APPROACH BY W. EUCKEN AND F. A. HAYEK FOR COMPETITION AND LEGAL REGULATION

Ilona Bažantová – Jan Horych

Abstract

The German economists of the Ordoliberal School, which was formed at Freiburg University, developed the first comprehensive European theory of competitive order and its regulation. The aim of this article is to analyse the opinion of Walter Eucken, founder of the School of Ordoliberalism, on competition. His views on competition and its legal regulation will be compared with the ideas of F. A. Hayek. A world-famous economist, Hayek drew mainly from the Austrian School tradition, but later in his life he became connected to Ordoliberal economists, influencing their thoughts on competition and being influenced by their ideas. Hayek sketched some ideas on the regulatory framework of liberal social order in some aspects and tone similar to ordoliberal thought in his essay "Free" Enterprise and Competitive Order (1947). Hayek was appointed a chair at Freiburg University in 1962.

Key words: W. Eucken, Ordoliberalism, F. A. Hayek, Austrian School, competition,

JEL Code: B 25, B 53, K 21

Introduction

The existence of competition is a fundamental element of the market economy. Nonetheless, various schools of economics view competition differently and provide lawyers and lawmakers different recommendations as to how competition should best be regulated (Gerber, 1998; Depoorter & Parisi, 2005). Three influential schools of economics were born in the German central European region: the German Historical School, the Austrian School, and Ordoliberalism (the Freiburg School). The recommendations of the German Historical School dominated government policy in the last third of the 19th century. The more recent School of Ordoliberalism also originated in Germany in the historic university town of Freiburg im Breisgau, Baden-Würtenberg, in the 1930s when a group of lawyers and economists was formed which included Walter Eucken (1891–1950), Franz Böhm (1895–

1977), and Hans Großman-Doerth (1894–1944). Ordoliberals appreciated from the very beginning the importance of cooperation between law and economics. The formation and publication of the most important works of the principal authors took place in the 1930s, however the most influential period of the school and its importance for the German discourse came after the end of World War II, in the second half of 1940s and at the beginning of 1950s. Ordoliberalism as a specific school for the European continent is discussed by many authors, and the ordoliberal view of competition has become the antimonopoly theoretical basis for the policy of the Federal Republic of Germany, the European Communities, and the current European Union (Gerber 1994, Krabec 2003, Grechenig & Gelter 2007, Horych 2018).

The Austrian School was formed in the last third of the 19th century in Vienna, but also developed in the Prague, Brno, and other Austro-Hungarian universities. It was based on the works of Carl Menger (1840–1921), Eugen Böhm-Bawerk (1851–1914), and Fredrich von Wieser (1851–1926). The next generation, including Ludwig von Mises (1881–1973), the author of the so-called praxeology, and Friedrich August von Hayek (1899–1992), Nobel Prize for Economics laureate, developed their concept of economics as a purely subjectivist science with a significant individualist methodology. The proponents of the Austrian School are typical representatives of classical liberalism of the *laissez-faire* type who criticise government intervention.

The main objective of this paper is to first briefly outline the ideational bases of the Ordoliberal School and the Austrian School, and then to compare the attitudes of Eucken and von Hayek to competition and to analyse the common aspects and differences in their views and recommendations. A considerable number of articles compare these two authors and their views on liberalism and democracy (Nientiedt & Kohler, 2016) and on justice (Woersdoerfer 2013), or compare Eucken's and Hayek's theories of the economic cycle (Bluemle & Goldschmidt, 2006), but few articles compare in particular their attitude to competition.

1 Ordoliberalism and W. Eucken

In contrast to the German Historical School, Ordoliberalism admitted considered it appropriate to apply abstract economy theory, irrespective of the period in time and place. The theory of economics should apply everywhere at a given time. This conception of the theory of economics was similar to the Austrian School. However, Ordoliberalism adopted at the same time the concept of private economic power (*Privaten Macht* or *Wirtschaftsliche Macht*) and dealt with the issue of economic coercion, which is in principle similar to state coercion (Böhm, 1928). This aspect also represents the main difference between Classical Liberalism and Ordoliberalism in general (Vanberg, 1999). According to Ordoliberals, economic power enables competitors to maintain their economic position through various undesirable practices, rather than by the superiority of their products and services, and this in turn deters business partners of the monopoly from accepting more advantageous offers from other providers. Eucken speaks about “new feudalities” (Eucken, 2004).

The preceding schools of economics did not address the issue of strong position and the power of private companies. Cartels and monopolies had a considerable presence in every European economy and were often considered a positive phenomenon facilitating coordination of the economy, enabling economies of scale, and supporting employment.

The methodology of Ordoliberals is dominated by the idea of “orders” (or *Ordnung* in German) and their mutual relations. “Thinking in orders” was such an important principle that the Ordoliberals adopted the “ordo” prefix in the name of the school to differentiate themselves from the traditional Classical Liberalism. Ordoliberals tried to understand the economic, legal, and other social phenomena occurring within an order, i.e., within a set of formal and informal rules. These rules then jointly create a general scheme which regulates and co-determines the given society. Extreme, pure cases of such orders were both the socialist orders focused on the central planning of economic and general human activities, and the *laissez-faire* order of Classical Liberalism perceiving the state as a night watchman. Ordoliberals viewed both these orders as wrong in principle and tried to create a concept that would reflect the deficiencies of both these orders and overcome them. This is how the conception of the ordoliberal state originated. It was vested with all the functions of the classical liberal state, but in addition had the task of ensuring a truly competitive environment and the basic aspects of competitive order, among other things by introducing an effective competition policy, inflation-free circulation of currency with an independent central bank as a public body, and the public provision of basic services (e.g., education, social security, healthcare), which would ensure social consensus.

The general social order was composed of several partial orders which had to be coordinated so that they could operate jointly. For example, if an open competitive economic order was to persist, it was necessary to introduce a legal order protecting competition so that it was possible to face the anti-system cartels and monopolies which may appear in an unregulated economy of the *laissez-faire* type. At the same time, Ordoliberals placed an emphasis on coordinating other partial orders, such as the tax or corporate law order, with the objectives and means of the competitive order (i.e., that the other partial orders do not support the excessive concentration of market operators).

From the practical point of view of competition policy and legal framework, Ordoliberalism promoted the general prohibition of cartels and any abuse of economic power. The Ordoliberals proposed that an independent agency be created to introduce and enforce these rules, to oversee the competitive environment, and to penalise the anti-competitive behaviour of competitors. This was later reflected in the so-called Josten draft of German anti-cartel and anti-monopoly legislation from 1949 (Karte & Holtschneider, 1981). Ordoliberals created the first European theory of competition order and its regulation. Although the original draft was eventually rejected and the final text of the GWB Act (*Gesetz gegen Wettbewerbsbeschänkugen*) of 1957 was influenced by political compromises, the principles and the spirit of the order was maintained.

2 Austrian School and Friedrich August von Hayek

The Austrian School views the economic reality differently, based on its approach of using consistent methodological individualism and subjectivism and strictly opposing the application of methods typically used in natural sciences to social sciences. There are no major differences in the conception of market mechanism and competition among individual authors of the Austrian School. Indeed, in the view of the Austrian School market is a social phenomenon, a process, which enables the coordination of acts of a huge number of individuals in the absence of a single directing authority. Hayek sees the market as an extremely large spontaneous order which helps individuals direct their productive efforts to activities that are most valuable to other members of society. The market process helps individuals overcome the natural fragmentation of knowledge in human society because it enables communication of the knowledge relevant for the given activities via simple pieces of information in the form of growth and the fall of prices. However, these pieces of information do not always take a form that is simple to communicate. Hayek (1980, p. 86-87) clearly states that on the contrary, a large proportion of information indispensable for economic behaviour cannot be communicated verbally due to its substance and the existence of a functional market is necessary for the use of such information.

This is closely related to the definition of market equilibrium. In his essay "Economics and Knowledge", Hayek defined the concept of equilibrium as a situation when the plans and assumptions of various members of society are correct. This means that individual plans are based on expectations of such behaviour by other persons that these other persons really intend to carry out and all partial plans are based on an identical set of external facts. The result of meeting all these conditions is a situation when no person has a reason to change the plans and hence there is no waste of economic resources (Hayek, 1980, p. 42).

The Austrian School typically took a critical stance on the so-called perfect competition model. Hayek explicitly claimed in his essay "The Meaning of the Competition" that the status described by the theory of perfect competition in fact cannot be denoted as competitive and that the theory of perfect competition does not provide appropriate leads for real policy. The reason for this is the failure to understand the causal relation. The status which the perfect competition theory assumes for its application can be achieved only by the operation of the competitive mechanism. The operation of this mechanism is coupled with phenomena which may be, according to perfect competition, undesirable (Hayek, 1980, p. 92).

Some basic assumptions of the perfect competition theory, i.e., the assumption of homogenous goods with a large number of suppliers and buyers and the assumption that every market operator has perfect information on the relevant factors on the market, show a failure to understand competition as an economic phenomenon. Hayek pointed out that *„the knowledge they [the market operators] are supposed to possess in a state of competitive equilibrium cannot be legitimately assumed to be at their command before the process of competition starts. Their knowledge of the alternatives before them is the result of what happens on the market, of such activities as advertising, etc.; and the whole organization of the market serves mainly the need of spreading the information on which the buyer is to act.“* (Hayek, 1980, p. 96).

According to the Austrian School, the information that the theory of perfect competition assumes market operators have is in fact the object of the operation of perfect competition. The same is true of excluding personal relations between market operators in the theory of perfect competition. Hayek pointed out that on the contrary, experience plays a significant role when choosing a seller or buyer. Goodwill and experience help to overcome the imperfect information possessed by market operators and to achieve a status desirable for them.

Hayek used the example of the services of a doctor or a lawyer to show that the "imperfection" of competition within the meaning of the perfect competition theory is not usually caused by the defect of the competitive mechanism but by the heterogeneity of the goods or services themselves, which is in many cases very desirable, and warns against the conclusions that may arise from such misconception for practical competition policy. On the one hand, the nature of a wide range of goods and services, in particular, makes it impossible to achieve the status of perfect competition. On the other hand, in the case of goods and services for which in the real world there is an approximation of perfect competition, this happens thanks to the objective nature of the given goods and services. For such goods and services, the knowledge of their production and provision is broadly disseminated and hence there is not much space for competitive activities. The conditions that should be created by such activities are already present.

This forms the basis for Hayek's conclusions on the competition efficiency test: *"The basis of comparison, on the grounds of which the achievement of competition ought to be judged cannot be a situation which is different from the objective facts and which cannot be brought about by any known means. It ought to be the situation as it would exist if competition were prevented from operating. Not the approach to an unachievable and meaningless ideal but the improvement upon the conditions that would exist without competition should be the test."* (Hayek, 1980, p. 100).

Therefore, it is not easy to determine the monopoly price because it would require the knowledge of competitive prices, which are not available in a monopoly situation.

Hayek's conception of the law of protection of competition is not completely identical to that of other representatives of the Austrian School; Hayek has a different, more complex, attitude to the issues of monopoly and cartel which is close to Eucken's approach. Hayek rejected the simple rules of the *laissez-faire* type or the absolute freedom to contract and placed more emphasis on the circumstances of specific cases. At the same time his work focused on the non-economic aspects of monopoly and cartel as Hayek was sceptical to the possibility of clear determination of the limit between the monopoly and competitive price. He rejected (as did other members of the Austrian School) the use of models of perfect or monopolistic competition as an aid for the assessment of the quality of competition, but similarly to Ordoliberals took into account the political and social aspects of economic power.

For Hayek, the issue of monopoly consists in that it gives the possibility to exercise coercion on other market operators. This does not occur in all monopolies, however, and it is necessary to distinguish between goods and services where the refusal to supply causes existential difficulties and those where it only causes inconvenience. Hayek illustrated the two situations with the example of a famous painter who refuses to provide his services to someone and the owner of an oasis who refuses to provide other people with access to water. Whereas in the first case the coercion possibility is clearly missing, the second situation gives the owner the opportunity to use the power acquired in this way. As a solution Hayek proposed a duty to be imposed on the seller to refrain from discrimination *"whenever there is a danger of monopolist's acquiring coercive power, the most expedient and effective method of preventing this is probably to require him to treat all customers alike, i.e. to insist that his prices be the same for all and prohibit all discrimination on his part. this is the same principle by which we have learned to curb the coercive power of the state."* (Hayek, 2006, p. 120).

A monopoly achieved through the quality of services or goods provided should not be penalised. Hayek proposes to impose a general rule prohibiting any discrimination with the purpose of imputing certain market behaviour. This category includes various types of tied selling also prohibited by the current legislation. Hayek expressed certain doubts concerning the knowledge of the supervising authority (as opposed to the Ordoliberals) and gave preference to the resolution of such disputes through private law. He even envisaged the formation of specialised law firms that would deal only with disputes of this kind. In contrast to the above-mentioned discrimination case, Hayek does give a role to the state in solving situations when a monopolist abuses his power by erecting barriers to the entry of potential competitors on the market.

In terms of the size of the company and market share, Hayek pointed out the fact that unless the competitive mechanism is allowed to operate freely, it is impossible to determine an appropriate production and organisational structure. This is why Hayek states that the power to determine such structure should not be held by a public body. Therefore, the control of mergers within the meaning of current law for the protection of competition would not be appropriate.

In the context of cartel agreements, Hayek mentioned the success of the Sherman Antitrust Act in forming the business climate, where explicit anticompetitive agreements were prohibited. However, he was concerned about a general prohibition of cartels and various necessary exceptions to this prohibition and recognised that in some cases such an agreement may be harmless or even beneficial for the consumer. As a solution he proposed "*to declare invalid and unenforceable every agreement in the restriction of business without exception, and to prevent any attempts to enforce them using intentional discrimination or by giving* *those on whom such pressure is exerted the right to general damages as already indicated above."* (Hayek, 2011, p. 457).

Unlike other representatives of the Austrian School (Bazantova & Horych, 2017), Hayek admitted a certain form of antimonopoly legislation, even though he did so very cautiously and with the imposition of major checks on the power of the state. Within the spirit of the Austrian School he added to his conception of the law of protection of competition: *"Even though I believe that one of the intentions of development of law should be the restriction of private power over the market behaviour of others and that this would result in certain benefits, it does not seem to be of a comparable benefit to that which could be achieved if the government refrained from helping the monopolies by imposing discriminatory rules or measures of economic policy."* (Hayek, 2011, p. 459).

Conclusion

Walter Eucken and Friedrich August von Hayek are clearly among the most influential personalities of European liberal thought of the 20th century. Although they are usually included in different schools of economic thought, their approaches and ideas do show some common features and they also shared mutual friendship and respect as well as membership in private (Mont Pelerin Society) and public (Freiburg University) institutions.

In the field of law for the protection of competition both authors show an awareness of the wider socioeconomic context of dominant market position or cartel agreements, they do not focus strictly on the lack of economic efficiency of monopolies. Both are aware of the fact that a monopolist or a cartel may use the acquired market or private power to make a profit by means of erecting barriers to the entry of other competitors or by using other predatory practices (such as tied selling) rather than by providing better services to consumers. However, they differ in the importance they give to such behaviour, and in their views on the occurrence of such behaviour on a free market, and on the approach to institutional regulation of such behaviour. Unlike Hayek, Eucken had more confidence in public institutions and proposed the establishment of a strong independent public authority for the protection of competition which would actively fight against negative manifestations of economic concentration. Cartel agreements would be illegal and penalised, and if a competitor gained a dominant position he would have the duty to act as if he operated on a competitive market (the so-called "as if" doctrine) and in necessary cases the antimonopoly authority could determine the prices for which such competitor had to offer his products or services. In general, according to Eucken, it is the role of the state to actively create a competitive order thanks to which the market will achieve results close to the perfect competition model.

In contrast, Hayek, in the spirit of the Austrian School's traditional scepticism towards the state, chooses rather cautious measures and leaves the enforcement of the measures up to the courts or the private initiative of the injured competitors. He is in agreement with Eucken in prohibiting cartel agreements, but in contrast to Eucken proposes to penalise such agreements only by making them invalid and unenforceable. Hayek disagrees with Eucken on the aim of competition rules, as he rejects the perfect competition model as fundamentally wrong and inappropriate for application in the real world, which is too heterogeneous. He proposes to prevent abuse of dominant position through a statutory prohibition of discrimination between consumers and prohibition of the sale of supplementary services or products unrelated to the original product or service tied to the original transaction. Hayek's objective is to create an order which will enable competitors to discover business opportunities and processes and will exclude only the most flagrant manifestations of abuse of economic concentration, which, however, will occur only exceptionally on a free market.

Acknowledgment

This article was written as part of GACR Project No. 17-07252S "Analysis of the views on the legal framework and regulation of the economic competition in the Czech Republic, in the legal-historical context and international theoretical comparison".

References

Bazantova, I. & Horych, J. (2017). Ekonomická analýza práva Rakouské školy s přihlédnutím k právu hospodářské soutěže. In Gábriš, T. *et al. Nedogmatická právna veda*. Praha: Wolters Kluwer, 145-158.

Bluemle, G. & Goldschmidt, N. (2006). Relevance for the development of theories of social order by Lowe, Hayek and Eucken. *European Journal of the History of Economic Thought*, 13, 4 (Dec 2006), 543-570.

Böhm, F., (1928) *Das Problem der Privaten Macht, ein Beitrag zum Monopolfrage,* as reprinted in *Grundtexte zur Freiburger Tradition der Ordnungsökonomik*, Mohr Siebeck, Germany, [2007], 49-67.

Depoorter, B. & Parisi, F. (2005). The Modernization of European Antitrust Enforcement: The Economics of Regulatory Competition. *George Mason Law Review*, 13, 2, 309-323.

Eucken, W. (2004). *Zásady hospodářského řádu*. Praha: Liberální institut.

Gerber, D. J. (1994). Constitutionalizing the Economy: German Neoliberalism, Competition Law and the "New" Europe. *The American Journal of Comparative Law*, 42 (1994), 25-84.

Gerber, D., J. (1998). *Law and Competition in Twentieth Century Europe. Protecting Prometheus.* Oxford: Oxford University Press.

Grechenig, K. & Gelter, M. (2007). *The Transatlantic Divergence in Legal Thought: American Law and Economics vs. German Doctrinalism*. The Harvard John M. Olin Fellow's Discussion Paper Series, 14 (2007), in http://www.law.harvard.edu/programs/olin_center/

Hayek, von F. A. (1980). *Individualism and Economic Order*. Chicago & London: The University of Chicago Press [1948].

Hayek, von F. A. (2006). *Constitution of Liberty*. London: Routledge Classics.

Hayek, von F. A. (2011). *Právo, zákonodárství a svoboda*. Praha: Prostor.

Horych, J. (2018). The Influence of Ordoliberalism on European Competition Law. 5th International Multidisciplinary Scientific Conference SGEM 2018, Vienna ART Conference Proceedings, 19-21 March, 2018, 5, 1.1, 341-348.

Kartte, W. & Holtschneider, R. (1981). Konzeptionelle Ansätze und Anwendungsprinzipien im Gesetz gegen Wettbewerbsbechränkugen – Zur Geschichte des GWB. *Handbuch des Wettbewerbs.* Verlag Vahlen, Germany, 202-205.

Krabec, T. (2003). Ordoliberalismus a sociální tržní hospodářství. *Politická ekonomie,* 2003(51), 6, 881-889.

Nientiedt, D. & Kohler, E. A. (2016). Liberalism and democracy – a comparative reading of Eucken and Hayek. *Cambridge Journal of Economic*, 40, 6, (Nov. 2016), 1743-1760. DOI: 10.1093/cje/bev081.

Vanberg, V. (1999). Markets and Regulation: On the Contrast between Free-market Liberalism and Constitutional Liberalism. *Constitutional Political Economy*, 10, 3, 219-243.

Woersdoerfer, M. (2013). Von Hayek and Ordoliberalism on Justice. *Journal of the History of Economic Thought*, 35, 3 (Sep 2013), 291-317, DOI: 10.1017/S1053837213000199.

Contact

Doc. JUDr. PhDr. Ilona Bažantová, CSc.

Charles University, Faculty of Law, Department of Economics

nám. Curieových 901/7, 116 40 Prague 1, Czech Republic

bazantov@prf.cuni.cz

Mgr. Jan Horych

Charles University, Faculty of Law, Department of Economics

nám. Curieových 901/7, 116 40, Prague 1, Czech Republic

horychj@prf.cuni.cz