Of rules and order: German ordoliberalism

It has had a big influence on policy during the euro crisis

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"NO MATTER what the topic, it's four to one against me," laments Peter Bofinger, one of the five members of Germany's Council of Economic Experts, which advises the government. The other four, he says, consider deficits and debt bad, oppose the European Central Bank's quantitative easing as "monetary meddling" and believe austerity is the answer to the euro crisis. In Germany, says Mr Bofinger, "I'm the last Keynesian—and I feel like the last Mohican."

The relationship between Mr Bofinger and his colleagues mirrors the gap that exists between German and Anglo-Saxon (or Latin) views of economics. German thinking on economics has long differed from the mainstream in other countries, including other euro-zone members. In the past six years of euro crisis, the gap has become larger, more visible and more controversial. Sebastian Dullien of the European Council on Foreign Relations, a think-tank, says that this amounts to a "decoupling" of Germany from the rest of the world.

Such a stance leaves economists outside Germany bewildered. Why are Germans sceptical of attempts by the ECB to pep up Europe's economies? Why do they insist on fiscal austerity in countries where demand is collapsing? And why are they obsessed with rules for their own sake, as opposed to their practical effects?

The answers are rooted in German intellectual history, especially in ordoliberalism. This is an offshoot of classical liberalism that sprouted during the Nazi period, when dissidents around Walter Eucken, an economist in Freiburg, dreamed of a better economic system. They reacted against the planned economies of Nazi Germany and the Soviet Union. But they also rejected both pure laissez-faire and Keynesian demand management.

The result was a school that was close both in personal contacts and in its content to the Austrian school associated with Friedrich Hayek. The two shared a view that deficit spending for demand management was foolish. Ordoliberalism differed, however, in believing that capitalism requires a strong government to create a framework of rules which provide the order (*ordo* in Latin) that free markets need to function most efficiently.

From the original ordoliberals sprang one big idea for state intervention when cartels dominated the economy: a muscular antitrust policy. A second was a strict monetary policy that focused rigidly and exclusively on price stability. A third was the enforcement of *Haftung*, which means not just liability but also responsibility. Germany has tougher insolvency laws than America or Britain, for instance.

Through Ludwig Erhard, West Germany's first economics minister and second chancellor, ordoliberalism strongly influenced post-war economic policy. There was a brief flirtation with Keynesianism in the 1960s. But Germany passed its philosophy of antitrust vigour and monetary hawkishness on to the European Union and the ECB. There are ordoliberal fingerprints on the euro zone's stability and growth pact, agreed on in the 1990s as a rules-based way of curbing budget deficits, even if it was a German centre-left government that first breached the pact.

The financial crisis of 2008 exposed the gap between Germany and the rest of the world even more starkly. In America it brought Keynesianism back into fashion. Both George Bush and Barack Obama responded with fiscal stimulus. Germany also adopted fiscal expansion, but many German economists cried foul.

Then, as the euro crisis unfolded, says Mr Bofinger, he was "permanently confronted with ordoliberal positions". Economists outside Germany agree that microeconomic reforms were necessary. But the

Germans almost uniquely argued for the anti-Keynesian concept of spending cuts amid declining demand. In Germany itself, a "debt brake" has been written into the constitution, requiring states to balance their budgets by 2020 and limiting federal borrowing (Germany's budget is now balanced at what is touted as the "black zero"). Germany has foisted similar rules on other EU countries through the 2012 fiscal-compact treaty, partly to limit its own liability to them.

Even more characteristic is the German attitude to rules. To some extent, this reflects the country's culture. But it also has an ordoliberal origin. Jens Weidmann, president of the German Bundesbank, often quotes Walter Eucken, especially in passages where *Haftung* "must go hand in hand with" control. This gives German economists an argument for opposing Eurobonds and other forms of debt mutualisation and stressing the euro zone's no-bail-out rule. Similarly, calls for "solidarity" (or fiscal transfers) run straight into concerns over moral hazard. Mario Monti, a former Italian prime minister, likes to claim that in Germany economics is seen as a branch of moral philosophy.

A moral tone certainly creeps into discussions of Germany's current-account surplus, now the world's largest. To non-German economists, huge surpluses represent an imbalance of saving over investment that has counterparts in other countries' deficits and, as the EU's own macroeconomic-imbalances procedure suggests, requires corrective action. To Germans surpluses are signs of economic virtue that merely reflect competitiveness and do not merit any policy response.

Not all German economists see themselves as ordoliberals, of course. But the tradition's influence remains strong at the universities where many study, as well as in the Bundesbank and at the Council of Economic Experts. And just as the original ordoliberals crossed into the humanities and the law, today's have often also trained as lawyers (a pattern that is notable in the finance ministry, for instance).

Critics find the ordoliberal tradition outdated or misguided. "Ordoliberalism is not very practical, it's religion," says Michael Burda, an American economist at Berlin's Humboldt University. Most German economists simply assume, for example, that the minimum wage introduced in Germany will lead to job losses, even though empirical evidence in America and Britain suggests this need not be so.

Ordoliberalism's biggest flaw, says Mr Burda, lies in "failing to do the aggregation step". It is at heart a microeconomic model that disavows macroeconomic policy because it treats countries, or even an entire currency zone, as if they were individual households. It makes sense for individuals to save when they are in debt, as the proverbial Swabian housewife does in Germany. But if all individuals cut spending at the same time, the result can be a shortfall in demand that negates the benefits of microeconomic reforms. Once in a while it is better to break rules than all go under in law-abiding misery. Yet that is not how things are seen in Berlin or Frankfurt.