

Values and Economic Order:

In Search of Legitimacy

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1. Introduction: Values in the Theory of Value

Any attempt towards an analysis of values meets a plethora of different and often incommensurable meanings of the notion 'value'. So it is in economics: On the one hand 'value' is at the core of economic science, because economics tries to explain human behaviour by means of a rational – or at least boundedly rational – evaluation of different actions. On the other hand, economists are reluctant to use the plural of 'value' if this is not to indicate the multiplicity of prices or costs. 'Values' in the sense of social or moral values are conceived as not belonging to the realm of economics. Although conceding the existence and, somehow, the importance of such values for human behaviour, economics tries to explain actions without scrutinizing those factors: "De gustibus non est disputandum" (Stigler/Becker 1977).

The same reluctance vis-à-vis values can be seen in Political Economy, i.e. the normative or prescriptive part of the economic discipline. It is clear that for any normative statement, e.g. a policy recommendation, a value is needed. There is no way out of the fundamental Is-Ought-divide. Thus, values should be at the core of Political Economy. But instead of taking different political values seriously, normative economics, once again, chose a single value – and the weakest imaginable, purely formal one: Pareto-optimality. Whether this value has any meaning outside of rigorous models that derive Paretian efficiency from highly 'stylized' assumptions, has long been questioned. This criticism means not only that the legitimation of the resulting policy recommendations might be rather weak or that the model might lead to fallacious policy

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advice, but also that arguments for a presumably better policy are, quite simply and practically, not convincing either for politicians or the public.

Not surprisingly, the normative branch of the economic science is in crisis. It is often complained by economists that practical politics is not guided by economic expertise or that all the clever economic recipes for better policies are neglected by politicians. Other economists are not that sure whether this neglect could also be beneficial:

Economic theory is static; and in the world of dynamic change in which we live a static body of theory consistently and persistently yields the wrong policy prescriptions. (...) The recent interest in evolutionary economics is, however, a heartening development (North 1999, 80).

Taking the „heartening development“ of evolutionary economics as its theoretical background, my article will focus on institutional policy and the recommendations to be derived from an evolutionary point of view to establish a set of institutions – an economic order – that can cope with the economy’s dynamical change. The crucial question is which values that are correspondingly ‘open’ can legitimize an economic order.

The starting point of my analysis will be the concept of *Ordnungstheorie* which, first, is a concept that takes dynamic change into account and, secondly, tries to legitimize its recommendations by values beyond allocative efficiency and, albeit often implicitly, by moral and ‘objective’ values. The latter is especially true for the Freiburg school of law and economics and its protagonist, *Walter Eucken*. *Friedrich Hayek*, which can be seen as another central figure of *Ordnungstheorie* contributed more explicitly the evolutionary dimension to the interdisciplinary research program. His skepticism towards economic policy is still the point of departure for any evolutionary analysis of economic policy.

2. Legitimate Economic Policy: The qualitative solution

In order to explore the common ground of *Ordnungstheorie*, I will summarize the concepts of Eucken and Hayek. Most basically, they share the view that the solution to

the problem of (legitimate) economic policy for dynamic economies is a qualitative one. Thus, the scale and scope of legitimate state action should be delineated by recourse on the (legal) form of state action.

2.1.1 The primacy of *Ordnungspolitik*

According to Eucken ([1952] 1990, 6), economic policy in advanced economies faces one central problem that lies in the high degree of complexity. Eucken juxtaposes to ideal types of governance and argues that each of them, if used in a pure form, cannot meet his criteria for a satisfactory management of economic complexity. These criteria are described by the goal of *Ordnungspolitik*, i.e. the implementation of an economic order that is both efficient (“workable”) and just (“humane”, “fair”) (Eucken [1952] 1990, 166). Laissez-faire as the first ideal type cannot solve the social problems of industrialised countries (Eucken [1952] 1990, 55 ff.); the second type dubbed experimental economic policy (“Wirtschaftspolitik der Experimente”) tries to eliminate the cause of those social problems, but thereby jeopardizes the functioning of a market economy (Eucken [1952] 1990, 149 ff.). Eucken presents a taxonomy of different forms of experimental economic policy, but most of his criticism is directed towards its far-reaching version, an economic policy that aims at a centrally administered economy (Eucken 1948; [1952] 1990, 58).

It is important to note that Eucken has such large-scale experiments in mind when he criticises experimental economic policy. More specific, he observes as a result of experimental economic policy a dangerous trend towards national monopolies which also induces, with necessity, a centralisation of political control (Eucken [1952] 1990, 55, 151 f.). This agglomeration of both economic and political power, he argues, is often promoted by policy makers (and public managers) that believe they could command a firm, an economy, and the society as a whole like a machine. Eucken ([1952] 1990, 56 f., 211) argues against such a social technology and the mechanic economics behind it and points to the limited knowledge about the effects of large-scale economic experiments. In sum, his rejection of experimental economic policy is based on two arguments, first the problem of uncontrolled power, which is not restricted to economic power but comprises – in contrast to a laissez-faire system – also

concentration of political power; second the limited knowledge of the experimenter, as an additional problem that is relevant only for experimental economic policy.

Following Eucken's rejection of both extreme types of economic policy, it is clear that a "middle way" is needed. As some of those intermediate forms that only vary the quantity of state interventions, fall under the verdict of being experimental (Eucken ([1952] 1990, 140 ff.), Eucken (1952, 95) finally presents a qualitative criterion, the "primacy of *Ordnungspolitik*":

The question whether there should be more or less state activity evades the essential issue which relates to quality, not quantity. (...) ...the state should influence the *forms* of economy, but not itself direct the economic process

According to Eucken's interpretation the historical experience shows that only one order can meet the criteria of workability and justice, i.e. the competitive market order (*Wettbewerbsordnung*). After the unsuccessful age (Eucken 1952) of political experimentation (Eucken [1952] 1990, 241) the goal of economic policy can, in other words, only consist in the implementation of a workable price system, a system of complete competition (Eucken [1952] 1990, 254)².

2.2 Rule of Law

Similar to Eucken, Hayek's argument starts from the high complexity of modern economies. He argues that (different types of) rules are crucial for the governance of such an "extended order of human cooperation" (Hayek 1988). In Hayek's view, there exists an exact correspondence between (types of) orders and different "systems of rules" (Hayek 1978, 72 ff.): While an "organization" (*taxis*) is built upon "commands" (*theseis*), a spontaneous order (*cosmos*) can only be guided by "the universal rules of just conduct" (*nomoi*). The potential complexity of an organization is always lower vis-à-vis a spontaneous order, because an organization is deliberately constructed to serve a

² For a description of Eucken's concept of complete competition in contrast to the strict notion of perfect competition and for a summary of the principles of the competitive market order, see Streit and Wohlgenuth (2000, 231 f.); Gerber (1998, 248 f.).

specific purpose of its makers and necessarily reflects their cognitive limitations. A spontaneous order, in contrast, allows the pursuit of a great variety of different purposes, the use of the dispersed knowledge of all elements of which the order consists and may thus achieve any degree of complexity (Hayek 1973, 38 f.). As the merits of the modern economy lie exactly in its ability to generate and use knowledge, it is clear that such a catallaxy is one – and the most prominent – example of a spontaneous order (Hayek 1978, 91).

Given these two types of orders, together with the implication of their different “knowledge management” capabilities, Hayek further elaborates on the different systems of rules. He specifies *nomos* and *thesis* in legal terms and postulates that public law is the realm of commands, while private law contains the universal rules of just conduct. He explicitly includes constitutional law in his concept of public law and thus conceptualises the constitution as a set of rules that aim at the construction of an organisation (Hayek 1978, 78). As Hayek (1978, 80) sees a dangerous confusion of these distinct legal spheres and especially the permeation of public commands into private law, he further elaborates on the (legal) characteristics of the rules of just conduct and stresses four criteria that allow the proper distinction of rules of private law. Rules must be abstract, only “referring to yet unknown cases and containing no references to particular persons, places, or objects” (Hayek 1960, 208 f.). At the same time true laws are required to be certain, in the sense that “the decisions of the courts can be predicted”³ (ibid.). “The third requirement of true law is equality” (ibid.), the fourth that its rules do not prescribe (positively) a certain behaviour, but only (negatively) exclude some actions from the range of allowed behaviour (Hayek 1960, 216).

It is clear, then that economic policy for an extended or spontaneous market order can only operate with rules of private law. It is less clear, however, whether such institutional policy is restricted to the enforcement of rules or whether – and to what extent – it could also deliberately modify the universal rules. In other words, the

³ Hayek apparently alludes to Holmes’ (1992, 163) famous sentence, which is often conceived as describing the program of legal realism : „The prophecies of what the courts will do in fact, and nothing more pretentious, are what I mean by the law“. Whether Hayek’s legal theory is compatible with legal realism is, however, debatable.

question of the origin of rules is crucial. In Hayek's view (1988, ch. I), there are three layers of rules inherited from the past, the oldest genetically fixed and shaped by biological evolution, the most recent represented by "constructivist" legislation. The most important layer, however, is the intermediate one "between instinct and reason", i.e. rules that are the cultural heritage of mankind, often learned implicitly by individuals and emanating from an evolutionary process of trial and error (Hayek 1967, 87; 1973, 18). In the course of this evolution "more experience and knowledge has been precipitated [in the rules] than any one person can fully know" (Hayek 1967, 92).

As instincts are obviously irrelevant for institutional policy, the interesting point is the relative importance of cultural evolution vs. deliberate implementation of rules. However, Hayek's analysis in this respect is somewhat ambivalent. Although he (1978, 74) concedes that "a spontaneous order may rest in part on regularities which are not spontaneous but imposed", he seems to eventually limit the necessity of deliberate legal innovations to cases where cultural evolution is locked in into a detrimental path of development, apparently assuming that these cases are quite rare (Hayek 1973, 88, 100). For an important part of private law he welcomes "improvements" of universal rules that could possibly be made with the help of a NIE analysis (Hayek 1988, 36, 69), but generally it is the process of cultural evolution that brings about the appropriate rules. The most important argument in favour of the spontaneous emergence of rules is that they "of necessity" comply with the stated criteria for rules of just conduct (Hayek 1973, 85).

Summarizing, Hayek's analysis of rules and orders and its policy conclusions can be seen as an elaboration of the primacy of *Ordnungspolitik* that specifies the legal form of economic policy. While his arguments against interventionism and for an institutional policy are similar to Eucken's, Hayek's additional argument of the evolutionary origins of institutions substantially changes the role of the state. Hayek, like the Freiburg School, makes out to central problems of interventionism, namely the lack of knowledge and the danger of uncontrolled power. For Hayek, however, a strong government that could limit the accumulation or at least the abuse of private power would only replace one problem with another, because public power, too, is difficult to control and could easily be abused. Even the state that refrains from interventionist experimentation and confines itself to institutional policy constitutes a "exclusive,

monopolistic power to experiment in a particular field – power which brooks no alternative and which lays a claim to the possession of superior wisdom” (Hayek 1960, 70) and is generally inferior to an evolutionary improvement of rules that is the result of numberless small and individual deviations from existing rules. In this sense Hayek (1988, 53) is indeed “in favour of experimentation”. As the outcome of the process of cultural evolution is generally in accordance with the rule of law as specified by the characteristics of the rules of just conduct, Hayek’s (1960, 222) qualitative delineation of the proper scope of government implicitly limits state actions also substantially:

... the rule of law provides the criterion which enables us to distinguish between those measures which are and those which are not compatible with a free system.

2.3. A critique of the qualitative solution

2.3.1 Economic order as an equilibrium?

The ordoliberal approach can be interpreted as an attempt to balance the dynamics of both the economic and the legal order. Note that Eucken’s ([1952] 1990, 180 ff.) interdependence of orders (*Interdependenz der Ordnungen*) is a dynamic one: On the one side there is the rapid change of industrialized countries’ economic order, on the other hand the change of the legal order is accelerated by experimental economic policy to an extent that must, according to Eucken’s analysis, be appeased by appropriate institutional policy. From an evolutionary point of view it is important to ask, whether this dynamic interdependence can be indeed interpreted as a statement about the different speed of change of evolving orders or whether either the economic or the political order is conceptualised in way that implicitly rule out creative change.

With respect to the economic order it is important to note the central role that the idea of equilibrium plays for Eucken’s concept of complete competition. Subsequent research in the line of the Freiburg School replaced this view with a more dynamic, Schumpeterian concept of competition and thereby introduced novelty and evolutionary

change into the market order⁴. For Eucken the importance of equilibrium is however not limited to the economic sphere: “The task is always the same: The establishment of a workable and just order. This double task can clarify the meaning of equilibrium. Workability is a matter of equilibrium. To the same extent is justice [a matter of equilibrium]. Thus, the meaning of equilibrium exceeds economics and its technique” (Eucken [1952] 1990, 166; my translation, S.O.). But what does equilibrium mean more precisely for the legal framework of a competitive market order? Eucken ([1952] 1990, 373) describes the equilibrium first as a state of harmony between the social macrocosms and the microcosms of “human nature”. Therefore the social order can “in certain sense” be seen as “a natural order or *Ordo*”. A second characterization (*ibid.*) refers to the correspondence between social order and historical trends. The competitive market order is meant to reflect the “strong tendencies that strive for complete competition”. Eucken stresses the fact that these tendencies do not bring about the appropriate order automatically. As the order that is in correspondence with historical trends must be deliberately established, it is “in this sense no natural order, no *ordre naturel*” (*ibid.*).

There is an obvious ambivalence in Eucken’s statement about the naturality of orders, but apart from this, each characterisation is problematic in itself. First, it is questionable whether the micro-macro-correspondence can be operationalized, i.e. whether human nature can instruct institutional policy. The second characterization has a flavour of historicism, although Eucken ([1952] 1990, 200 ff.; 1952, 89 f.) rejects e.g. the Marxian philosophy of history and its idea of inevitable institutional developments⁵. It seems as if for Eucken the co-evolution of economic and political order could come to an end once the appropriate legal framework is scientifically determined. The subsequent implementation of a stable legal order appears to be a “re-creation of reality” (Eucken 1938, 198) leading to the desirable end-state of historical development. Further experimentation is in this perspective indeed meaningless. Such an “end-state-

⁴ Mantzavinos (1994) offers an excellent survey on German *Wettbewerbstheorie*, see for a short summary Mantzavinos (2001, 191 f.).

⁵ As Eucken [1952] 1990, 27) notes, *laissez-faire* was equally convinced of having „finally discovered the one and only right, natural and divine order” (translation by S.O.).

liberalism” (Barry 1989, 112)⁶ is necessarily incompatible with an evolutionary theory of institutional change, which would focus on open-ended processes.

2.3.2 Are the qualitative criteria reliable ?

(1) Institutional policy vs. regulation

Even if the legal framework of the competitive market order could be specified and legitimised in a way that avoids the problematic concept of equilibrium, an evolutionary perspective on the interdependence of economic and legal order has important consequences for the qualitative statement concerning the scope of government, i.e. the primacy of *Ordnungspolitik*. Whatever legitimation and whatever delineation for the institutional arrangement is chosen, this choice can never be interpreted as a final state but only as a provisional one (Hesse 1979, 218; Koch 1996, 141). The institutional arrangement will always and necessarily undergo changes, because – unlike the metaphor of a framework suggest – the legal order, i.e., in Eucken’s word the “form of economies” , is not only an exogenous restriction for the economic process but is endogenously co-determined by the process (Budzinski 2000, 224 ff.). From an evolutionary point of view it is clear that within the economic process novelty can occur as a result of the actors’ creativity. With respect to the interdependence of institutional arrangement and economic process this also implies that actors can react creatively on legal rules, even if the law remains absolutely unchanged (Okruch 1999), and that it is impossible to calculate the actors’ reaction on a modification of the legal order. Therefore the beneficial effect of a political measure cannot be determined by the qualitative criterion of form. Although some forms of interventionism are obviously incompatible with a competitive order this statement relies on the probable effects and not on the form of the measure. This is true for such crude interventionism as price controls or quotas, as the addressees creativity is directed directly toward the evasion of the regulation, so that these interventions are both futile and obviously anti-competitive.

⁶ „An end-state doctrine... supposes that a particular pattern or form of economic or social organization is desirable on ethical or metaphysical grounds and that it may be imposed. Thus whereas procedural or process theory directs attention towards how things come about, end-state theory tries to demonstrate the intrinsic desirability of things as they are, or could be”; Barry (1989, 112).

But in contrast to this blatant cases it is far more difficult to foresee the reactions on the modification of the more general rules of the economic game.

Given this co-evolution of economic and legal order, the distinction between *Ordnungspolitik* and direct intervention into the process becomes less clear. Potentially, however, the Hayekian specification of the legal form of *Ordnungspolitik* could deliver more reliable criteria for the forms of institutional policy that are beneficial for the (spontaneous) market order.

(2) *nomos* and *thesis* in a legal perspective

Hayek's legal theory consist first of his legal systematic that links the two kinds of rules to public vs. private law and secondly of his criteria that rules of just conduct have to meet and that are connected with the theory of cultural evolution.

With respect to the first part it is, not only from the standpoint of continental constitutional law, surprising that Hayek confines the constitution to commands for the organisation of government. Consequently, general civil or human rights, that are laid down in a constitution should be seen as being part of private law. Whereas this might be a minor problem of taxonomy, there is a more general problem with the strict dichotomy of public (and especially administrative) law as a sphere of command and coercion and private law as the domain of liberty. Within legal science this traditional concept has been contested and substantially modified. Although many lawyers share Hayek's scepticism vis-à-vis an over-regulation by public law and some legal scientist even were in search for an "post-interventionist law", the growing intermixture of the public and private law is not longer perceived only as an apostasy from legal purity but also as a result of and a chance for a "learning law" (Trute 1996, Zumbansen 2000). [*] Ladeur (1997, 191) convincingly argues that the classical liberal model of law for a "society of individuals" must undergo changes given "the rise of organizations... as the primary actors", so that legal theory has to ask "how the model... has to be varied in conditions of the society of organizations, by looking for supplementation and functional equivalents for the market's knowledge-generating function" (ibid.).

The second part can be seen as an elaboration of Hayek's (1978, 250) "twin ideas of evolution and of the spontaneous formation of an order". Hayek argues that the rules which are necessary for the maintenance of a spontaneous order are mostly the result of

an evolutionary process, i.e. cultural evolution. The cultural evolution produces, in other words, the universal, abstract and certain rules of just conduct. As Hayek (1978, 100 f.; 1973, 94 f.) further is convinced that these beneficial rules could only emerge in a common law system, the central agent within the process of cultural evolution is the judge (Okruch 2001).

There are, to my point of view, two (interdependent) shortcomings of Hayek's concept: First, with the criteria that every single rule must cumulatively meet, Hayek's sets a utopian standard (Weinberger 1992, 270), especially with respect to the assumed harmony between the abstract universality and the certainty of rules. Secondly, his view of the adjudication's role in cultural evolution does not fully reflect the complex interplay of rules, decisions and principles that guide them. This, ironically, results in viewing the legal order as quite rigid.

The common cause of both deficits lies in some terminological confusions about rules and principles: on the one hand it is not clear whether rule means the factual uniformity of behaviour ("is") or whether it signifies a prescription for behaviour ("ought"). On the other hand rule can either mean a prescription for behaviour or a legal principle ("principles as rules", Hayek 1978, 101; "principles as inchoate rules", Hayek 1973, 119). This vagueness leads to the described shortcomings: The characteristics of or the criteria for rules (as prescriptions) are internally inconsistent, because these requirements can only be met by the interplay of both legal norms (rules) and legal principles that finally leads to a judicial decision. Law as only a "model of rules" (Dworkin 1996, 14) without principles can be certain, but is unable to cope with novel conflicts ("Hard cases make bad law", Holmes 1992, 130). A model of principles (Steiner 1976, 143, 150) without rules can be abstract as it is able to cope with potentially every conflict, but cannot yield certainty; the concrete judicial decisions cannot be foreseen⁷. The balancing of certainty and flexibility is the task of judicial procedures. Only a legal system that contains rule, principles and procedures can produce both reliability and flexibility, (Dworkin 1996, Alexy 1996). Without focussing on principles and procedures the change of legal norms is explained in a way that confuses the basic distinction between "is" and "ought", because the change of factual

(individual) behaviour is linked to directly to the change of (collectively binding and beneficial) norms (Vanberg 1986).

The direct causal link from behaviour to norms, which ignores the effects of principles and procedures, also results in an overestimation of the certainty of judicial decisions. According to Hayek the judge can easily make this step from “is” to “ought”, and it is interesting that Hayek (1978, 79; 1967, 166) refers to this decision making process in terms of a “discovery” or “finding” of rules. The innovative potential of adjudication is thereby underrated (Okruh 1999). Eventually Hayek – similar to Eucken – refers to the idea that the change of legal orders is guided or even determined by the “nature of things” (Hayek 1973, 106).

(3) *nomos* and *thesis* as different forms of governance

Hayek claims that a spontaneous market order needs the abstract and certain universal rules of just conduct or that, the other way round, the enforcement and cautious modification of those rules can guarantee the spontaneity and workability of a market order. Any attempt to govern the economic system more directly is impossible, as it requires the use of commands for a specific purpose and would ultimately transform the economic order into an organization.

This impossibility-theorem of governance, however, underrates the creative potential of the addressees of any political measure (Wegner 1997; 1996). Even if economic policy does only operate with general and abstract prohibitions that narrow the addressees set of possible actions it is not guaranteed that the economic actors react in way that support the spontaneity of a market order. Universal rules can be, in other words, so strict that the ultimately destroy a spontaneous order. This leads to the conclusion that, once again, the beneficial or detrimental effect of a political modification of the institutional arrangement cannot be qualified along formal criteria, but only on the basis of an economic analysis that must – from an evolutionary perspective – take into account the creativity of actors.

Such an analysis (Wegner 1996, 1997) has to differentiate, first, whether either the actors can expand the set of potential actions creatively or whether they lack the innovative potential to do so. It is clear that, secondly, it should be analysed, whether

⁷ „General propositions do not decide concrete cases” (Holmes 1992, 306). A principle „states a

the addressees' action ultimately help reaching the goal of the measures taken. This two-dimensional analysis results in a classification of four possible cases, and it appears that Hayek's impossibility theorem describes only one of them. This case is characterized by the failure to reach the political goal, because the creative actors do not find ways to creatively substitute the prohibited action by an innovative option that is conform to the goal. Additional attempt to reach the goal ensue and finally lead to stagnation. Note that this consequence crucially depends on the lacking ability to innovatively expand the set of possible actions. As far as actors are endowed with creativity there is, in other words, a potential for the political governance of the economic system. Whether a deliberate modification of the institutional arrangement, that is the set of prohibited actions, depends on the innovative potential in the specific case and is irrespective of formal legal criteria Hayek views as decisive.

The potential success of institutional policy can only be assessed for a specific situation and has to estimate the innovative potential in relation to a considered measure. Given the creativity of the addressees and the possibility of unanticipated novelty, an optimal measure can never be determined. Institutional policy therefore is always a venture that political entrepreneurs have to answer for. As the knowledge about the reaction on a political measure can never be certain but is necessarily fallible and subject to future learning, an "evolutionary policy maker adapts rather than optimises", his attention "shifts away from efficiency towards creativity" (Metcalf 1995, 418). As there is, in other words, "a strong case for experimentation and policy learning" (Metcalf/Georghiou 1997, 7) in order to improve the knowledge about governance, it should be asked how the experimental and learning process is to be designed so that most knowledge can be used for institutional policy.

3. Legitimate Economic Policy: Procedural Criteria

The procedural analysis can be structured along the distinction between institutional choice and institutional change. The dichotomy is analogous to Eucken's ([1952] 1990, 375 f.) notion of grown vs. made orders and can also be related to Hayek's

reason that argues in one direction, but does not necessitate a particular decision" (Dworkin 1996, 26).

differentiation of *nomos* vs. *thesis*, as the former is consciously chosen, while the latter is for the most part the result of evolutionary change.

As it has been shown above, Eucken and Hayek take a similar starting point, that is the problem of an appropriate institutional arrangement for a dynamic economy. Their solutions, however, differ substantially in setting the focal point within the continuum between choice and change. While Hayek mainly relies on the gradual change of institutions by adjudication, ordoliberalism aims at the choice and implementation of a workable and just order. Note that this choice, according to Eucken, is not the choice of the people concerned, but it is a scientific decision on the basis of historical experience derived from past experiments. As this historical substantiation, as argued above, is questionable, the institutional choice must be legitimised in another way.

The legitimation Hayek gives for the rules that are the outcome of cultural evolution is their superior problem solving capacity. As there is no choice to be made, it is once again not the individual decision of the people concerned that is decisive, but the beneficial function of evolved rules, that is to “help to make the members of the society in which they prevail more effective in the pursuit of their aims” (Hayek 1976, 21). Beside the foregoing critique of Hayek’s view on the process of judicial change of rules, one may ask whether there could be other mechanisms that produce rules that promote the success of societies.

3.1. Input-legitimation in institutional choice

The legitimacy deficit of ordoliberalism can be cured, if and when the institutional choice is explicitly based on a decision of those who will be affected by the institutional arrangement (Vanberg 1988, 1997). Hence institutional choice is seen as an agreement on a social contract that reflects the preferences of all people concerned. As it is important that each contractor voluntarily assents to the contract, the institutional choice has to be taken unanimously. Unanimity is a central requirement of the contractarian approach and can be interpreted as analogous to the Pareto-criterion (Brennan/Buchanan 1985, 135 ff.). Given this analogy also the contractarian interpretation of ordoliberalism uses the idea of equilibrium for the legitimation of order. This provokes two questions:

First, whether factual consensus could be a utopian normative standard, an ideal norm that – similar to Pareto-efficiency – could only be reached in nirvana (“Pareto-illusion”, Albert 2001, 32). Secondly and interrelated, whether consensus can fruitfully be used as an explanatory principle, too. This means using it for a positive constitutional economics (Voigt 1999) that explains institutional change. The latter question can be answered in two ways. Either empirical modifications of the institutional arrangement are rationalized by describing a hypothetical consensus, or institutional change is explained by the change of preferences that could be expressed in a new actual consensus. The first solution is highly problematic in that it only alleges the voluntary agreement of individuals, that is it assumes preferences that could never be revealed by actual choice. The second solution is plagued by the described problem of actually reaching a consensus.

In order to avoid the difficulties of the potential nirvana approach that the principle of unanimity represents, a comparative institutional approach is to be taken. This means, I argue, not to focus on consensus or on majority rules (as deviations from consensus), but to take into account the complex system of democratic institutions. “It is not the majority rule alone, that is meant to “substitute” consensus, but it is the system of parliamentary-democratic institutions. [This system] is to be evaluated as to whether and to what extent it offers the protection against discrimination the consensus offers” (Homann 1985, 59; translation by S.O.).

This version of democratic legitimation has in common with a contractarian approach the reference made to the peoples’ preferences that ought to be actually expressed. Basically both approaches use – from the point of view of the individuals that make the institutional choice – an internal criterion for the quality of choice, that is the correspondence with people’s preferences (Vanberg 1994, 208). Below perfect consensus it can be asked to what extent preferences flow into the “production” of the institutional framework. Therefore this kind of legitimation can be dubbed “input-legitimation” as “government by the people” (Scharpf 1999). Scharpf (1999, 8 f.) points to an important prerequisite for input-legitimation, namely the high degree of common identity that limits the possible number of people involved. This can be illustrated by examining the institutional preferences more closely.

Following the argument of Vanberg and Buchanan (1994a, 168 ff.) concerning constitutional preferences, two dimensions can be distinguished, namely constitutional interests and constitutional theories. Theories in this context mean “predictions (embodying assumptions and beliefs) about what the factual outcomes of alternative rules will be” (Vanberg/Buchanan 1994a, 169). Vanberg and Buchanan argue that a consensus on theories could be approached by discourse and deliberation, whereas the conflict of interest would persist. The probability of an agreement on theories, however, will first depend on the number of people involved. Secondly and decisively, it depends on the cultural homogeneity of the participants of the discourse (Scharpf 1999, 9). The more people from different “epistemic communities” are involved, the lower the probability of consensus will be for the theory dimension, too (Hegmann 2001).

From an evolutionary point of view, at least two interesting features of this approach should be stressed

- The theory dimension in institutional choice introduces knowledge as an important factor (Vanberg/Buchanan 1994b, 180 f.). Note that theory does not mean to make a scientific statement about the best of all possible worlds (like the described end-state liberalism), but theories consist of the fallible knowledge of people involved (what comprises, of course, scientific advisors).
- Secondly, mechanisms of using knowledge are described, that is mechanisms of mutual learning about theories. This procedural view is able to perceive democracy not only as the application of the majority principle but as a “process of forming opinions” (Hayek 1960, 108)⁸.

One additional distinction, however, has to be made with respect to the knowledge encapsulated in theories, in order to better specify the conditions under which a consensus of theories can be reached by discourse. According to Vanberg and Buchanan (1994a, 169) “theories are about matters of fact”, but as Hayek repeatedly argues, “the rules of fact which one knows” (Hayek 1967, 80) are only one part of the knowledge necessary to act in way so that an order of actions can be sustained (Hayek 1960, 25 f.). The formal institutions that are deliberately chosen are, in other words, embedded in a system of informal institutions. As one cannot assume that a change of formal

institutions is always in harmony with the informal constraints, but the latter also influence the effect of a change of formal institutions, one may argue that the individual knowledge about outcomes of institutions is partly “knowing that”, partly “knowing how” (Ryle 1949). These two kinds of knowledge differ in the way they can be communicated. While knowing that can be expressed by means of language, so that it can be exchanged in a discourse, knowing how cannot be expressed in words and is best acquired by imitation, that is learning by doing or learning by using. If an individual has acquired such practical knowledge about the working properties of a specific institutional arrangement (containing both formal and informal institutions), it is not at all certain that she is convinced by theoretical (that is knowing that) arguments about the superior quality of another institutional setting. Given that knowing that cannot be transformed into knowing how and vice versa, the discourse will have difficulties reaching an agreement, if the participants’ theories also embody knowing how. This problem is aggravated by psychological effects that have been long neglected by both economics and the philosophical tradition that focuses on discourse and deliberation (Kahneman/Knetsch/Thaler 1991). A strong status quo effect will plausibly also prevail in institutional choice. This status quo effect needs not be viewed as an irrational anomaly only, given the high degree of uncertainty about the performance of an institutional innovation (Fernandez/Rodrik 1991), that is the utility derived from the “consumption” of a changed institutional arrangement (Rabin 1998). Theoretical arguments will not be sufficient to overcome inertia of this kind.

Both arguments – the distinction of different kind of knowledge as well as the status quo effect – hint at difficulties a discourse will have in reaching an agreement. In other words: Learning by discourse, that is the theoretical examinations of different options in institutional choice, is only one learning mechanisms. Beside these thought experiments there might be the need for real world experiments, in order to give the opportunity for learning by using and overcoming the uncertainty that induces the status quo orientation (Heinemann 2000). This is, of course, already an argument related to output legitimation.

⁸ Hayek (1960, 109) points out that „[i]t in its dynamic, rather than in its static, aspects that the

3.2 Output-legitimation in institutional change

Input-legitimation focuses on the collective institutional choice in a “constitutional moment”. A change of the institutional arrangement is possible – no institutional setting could be qualified as the end-state – but has to wait until the next constitutional moment. This also means, that an individual that is discontented by the institutional arrangement, cannot make an individual institutional choice that would express her preferences, as long as only input-legitimation prevails. Introducing the possibility of individual choice of orders according to the “output” the relevant institutions “produce” for the individual, can be seen as one mechanism of “output-legitimation” (Scharpf 1999, 10 ff.)⁹. This means that the individual can choose among different international orders (institutional/systems competition)¹⁰, among different intranational orders (federalism)¹¹ or among different functional equivalents (functional federalism)¹². In any case there is no longer a monopoly for the institutional supply, but different suppliers make their institutional offers in a competitive process. This implies competitive control but also the incentive to generate and use new knowledge. Institutional competition, too, is a discovery procedure, a “constitutional exploration, for the inventing of and experimenting with new solutions to constitutional problems” (Vanberg/Buchanan 1994b, 188).

Although the limits to these different forms of institutional competition must not be overlooked, the very idea of competitive supply of institutions should not be rejected a priori. Such fundamental criticism would, as recently Oates (1999) pointed out, once again imply the pretence of knowledge about an desirable end-state. With respect to the economic theory of (fiscal) federalism he points to a neglected dimension dubbed “laboratory federalism”: “In a setting of imperfect information with learning-by-doing,

value of democracy lies“, that is „democracy is the only effective method of educating the majority“.

⁹ Scharpf (1999, 11) characterizes output-legitimation as „government for the people“ that derives legitimacy from its capacity to solve problems requiring collective solutions.

¹⁰ See for an evolutionary theory of institutional competition Vihanto (1992), Vanberg/Kerber (1994), Wohlgemuth (1995). Cf. Voigt (1999, 182 ff.) for a short summary of the competing views on institutional competition.

¹¹ Cf. Dye (1990), Oates (1999).

¹² See especially the concept of „functional overlapping competing jurisdictions“, advocated by Frey (1996) and Frey/Eichenberger (1996).

there are potential gains from experimentation with a variety of policies for addressing social and economic problems. And a federal system may offer some real opportunities for encouraging such experimentation and thereby promoting ‘technical progress’ in public policy” (Oates 1999, 1132).

Oates (ibid.) refers to the US welfare reform in 1996 which “replaced the longstanding federal entitlement programs with a new system under which the states have broad scope both to determine the form and levels of their programs to assist the poor” (Oates 2001, 141). Simultaneously, however, “the federal government continues to provide extensive financial support to the states... in the form of substantial block grants with few strings attached to them” (Oates 2001, 142). This example is interesting in that it combines the competition of jurisdictions (“laboratories”) with a federal “supervisor” that seeks “to find out what sorts of programs can work” (Oates 1999, 1132). There is, in other words, not only a competitive feedback that works among the different states, but also the potential of horizontal or vertical cooperation and learning (Oates 1999, 1133).

4. The division of knowledge as a blind spot?

With regard to the cultural evolution and to its most important mechanism - the competition of systems of rules – Hayek (1960, 37) makes the following important statement:

The competition on which the process of selection rests must be understood in the widest sense. (...) To think of it in contrast to co-operation or organization would be to misconceive its nature. The endeavour to achieve certain results by co-operation and organization is as much a part of competition as individual efforts. (...) The relevant distinction is not between individual and group action but between conditions, on the one hand, in which alternative ways based on different views or practices may be tried and conditions, on the other, in which one agency has the exclusive right and the power to prevent others from trying. It is only when such exclusive rights are conferred on the presumption of superior knowledge of

particular individuals or groups that the process ceases to be experimental....

This paragraph provokes the question whether the cooperative element only prevails in institutional competition. If this question is answered negatively – that is, if there is possibly an analogy between market competition and competition among rules – then a more fundamental problem arises for both kinds of competition. Given the importance of organization of actions and of voluntary cooperation one may ask what Hayek’s theory of the spontaneous market order has to say about it¹³. Analysing organization and cooperation would mean to introduce a third layer in between the “order of actions” and the “system of rules”: the order of actors. “Order of actors” can, in principle, mean two different things. It can refer to the intermediate level between individual actions (and their competitive order) and general rules or, within this intermediate level, the internal organization of entities like firms, governments or bureaucracies. The first meaning locates “cooperation and organization” logically between autonomous individual action and heteronomous general rules, the second focuses on the governance rules that, as Hayek directly connects “cooperation and organization” apparently need not be (only) the coercive “rules of organizations”. Both dimensions are interrelated: In order to understand the action of corporate actors one needs to know the internal governance structure. To the extent that corporate actions show peculiarities, it is necessary to introduce an intermediate level. Then it is impossible to reduce the “society of organizations” (Ladueur 1997, 190 ff.) to a “society of individuals” (Elias [1939] 1991) (and an order of individual actions). Hayek (1988, 37) notes that “as the overall spontaneous order expands, so the sizes of the units of which it consists grow. Increasingly, its elements will not be economies of individuals, but of such organizations as firms and associations, as well as of administrative bodies”, but is debatable whether the difference between the elements is only one of size.

Concerning the internal governance structure the vast literature on the theory of the firm can be used to fill the gap – as far as the underlying theory is compatible with

Hayek evolutionary approach¹⁴. The same caveat applies to the Public choice literature that analyses bureaucracy and government.

Interestingly, a deeper analysis of the cooperative element within competition for a knowledge-based economy has been advocated by Helmstaedter (2000; 2001), who elaborates on the institutional implications of Hayek's cursory reference to the "division of knowledge". Helmstaedter points to the need for institutions that promote the cooperative sharing of knowledge. In a similar vein, recent contributions to innovation theory stress the importance of a cooperative element in R&D, because the process of invention regularly exceeds the boundaries of a single firm (Hippel 1987). Both empirically and theoretically it has been paid special attention to the role of informal networks for the generation of such "collective inventions" (Silverberg 1990). Because such networks are stabilized by informal institutions and norms of trust and reciprocity, focusing the order of actors automatically broadens the horizons of values that are to be taken into account.

5. Conclusion

I have argued that ordoliberal and Hayekian answers to the question of legitimate economic policy for a complex and dynamic economy point to the central knowledge dimension inherent in the governance of an evolving system. The formal solutions for the knowledge problem, however, are based on assumptions that are problematic both from the perspective of evolutionary economics and legal theory. Both the legitimation of institutional choice and the legitimation of institutional change, ultimately encapsulate the idea of institutional experiments. The necessity of organizing the experimental process points to an intermediate level, the order of actors, as an important dimension for political intervention that has been neglected with the Hayekian dichotomy of actions and rules. This is not only a way out of the "impossibility

¹³ Cf. Foss (1998): „It has often been observed that Austrian economics does not feature a theory of the firm.... Austrians have next to nothing to say about pricing, buyer-seller relations, vertical integration and other aspects of economic organization; in other words, one of the most important constituent mechanisms of the market process, namely firm behaviour, is simply not theorized in Austrian economics”.

¹⁴ See for an extensive survey Foss (2000).

theorem”, but also a way of taking different values within the order of actors into account – without prescribing, however, which values one should hold and without deriving values from “human nature”. Against such tendencies “de gustibus non est disputandum” pleads for modesty and caution – it needs not to exclude values from economic analysis.

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