to our understanding of economic phenomena. Yet, it remains true that these models are vague about the fundamental significance of transaction costs and bounded rationality (Denzau and North 1994). All too frequently, the technical discussion moves back and forth haphazardly between different levels of abstraction. Economic activities that are supposedly carried out within one universe are judged relative to an efficiency standard or other considerations that have their origin and justification in a completely different universe. Ultimately, it would seem that analysis cannot be 'half ' neoclassical and 'half ' neoinstitutional."

[37] His "perfect competition" demands only a market system (order) of many small (non-cooperating) suppliers and demanders who take the price of the traded commodity as a planning datum - as a consequence of the size of the market and the negligible size of supply or demand [and act according to the economic principle] (see Eucken 1950, 140).

[38] The collective choice problem of market organizations is "Who pays?" for the public good (like antitrust measures). Olson answers: "…the larger the group, the farther it will fall short of providing an optimal amount of a collective good." (loc. cit. 35) The reason is that large groups will face relatively *high transaction costs* when attempting to organize for collective action (i.e., high costs of setting up, administering and enforcing a collective order or constitution, incl. the costs of keeping away free riders). In contrast, small groups will face relatively low transaction costs. Furthermore, the incentive to contribute to the collective good (and willingness to pay) differs: individuals in large groups will gain relatively less per capita of successful collective action and thus are less keen to contribute to the "common wheal" compared with individuals in small groups who will gain relatively more per capita. Olson's *logic of collective action* contains important insights at the borderline between the NIE proper and public choice theory as originated by Buchanan and Tullock (1962) or the general field of *political economy* (Bernholz and Breyer 1993, Drazen 2000, Persson and Tabellini 2000).

consequence of the Lemons Principle (Akerlof 1970). It is particularly important for asset markets, and received broad attention of economists in the course of the financial crisis of 2008. [39]

(2.) A viable price mechanism demands **stable money**. Now, “money” – stable or not – is itself an institution. It presupposes an explicitly or implicitly agreed upon constitution or “order.”

The use of money has been justified, for a long time, as a means to ease transaction costs (“frictions”)[40]; however, it is also recognized as an instrument to cope with problems of incomplete foresight (”uncertainty”)[41] and bounded rationality[42] - i.e., the three basic disturbances of the neoclassical world that underlie the New Institutional Economics.

Amazingly, the institution of “money” does not play much of a role in the development of the NIE.[43] Yet its analytical methods may be easily applied to explain issues of the institution of money, in particular of its constitution or order.[44]

Eucken’s preference of an automatic money supply mechanism - “100 Per Cent Money” plus “Graham Plan” – corresponds to extreme conservative views of his time (1940)[45] but contrasts NIE. It leaves no room to (central or commercial) banks to adapt to unforeseen events. Because of incomplete foresight public or private institutions have to leave gaps in their design.[46] To avoid (or minimize)

[39] Hellwig (2008), Richter (2010).
[40] Money as a “contrivance for sparing time and labor.” [Mill (1987, chap. 5 as quoted by Niehans (1978, 3)].
[41] Hicks (1946, 139) explains liquidity preference indirectly as a consequence of “…the uncertainty of the future and the desire (of the consumer) to keep ones hands free to meet that uncertainty, ….”
[42] As for the latter, money in its capacity as *accounting unit* and *means of payment* is an ingenious way to determine the form of calculating and the manner in which “payments” are made (cash payments, check payments, bank transfers, etc.). Schumpeter (1970, 206) describes “payments” as being basically bookkeeping entries in an imaginary “social ledger.” (Richter 1989, 100)
[43] Furubotn and Richter (2008).
[44] See, e.g., Richter (1989, Chapter 4).
[45] Milton Friedman favoured 100% money (Friedman 1948), but rejected the Graham Plan (Friedman 1951). As for the rest, Friedman (1948, 246) repeats Eucken’s opinion: “(1) Government must provide a monetary framework for a competitive order since the competitive order cannot provide one for itself. (2) The monetary framework should operate under the ‘rule of law’ rather than the discretionary authority of administrators….”
[46] See Furubotn and Richter (2005, 21). Or they have to be subject to the same legislative process as tax changes. The suggestion that the rule should be embodied in a constitutional amendment reflects excessive confidence (or hubris) (see S. Fisher 1980, 230).

opportunistic behaviour of parties in charge (central bank presidents, head of elected governments, corporate executives), governance by legal procedures has to be supplemented or even substituted by that of extrajudicial ordering to effectively protect citizens or legal parties against the opportunistic behaviour of civil servants or legal counterparties. In other words, because of incomplete foresight the "rule of law" has to be supplemented by some kind of extrajudicial governance or discretionary authority such as by the board of directors of the central bank or corporative boards. As for the institution of paper money, the predominant opinion of how to guarantee stable money can be described by the following constitutional principles:

The state (parliament) should pass a law stating that

1. The central bank alone has the right to issue notes;

2. The management of the central bank is not subject to instructions by the government;

3. The central bank is legally obliged "to guarantee price stability".[47]

In addition, the executive board of the central bank must be made up of people who have the reputation of standing for stable money, and who are not at any price ready to jeopardize their reputation.

The purchasing power promise is then enforced – so the theory goes – by the threat of money users to destroy the reputation of the members of the central bank's executive board. They would do this by unleashing a hyperinflation

[47] However, price stability (or "sound money") does not guarantee financial stability – an old problem heavily debated when Peel's Bank Act of 1844 was passed (Fetter 1965, 165 – 197). The financial crisis of 2008 reminded central banks of their function of lender of last resort and of the Bagehot rule. The Fed or other central banks took, as is said, "unconventional" measures like "quantitative easing." They were insofar "unconventional" or "inventive" measures as they consisted in a particularly carefree application of the old Bagehot Rule (Bagehot 1873/1962, 25).

through their refusal to use the central bank's money.[48] Doubts can be raised,[49] though we'll stop here. Anyway, our presentation reveals the wide gap between Eucken's institutional demands for stable money and that of modern, in a sense, institutional economic theorists.

(3) Eucken's (264 ff.) principle of **open markets** is directed against public and private impediments of the price mechanism. This principle appears to be a plausible norm of competitive pricing. However, resource allocation takes place not only on markets, controlled by the price mechanism, but also within firms, controlled by decree. Thus, the decision to produce some good is preceded by a "make or buy" decision, i.e., by the decision to *make* the good yourself within your firm or to *buy* the good on the market. In other words, the foundation or the size of firms becomes an issue. As Coase (1937) had shown and Williamson (1985) specified, firms may be resource saving *alternatives* to markets. Which organizational mode (firm, market or anything in between) is preferable depends on the actual levels of transaction costs, Knightian uncertainty and the limits of human rationality. Anyway, from aspects of the new institutional economics, it is impossible to rate barriers to trade *prima facie* as economically unwelcome impediments of the price mechanism.

Interjection on the following three constitutional principles of private property, freedom of contract, personal liability:

They correspond to the three "fundamental laws of nature," which are, according to Hume ([1739–40] 1969, 578), "…that of the stability of possession, of its transference by consent, and of the performance of promises." According to the doctrine of natural rights, who provided the basis for classical econom-

[48] There is an extensive literature on this topic. In addition to Kydland and Prescott (1977), there are the works of Barro and Gordon (1983), Blackburn and Christensen (1987), Persson and Tabellini (1990) among others. For a survey see Persson and Tabellini (1990). These are works of the "new classical macroeconomics", according to which in the short-run, despite the hypothesis of rational expectations, room remains for monetary stabilization policy. We announce our doubts about this approach.

[49] Richter (2002).

ics, man is seen as a selfish creature.[50] Taking this into account, above three principles can be seen as the elements (incentive structure) of a social-economic control system or “order” that coordinates the allocation of resources within a society of selfish people *by means of individual self-interest*. Together with the institution of money such an individualistic control system is a method to overcome the shortcomings of positive transaction costs, limited foresight (Knightian uncertainty) and bounded individual rationality – the three basic assumptions that distinguish NIE from neoclassical microeconomics.

(4) The principle of **private property** (in material and immaterial goods)[51] unfolds its social control function only if sanctioned ownership rights are transferable by consent and in accordance with the principle of freedom of contract. Central insight of property rights analysis is that under the conditions of NIE[52] the allocation of property rights to selfish individuals (the “owners” of resources who are following the economic principle[53]) gives them not only an incentive to handle their allotted (“owned”) resources parsimoniously but navigates their use also into the macro economically right direction. Eucken continues: Only under conditions of perfect competition do both, owners and non-owners, profit in the institution of private ownership.[54] Thus, as private ownership in resources (“means of production”) is a precondition of a competitive order (*Wettbewerbsordnung*) as is a competitive order a precondition of avoidance of economic and social grievances due to private ownership in resources. Therefore: *Private ownership of the means of production demands its control by competition* (Eucken, loc. cit. 275 – own translation; emphasis added).

The principle of private property cannot be too highly praised. It forms the basis of human self-determination – described by John Locke as “property in one’s own person.” [55]

[50] Who “loves himself better than any other single person, and in his love of others bears the greatest affection to his relations and acquaintances” (Hume [1739–40] 1969, 539).
[51] Understood in the sense of full ownership.
[52] Among them information costs due to which knowledge is “not given to anyone in totality” (Hayek 1945).
[53] Eucken (1950, 281).
[54] Because: “In the state of perfect competition [Eucken means: in general equilibrium] are private owners of firms in an equilibrium of economic power.” (Eucken 1952, 274) In microeconomic terminology: The state of general equilibrium is Pareto efficient – a term not used by Eucken.
[55] The relevant sentence is: “Every man has a property in his own person. This nobody has the right to but himself ” (Locke [1823] 1963). For further interpretations see Furubotn and Richter (2005, 91 f.).

(5) The principle of **freedom of contract** means *inter alia* that the individual has the right to contract the transfer of property rights with a freely chosen partner in a mutually binding agreement. It supplements the principle of private property in an essential way insofar as it allows individuals to use their specific knowledge ("not given to anyone in totality" Hayek 1945) to adapt to unforeseeable events that would be uncontrollable (or very costly to control) by central decision-making. Actually the principle of freedom of contract, just as that of private property, reveals its relevance as an instrument of social control only under conditions of the NIE. Eucken (1952, 275 f.), who highlights the working of the price mechanism, emphasizes its role as precondition of competition. His argument that the principle of freedom of contract can be (and actually is) used to form coalitions with the purpose to restrain competition (Eucken 1952, 48), implies the assumption of positive transaction costs. In such a world the constitutional state (*Rechtsstaat*) must protect its citizens not only from the coercive power of government but also from arbitrary acts by other citizens.[56] Insofar, Eucken can conclude:

> […] it has become obvious that the modern industrialized world does not of itself produce an effective economic system, but requires certain controlling constitutional principles as a foundation. […] Legal thought and practice will to an increasing extent have the task of co-operating [with economics] in the building and establishing of the economic constitution. (Eucken 1950, 315)

One should add, at least after the financial crisis of 2008, that the principle of freedom of contract allows also the creation of "financial products" that are prone to above mentioned Lemons Principle, i.e., to market collapse – an object of public interest that

[56] "If the constitutional State (*Rechtsstaat*) was able to protect its citizens from arbitrary acts of the State itself, it was unable to save them from the arbitrary acts by other citizens" (Eucken 1952, 52). Eucken warns that the constitutional state is only able to succeed completely if together with its public legal order an "adequate" economic order is realized (52).

demands public measures (given positive transaction costs), as do monopolistic practices.

(6) The principle of **personal liability** relates to the concept of contract, which according to common law is a commitment to act later.[57] Debtors should not promise more than they expect to be able to fulfil. The principle of personal liability, therefore, is supposed to invoke trust in future actions of the promisor. Anyway, it commits the promisor. If the debtor doesn't live up to his promise, the creditor (promisee) may sue him to get access to his wealth. The *social control function* of the principle of personal liability springs from the incentive for the debtor to act judicious.

Differently expressed, personal liability is a device for forcing actors to internalize the social cost of their actions. "Limiting liability can thus be seen as subsidizing risky behaviour and allowing some actors to externalize part of the costs of their actions." (Carney 1999, 665).

Eucken (1952a, 280), whose central interest is the working of the price mechanism, emphasizes that the principle of personal liability impedes the merger of firms in their "thirst for power." It therefore would strengthen the formation of a competitive order (*Wettbewerbsordnung*) and help make the competitive process effective. He states, "Without personal liability a competitive order becomes just as little functioning as without adequate market forms and monetary orders." (1952a, 280 f.) He observes skeptically the enormous increase of the number of corporate bodies "during the last decennia", and with it the decline of the importance of personal liability. Limited liability rules "…would promote concentration of firms and impair the functionality of the price mechanism."[58] They would greatly contribute to the evolution of business

[57] Following Llewellyn (1931–32, 708): the term "contract" understood as "the legal effects . . . of promises." Time is involved in an essential way – as opposed to the language of the German Civil Code according to which contract is "a juristic act [*Rechtsgeschäft*], normally consisting of two declarations of will [*Willenserklärungen*]." (Horn, Kötz, and Leser 1982, 74).

[58] Eucken (1952a, 281).

mergers and monopolistic practices and impair the working of the price mechanism (ibid.).

However, Eucken disregards that, because of incomplete foresight (Knightian uncertainty), not all risks can be shifted through the market wherefore Arrow (1970) concludes

> … the failure of the market to achieve adequate risk-shifting leads to compensatory alterations on social institutions, licensing, bankruptcy and limited liability, and large business organizations. But all of these institutions are steps away from the free working of the price system… [and] all the institutions…decrease the flexibility and responsiveness of the system to change and innovation. (loc. cit. 141)

Of course, interruptions of the 'natural' capitalist control mechanism – i.e., its control by the price mechanism – has to be bridged by some appropriately designed non-market control mechanisms (organization) like corporations, corporate boards, securities and exchange commissions, financial regulators, bankruptcy courts, the judiciary in general, etc. However, Eucken distrusts such non-market control mechanisms.[59]

To be noted, in this context, is that Eucken, as most economists of his time, dealt with price theory only on the basis of spot markets and their equilibrium, as illustrated by the 'Marshallian Cross'. Futures markets are left out, and thus financial markets - like bonds and stock markets. However, it is in particular here where the problem of liability arises, and where Akerlof's Lemon Principle emerges. It supports Eucken's demand for a publicly designed order (a *collective good*) such as of public supervision of asset markets and the application or threat of legal coercion.[60] The unpleasant results of a *laissez faire* policy are illustrated, i.a., by the consequences of the financial crisis

[59] Eucken (1952a, 281 ff.).
[60] See also Böhm (1937, 106).

of 2008.[61]

The existence of incomplete foresight (Knightian uncertainty) can in principle be allowed for (and are in fact regarded) by the design of workable organizations that bridge the gaps in the chain of personal liabilities and thus try at least to mend the self-enforcing mechanism of a liberal market economy. One has to accept that, in a world of incomplete foresight, the price mechanism has its limits.

The principle of **constancy of economic policy** makes sense only for Eucken's economic constitution of the real part of the economy,[62] not of its monetary system for which he demanded a once and for all fixed automatism. As for the rest he allows for changes of the institutional framework. However, if order-political measures are chasing each other the borderline between *Ordnungspolitik* and *Prozesspolitik* becomes blurred. Too frequent changes of norms are in effect not much different from *Prozesspolitik* and would disturb the functioning of the price mechanism and hamper investment planning.

[61] One such moral hazard was that banks, instead of holding loans on their balance sheets, changed to an 'originate and distribute' model. 'They repacked loans and passed them on to various other financial investors, thereby offloading risk' (Brunnermeier 2009, p. 78). In doing so, banks created 'structured' products – *collateral debt obligations* (CDOs) consisting of diversified portfolios of mortgages and other types of loans – sold in private placements with confidentially agreements. Banks then sliced these portfolios into different tranches, which they sold not only to investor groups with different attitudes toward risk but also to themselves. Furthermore, buyers could also protect themselves by purchasing *credit default swaps* (CDSs).

[62] Especially private property rights, contract law, regulation of personal liability, competition law, labor law, etc.

5. Retrospective and Inferences

As was mentioned at the beginning, it is not easy to translate Eucken's ideas in to-day's economic language and do him justice. We'll try to do our best by discussing our expositions of Eucken's ideas under two aspects: Firstly, from a political-economic point of view, as an economic policy program against a strong anti-liberal, anti-civil movement and its outfall since 1933 and after; Secondly, from an analytical point of view, as an attempt to describe (or understand) the economic process morphologically, i.e., from its "outside", its institutional framework or "order," within which it occurs.

On political-economic aspects: Eucken's *Ordnungstheorie* is characterized by its emphasis of and trust in the *price mechanism* (control of demand and supply by price competition), given an adequate economic constitution, and its distrust in a *laissez fair* development of an adequate economic constitution or "order". As a direct consequence, Eucken wants the state to enact, implement and administer an economic constitution whose norms agree with above-described constitutional principles. Given the enactment of such an economic constitution (*Wirtschaftsordnung*) and its administration by *Ordnungspolitik* "…economic power [will] disappear[s] completely" (Eucken 1950, 269), where "economic power" means "market power" or the power to admit/exclude someone to/from a market and to make/take prices. Eucken's emphasis of the term of "power" is to be seen against the background of the widespread belief that "…modern technology concentrates production and economic power, and that competition is doomed to vanish from modern economy."[63] Instead of the term of "economic power," Eucken might as well have used its antonym "economic freedom" - as did his Freiburg colleague Franz Böhm a couple of years earlier. Böhm demanded the "restoration of a free market constitution in its best possible purity" (Böhm 1937, 71). Anyway, after the

[63] Eucken (1952b, 41f.); this view underlies, e.g., Schmoller's defence of cartelization (Schmoller 1906, 242 f.).

West German currency reform of 1948 the *ordo-liberal* concept of the Freiburg School was at least partially realized.[64] It served as the theoretical basis of the West German *Wirtschaftswunder* - in spite of the fact that the views of the Freiburg School contrasted sharply with the, at that time, most widely propagated Keynesian doctrines in Britain and, to a lesser extent, in the United States. „Therefore, most of the comments forthcoming in Britain and the USA tended to be suspicious, disapproving, pessimistic, or outright condemnatory." Thus Hutchison (1979, 435) with interesting references to Balogh and other Keynesians.

On analytic aspects of *Ordnungstheorie*: As indicated above, with his morphological approach - or *Ordnungstheorie* -, Eucken attempts to strike a balance between the (in Germany at his time predominant) historic-legal approach and its opposing purely theoretical way of thinking. The historic-legal approach deals with variable historic phenomena of economic life, it shies away from general explanations. Its considerations may be compared with the strategic reasoning of lawmakers who are primarily interested in the general consequences of the draft bills (the institutional framework) they are voting on. The opposing theoretical approach aims at a detailed prediction of the economic process as it actually takes place that institutional framework. Both approaches demand specific forms of "exactitude": the historic-legal approach requires descriptive precision; the purely theoretical approach logical rigor. In Eucken's attempt to balance these two extremes by his morphological approach, "exactitude" means a precise "isolated abstraction" (abstract replication) of the ideal typical features of an economy's institutional framework. The economic process occurring within that framework is assumed to be driven by only vaguely described laws of economic behavior such as "…all normal men everywhere and at all times act in accordance with the economic principle."[65] In other words, Eucken's measurement problem focuses on the precise reproduction of the institutional characteristics (the constraints of individual behavior like property rights, contracts,

[64] Except antitrust legislation that had been enacted later – pretty much watered down (*Gesetz gegen Wettbewerbsbeschränkungen vom* 27, 07, 1957).
[65] Eucken (1950, 293); no reference to marginal utility theory.

obligations, the structure of the monetary system, market orders etc.) and not on a detailed description of behavioral hypotheses as in standard neoclassical or Keynesian economics – and their econometric offshoots.

The basic idea of Eucken's morphological approach, his "isolated abstraction" of ideal typical features of an economy's institutional framework, turns up (in a way) later in the form of Williamson's "efficient governance" structures (1985, 79) or his description of the basic nature of transaction cost economics (1993, 107).

On analytic aspects of *Ordnungspolitik*: As with regard to Eucken's *Ordnungspolitik*, it is interesting to note that his constitutional principles focus on the basic principles of natural law, viz., private ownership, freedom of contract, and acceptance of obligation.[66] They are the linked up parts of an ingenious social-economic control system ("order") that coordinates in a "natural" way, i.e., *by means of individual self-interest,* the allocation of resources within a society of selfish people.[67] It forms the basis of neoclassical microeconomics in its pure form with zero transaction costs, complete foresight and perfect rationality. Insofar, Eucken's (1950, 269) verbal description of an *exchange economy* with perfect competition on all markets is quite similar to the, at his time, strictly modelled "pure spot economy" of Hicks (1946, 140).[68] Here – as in Eucken (1950) – all markets are only spot markets. However, different from Hicks and other neoclassical economists, Eucken assumes simply that all decision makers act according to the "economic principle" – not enough for neoclassical micro-economists but quite agreeable with neoinstitutional economists to whom allocation efficiency (Pareto efficiency[69]) is a meaningless concept. The reason, why new institutional economists question the notion of allocation efficiency is that individual decision making suffers not only under positive transaction costs but also (and in particular) incomplete foresight and bounded ra-

66 Hume ([1739–40] 1969, 542).
67 "…who find it in their own enlightened self-interest to cooperate with their neighbours in a long term relationship." (Binmore 1992, 21) Game theorists can demonstrate that formally - under ideal assumptions..
68 Hicks's book is listed but not referred to in Eucken (1950, note 41).
69 Defining a state of the economy in which all individuals maximize their utility under some complex set of constraints.

tionality. North (1990, 80) suggests to strive for "adaptive efficiency"[70] instead of allocation efficiency. He concedes, though, that

> …we are far from knowing all the aspects of what makes for adaptive efficiency, but clearly the overall institutional structure plays a key role in the degree that the society and the economy will encourage the trials, experiments, and innovations that we can characterize as adaptive efficient (loc. cit. 81).

In his elaboration on the notion of adaptive efficiency North relates to Pelikan (1987, 29), who advocates the development of suitable organizational structures that allow, i.a., "…societies to maximize the efforts required to explore alternative ways of solving problems." (North 1990, 81) The role of the Knightian entrepreneurs[71] as creative talents among decision makers of firms and other organizations comes to the fore.[72]

Different from Eucken, the relevant answer to the problem of rapid adaptation is not the demand of 'more market,' such as an increase in risk shifting that may invite moral hazard (opportunistic actions of the counterparty),[73] but the search for an efficacious mix of market and hierarchy as has been explained by Williamson (1985).

6. Afterword

The new institutional economics is not to be seen – as frequently occurs - as a form of neoclassical economics enriched by the assumption of positive transaction costs but as something else. It is a new style of economic analysis based on the three interrelated assumptions of positive transaction costs, incomplete foresight and bounded rationality that are assumed away in neoclassical economics. Institutions are no mere means to economize on transaction costs subject to constraints – an organizational problem that would soon solve itself in the wake of to days the rapid IT evolution. Rather, they are complex social tools to overcome the

[70] The concept of adaptive efficiency may be read as an answer to Hayek's claim that "… the economic problem of society is mainly one of rapid adaptation to change in the particular circumstances of time and place." (Hayek 1945, 524).
[71] Knight (1921, 268 f.).
[72] See Richter (2010) on the role of entrepreneurs as surrogate forward traders.
[73] Arrow (1970, p. 142 ff.) expressly points to this problem.

shortcomings of our limited foresight and rationality in a world of positive transaction costs and ever changing circumstances in an economically justifiable manner. Pareto efficiency, any form of constrained optimization, does not make much sense under these conditions. Rather, what matters to neoinstitutional economists is some form of evolutionary or **adaptive efficiency**, i.e., the capacity of individual or collective actors to adapt to unforeseen events at reasonable cost. To tackle the problem of "adaptive efficiency", instead of defining it away, is an important, though not a simple task in our "non-ergodic"[74] world that is characterized by ever changing circumstances (crises).

The problem is how to describe the social tools that are helping to overcome the shortcomings of limited foresight and rationality in an economically justifiable manner under conditions of positive transaction costs. To ideally answer this question, it is neither sufficient to specialize on the "physiology" of economic life, given its institutional "morphology," as done in main-stream economics. Nor is it enough to focus on the economy's institutional framework, given elementary assumptions on the behaviour of actors as in Eucken's morphological approach. Ideally, both must be analyzed: the economic system ("order") and the economic behaviour occurring within it. That does neither Eucken by his morphological approach nor mainstream neoclassical theory and its various spin-offs. Still, Eucken's morphological approach, his "ab-straction of the distinguishing or significant characteristics" touches upon an important area that is neglected by most economic theorists. It is reminiscent of later neoinstitutional styles of reasoning – such as Williamson's use of the concept of efficient governance structures –, whose behavioural assumptions (like that of "opportunism") go further than the general be-havioural assumptions underlying Eucken's morphological approach. To be noted is that both institutional methods have one advantage - different from the economic analysis of law -, they put economic and legal analysis of institutions on equal footing. That is best illustrated by the

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[74] North (2005, 19).

close cooperation of Eucken with legal scholars at Freiburg and – to a degree – by the interest of (German) young law professors in the insights of neoinstitutional economics.

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