

# **Neoliberalism: The Genesis of a Political Swearword**



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## Foreword

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We are again in turbulent economic times—described universally as a ‘crisis.’ The climate of ideas and policies has changed decisively against markets and in favour of government intervention. ‘Neoliberalism,’ taken as synonymous with ‘market fundamentalism,’ is under intense attack, not least from Kevin Rudd in his recent essay in *The Monthly*.

Oliver Hartwich’s essay is a useful corrective. He describes the origins and evolution of a peculiarly German neoliberalism, especially as seen through the lens of one of its founding fathers, the historical sociologist Alexander Rüstow. Rüstow was a German academic-intellectual of his time, a classical philologist and the last in the line of epic practitioners of historical philosophy (what the Germans call *Geschichtsphilosophie*). His *magnum opus*, *Ortsbestimmung der Gegenwart* (roughly translated as the ‘localisation of the present’), in three monumental volumes, was, as the author modestly put it, ‘a reckoning of ten thousand years of human history.’

The neoliberalism of Rüstow and his kindred spirits is hardly known outside the German-speaking world, and largely overlooked or forgotten inside it since the 1960s. German neoliberalism encompasses the legal-economic ‘ordoliberalism’ of the Freiburg School and the ‘social market economy’ that came to be associated with the economic policies of Ludwig Erhard, the architect of Germany’s post-war *Wirtschaftswunder* (economic miracle). As Dr Hartwich explains, these strands of thought emerged as a response to Germany’s historical wrong-turns: anti-liberalism in the late nineteenth century; cartelisation in the interwar years; Hitler’s version of the command economy, reinforced by Nazi terror; and wartime destruction.

Yet German neoliberalism contains general insights, reaching beyond German history and policy, that resonate with the classical-liberal tradition and are relevant today. True, some of its luminaries—Rüstow

in the lead—caricatured Adam-Smith-type liberalism, dismissing it as Manchester-style ‘paleoliberalism’; swooned with agrarian and small-town-based social romanticism; and favoured government interventions to correct perceived market failures that would make most market-liberals feel uncomfortable. But they also emphasised the moral and institutional underpinnings of a free-market order: the primacy of individual freedom, private property rights, and so on. The state’s role is to be an effective, impartial umpire of the market *order*, not a biased player in the market *process*. To Rüstow, the state has to be limited to core functions if it is to be ‘strong.’ The ‘weak’ state, in contrast, is the big state with diffuse functions. Still, contrary to Mr. Rudd’s caricature of neoliberalism, the strong-but-limited state has responsibilities that go well beyond the range of the minimal, night-watchman state.

Now, at a time of escalating government intervention, Mr. Rudd and other politicians for all seasons—the compass-less pragmatists of the modern age—stress the limits of markets while disregarding the limits of government. German neoliberalism, in common with Anglo-Saxon classical liberalism, points to a much better balance of state and market. That is why Dr Hartwich’s intellectual-historical excursion makes worthwhile reading in the current climate.

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*One of the uses of history is to free us of a falsely imagined past. The less we know of how ideas actually took root and grew, the more apt we are to accept them unquestioningly, as inevitable features of the world in which we move.*

—Robert H Bork<sup>1</sup>

## **A ghost story**

A spectre is haunting the world, just as Karl Marx and Friedrich Engels wrote in the Communist Manifesto of 1848. This time, however, it is not the spectre of communism but that of neoliberalism.<sup>2</sup> Just as Marx and Engels reported of ‘a holy alliance to exorcise this spectre,’ there is once again an alliance, whether holy or unholy, that has formed to chase the ghost of neoliberalism from the world stage.

In any case, it is a curious alliance that has committed to fighting neoliberalism: Religious leaders and artists, environmental activists and globalisation critics, politicians of the left and the right as well as trade unionists, commentators and academics. They all share a passion to unmask neoliberalism as an inhuman, anti-social, and potentially misanthropic ideology or as a cynical exercise by strangely anonymous forces that wish to exploit the world to their own advantage.

The members of this colourful alliance against neoliberalism are as united in their opposition to neoliberalism as they are diverse. This suggests that neoliberalism cannot be too clearly defined as a concept. Rather, it is a broad umbrella under which very different groups with various points of view can meet. In the church of anti-neoliberalism,

there is a place for anyone who believes that neoliberalism stands in the way of reaching his or her political goals. This may also explain the lack of any clear and coherent definition of neoliberalism among its dissenters.<sup>3</sup>

Yet the most curious characteristic of neoliberalism is the fact that these days hardly anyone self-identifies as a neoliberal. In former times, ideological debates were fought between, say, conservatives and socialists, collectivists and individualists. While there may not have been any other agreement between these opposing groups, at least they would have agreed about their respective identities. A socialist would not have felt offended by a conservative calling him a socialist and vice versa.

In present-day debates around neoliberalism, on the other hand, most accused of holding ‘neoliberal’ views would not accept being called ‘neoliberal.’ Either they would insist on being something else (whether it is ‘liberal,’ ‘classical liberal,’ or ‘libertarian’), or they would simply claim to be misunderstood by their opponents. In any case, scarcely anybody wants to be a ‘neoliberal’ any more. For example, in an online survey of the readers of Andrew Norton’s blog, out of more than 1,200 participants not a single person self-identified with the term, while ‘classical liberal,’ ‘conservative,’ and ‘libertarian’ were strong responses.<sup>4</sup> These are strange debates indeed when the enemy you are fighting claims he does not exist.

Maybe this is not so strange after all. If neoliberalism is hardly ever defined, if it can mean anything you wish to disagree with, then it is understandable that it results not from an attempt to gain theoretical knowledge but from the desire to defame your political opponents. In this way, the neoliberal label has become part of political rhetoric, albeit as an almost meaningless insult.

It was not always like this. At the beginning of neoliberalism, when the term was invented, it was quite the opposite of what we think of it today. The shallowness with which we use neoliberalism in a pejorative way corresponds inversely with the depth of thought by its original users. Even more surprisingly, the original ‘neoliberals’ have little in common with those who are nowadays called ‘neoliberal.’

If all this *sounds* vague, it is because it really *is* somewhat vague. The early history of neoliberalism is hidden in obscurity, but it is well

worth exhuming. By understanding the motifs of early neoliberalism we can see the political, philosophical and economic foundations in which it is rooted. Furthermore, we will be able to see how early neoliberals shared some of the concerns of contemporary anti-neoliberals. They, more than anybody else, should be surprised that the alternative to their pet-hate of neoliberalism may be a rediscovery of neoliberalism, properly understood.

## **Crisis and neoliberalism**

Times of crisis naturally induce a wide-ranging critique of hitherto unchallenged concepts. So it is unsurprising that times of economic crisis, too, have provoked re-examinations of the way markets work. Two quotes may exemplify this.

There is one author who writes about the economic turmoil of his time: ‘[The crisis] has called into question the prevailing ... neo-liberal orthodoxy that has underpinned the national and global regulatory frameworks that have so spectacularly failed to prevent the economic mayhem which has now been visited upon us.’ He goes on to claim that ‘in the past year we have seen how unchecked market forces have brought capitalism to the precipice’ and concludes: ‘Neither governments nor the peoples they represent any longer have confidence in an unregulated system of extreme capitalism.’

Another commentator is equally clear. He diagnosed the ‘chaos of a pluralist, predatory economy’ and the ‘failure of economic liberalism.’ What was needed, he insisted, was ‘a strong state, a state above the economy, above the interest groups where it belongs.’

Although both commentators seem to come from similar points of view, they could not be more different. They are separated not only by some 70 years but also by their political persuasions, professional backgrounds, and nationalities. Furthermore, the first author claims to be a fierce critic of neoliberalism while the second one is the original inventor of the term neoliberalism.

To solve this riddle, let us lift the curtain and reveal their identities. The first quotes are taken from the essay ‘The Global Financial Crisis’ by Australian Prime Minister Kevin Rudd, which he published in the journal *The Monthly* in early 2009. It was seen as Rudd’s broad sweeping attack on neoliberalism.<sup>5</sup>

The second commentator is Alexander Rüstow, a German sociologist and economist, and the quotes are from a speech<sup>6</sup> he delivered to the *Verein für Socialpolitik* (Social Policy Association), a German economics association, in 1932 and the title of one of his books that was published in 1945.<sup>7</sup> It was the very same Alexander Rüstow who, in 1938, coined the term neoliberalism.

If Rudd and Rüstow sound so similar, yet one of them rejects the concept of neoliberalism while the other invented it, then either there must be some sort of misunderstanding or the term itself has undergone a transformation over the past decades.

In a way, one could argue that what happened in a small, far-away country almost a century ago (i.e. early twentieth century Germany) should hardly matter for contemporary Australian politics. The world has moved on and today's debates are not the same as, say, those of the 1930s. On the other hand, it is more than just a vain exercise in intellectual archaeology when we are dealing with the birth of neoliberalism. We will find some parallels in the economic debates then and now that were triggered by economic crises of the time. More importantly, we will see that early neoliberalism recognised both the power of markets and their limitations. Today's critics of 'neoliberalism' are probably unaware that one of the defining features of early neoliberal conceptions was to put a check on unfettered markets and market power. This may well hold some ideas for policy makers today simply because neoliberals distinguished between areas in which the state could and should intervene and others in which it should not.

So let us go back almost a century to understand why Rüstow and some of his colleagues came to formulate an idea they called neoliberalism. We shall then be able to see whether Kevin Rudd was right when he claimed that 'Neo-liberalism ... has been revealed as little more than personal greed dressed up as an economic philosophy.'<sup>8</sup>

## **The pre-history of neoliberalism**

Neoliberalism as a concept has its roots in Germany between the two World Wars. It is, therefore, necessary to explore the intellectual and political climate of this period, but also its historical background. In particular, we need to evaluate whether Alexander Rüstow was right to claim that economic liberalism had failed in Germany. Rüstow was a

fierce critic of leaving free markets to their own devices. This is strange because it is very doubtful (to say the least) that such free markets had ever existed in Germany. For this reason we have to get acquainted with the history of Germany's economic order.

When we look at the Germany of the 1920s and 1930s, we think of the struggle to keep the first republic, the Weimar Republic, alive between the political extremes of the left and the right. We also think of Germany's hyperinflation of 1923 and the disastrous economic effects of the Great Depression, which had unemployment soaring in Germany to previously unknown levels. Germany's post-World War I history is usually analysed with regard to the catastrophe of the ensuing rise of national-socialism, World War II and, ultimately, the Holocaust.

Sometimes this perspective makes Germany's march into the 'Führer state' of the so-called 'Third Reich' look inevitable. It may seem as if the national-socialist dictatorship had brought the German preference for a hierarchical state, strong government, and top-down organisation to its logical conclusion. Indeed, some (usually left-leaning) historians had long argued that Hitler was the unavoidable conclusion of German history prior to 1933, Germany's alleged 'Sonderweg' (special path). In the words of Fritz Fischer: 'Hitler was no industrial accident.'<sup>9</sup>

This is not the appropriate place to discuss (and possibly refute) the thesis of a German 'Sonderweg.' Unfortunately, though, the discussion about there being any specifically German inclination towards anti-liberal sentiment has distracted from the fact there were indeed some important liberal movements, periods and thinkers in German history. Whether taken together they can rival the great British liberal tradition of John Locke, David Hume, and Adam Smith may well be disputed. But that there has been liberal thought in Germany cannot be denied,<sup>10</sup> and it would be desirable if the Germans themselves paid closer attention to the history of their own branch of liberalism.<sup>11</sup>

In order to understand the genesis of the conception of neoliberalism in interwar Germany, we need to understand how this peculiar kind of German liberalism had previously developed. It is probably right to say that Adam Smith's new system of economics did not find many supporters in Germany when he first published his *Wealth of Nations* in 1776.<sup>12</sup> The Prussian Reforms of 1806, which liberalised and modernised government, were mainly a result of the military collapse of

the Prussian state against Napoleon. But not all these reforms survived the European Restoration after the Congress of Vienna in 1815. In fact, in some German regions the reformist trade laws were taken back and the guilds partially reinstated.<sup>13</sup>

While other countries, most notably of course England, had long embarked on a process of industrialisation, Germany's economic structures lagged behind. But when industrialisation finally took off in Germany, it happened at a remarkable speed. This would not have been possible without the liberalisation of trade laws and the law of contract. It was further enhanced by the removal of customs barriers among the fragmented German states. On top of that, the consequences of the Franco-Prussian War of 1870–71 had given Germany an economic boost. French reparations flooded Germany with gold, while the annexed province Alsace-Lorraine increased Germany's industrial and mining capacity.

Free enterprise was guaranteed for the North German Confederation with the *Gewerbeordnung* of 1869, which two years later was extended to the newly founded German Empire. Freedom of contract was also introduced in the second half of the nineteenth century, and the last medieval restrictions on charging interest were abolished.<sup>14</sup> As a legal historian stated in 1910: 'Everybody may enter into contracts, make his testament, establish associations, in whichever way he pleases.'<sup>15</sup>

The codification of civil law is a case in point. After German unification of 1871, it took almost three decades until the *Civil Code* (*Bürgerliches Gesetzbuch*) was introduced. The delays were due to the fact civil law was fragmented within the federal structure of the Reich. But the end result was an expression of the prevailing economic liberalism of the time, which was heavily criticised by both conservative lawyers and socialists.

During the debates on the draft *Code*, the socialist law professor Anton Menger (1841–1906) published a pamphlet called 'Civil law and the deprived classes' in which he polemised that he could have hardly found a bill that 'so one-sidedly favoured the property-owning classes and made this preference so obvious'<sup>16</sup> like the draft of the German *Civil Code*. Similarly, the conservative historian Otto von Gierke (1841–1921) demanded the injection of 'a drop of socialist oil' into the *Code* and argued that 'unlimited freedom of contract would destroy itself.'<sup>17</sup>

This, however, did not happen and the final *Civil Code* offered an almost complete set of contractual freedom—or, as Gierke complained, it became an expression of ‘an individualist and unbalanced capitalist tendency towards pure Manchesterism.’<sup>18</sup> There were no special employment provisions, no clauses against unfair dismissal, no protection for tenants. As a civil code, it was an expression of almost pure economic liberalism.<sup>19</sup>

The German courts of the time were also influenced by liberal economic thought. The Imperial Court (Reichsgericht) was completely unwilling to outlaw trade practices that were not explicitly forbidden by law. In this way, it refused to use general rules of civil law to interfere with market transactions unless patents or copyrights were infringed.<sup>20</sup>

Decades later, the economist Lujo Brentano remarked in his memoirs that at the time ‘opinions from neither the left nor the right had a chance against this doctrine [Manchesterism] that was so dominant in the legislature and the press and in which the laws of nature under the influence of restrained egotism have created the best of all worlds.’<sup>21</sup> It is fair to state that the general spirit of the time was heavily influenced by semi-liberal ideas, although Imperial Germany certainly was not liberal in the British sense of the time.

Having said this, it is worth pointing out that this is not the whole truth. While freedom of contract and freedom of commerce were strong in late nineteenth century Germany, economic liberalism was far from complete. What is even more important to recognise: The liberalisation that took place in nineteenth century Germany was a liberalisation from above, and it became more interventionist in the final quarter of the century.

Germany lagged behind England, the economic and political superpower of the nineteenth century, by several decades. The Industrial Revolution with all its spinning wheels, steam engines, and railways was an English invention. It had happened at a time in the late eighteenth century when Germany was still, by and large, an agricultural country, governed by the remnants of medieval structures, and split into dozens of independent principalities and kingdoms, separated from each other by tariff barriers.

For the German states to catch up with England in per capita income terms and industrial production, it was thought necessary to imitate its

economic success story. After the Prussian Reforms of 1806, the idea of modernising and liberalising market structures had become dominant within the ministerial bureaucracy. Industrialisation and modernisation were desired, but it had to happen under the political leadership of the political elites.<sup>22</sup>

Nevertheless, it took decades until modernisation actually took off, but when it eventually did around the middle of the nineteenth century, the pace of industrialisation was fast and economic growth strong. As the economic historian Werner Abelshauser characterised it, it was a 'liberal market economy from above.' As such it was 'the result of the reforms which, after the confrontation with revolutionary France and the economic challenge of the English industrial revolution, paved the road to modernity for the German states.'<sup>23</sup> In any case, liberalism in Germany did not have centuries to grow as in the case of Britain, and it was certainly something that did not develop against the wishes of the political rulers. On the contrary, economic liberalisation happened under the auspices of the ministerial elites and only to the extent to which it promoted official interests.

As mentioned before, Germany's economy grew strongly in the immediate years following the country's unification in 1871. But this extraordinary boom was short-lived and came to an abrupt end with the *Gründerkrise* ('the founders' crisis') of 1873. The German economy had overheated and built up overcapacities. An international banking crisis, which also triggered the collapse of a Berlin-based bank, and the end of French reparations contributed to the sudden end of the boom years.

Although the following decades are often referred to as the 'Great Depression,' in modern economic terms it clearly was not. The German economy was still growing in most of these years, albeit at a reduced rate.<sup>24</sup> However, the contrast between the preceding boom and the comparatively more subdued growth rates undermined the confidence in economic liberalism and the market economy.<sup>25</sup> As a consequence, economic policy took a different course after 1873, and the German Empire became more interventionist. It was in this period that the liberal market economy from above turned into a new kind of corporative or organised capitalism.

The first and most important step in this direction was the change from a free-trade policy towards protectionism. The economic crisis had strengthened those industrial associations that had long campaigned for the introduction of protective tariffs. From the mid-1870s, they had been united in the ‘Centralverband deutscher Industrieller’ (Central Association of German Industrials), and they were vocal in their call for an end to free trade.

Under the impression of these campaigns Germany’s Chancellor Otto von Bismarck, originally a free-trader, changed his trade policy towards protectionism. He also planned to strengthen the Empire’s budget through the expected tariff revenue to make his national government less dependent on contributions from the German states, which collected most of the taxes and remitted some to Berlin.

In the German Parliament, too, the balance shifted away from the previous liberal trade policy. After the 1878 election for the Reichstag, which the conservative parties won, the protectionists had a majority and voted for the introduction of a new tariff regime in 1879—just as the Centralverband had demanded.

It was the first visible sign that something important had changed in Germany’s economic order, but the changes did not stop there. As Werner Abelshausen, one of Germany’s leading economic historians, expressed it: ‘Since the “year of change” 1879 the principle of co-operation replaced the principle of competition in competition policy, productive mobilisation replaced *laissez faire* in order policy, in social policy corporative self-rule took the place of organised self-help.’<sup>26</sup> The German Empire as a whole became a corporatist market economy. It was still a market economy, still a variant of capitalism, but with a much stronger and more interventionist state. It was a kind of ‘organised capitalism,’ a term first coined by the social democrat Rudolf Hilferding, whose main features were the ‘concentration of capital, market regulation by formal, hierarchical and bureaucratic administrations, increasing pressure of organised interests to influence state political decision-making and systematic state intervention in the economy.’<sup>27</sup>

What is important to recognise is that Imperial Germany, despite having implemented a number of liberal reforms in trade and civil law, had ended the brief flirtation with *laissez faire* capitalism by the late

1870s. Economic liberalism, which had had its heyday in Germany between the early 1850s and the crash of 1873, had been superseded by a mixed economy model in which the state played an important role in coordinating and steering economic activity.

One of the consequences of this economic and political arrangement was the development of dozens if not hundreds of cartels. They first formed after the crisis of the early 1870s but remained in place thereafter. There are good reasons to assume that the political situation of the time played a crucial role in the permanence of the cartel phenomenon. Crucially, the erection of tariff barriers blocked out foreign competition. Protected by these trade barriers, German companies could restrict domestic competition. But such restraints of trade would have been far less successful if foreign imports could have challenged the cartels. In his *History of Economic Order in Germany*, Hans Jaeger assessed the importance of protectionism for market structures as follows: ‘The tariffs that had been introduced for the Empire since 1879 were an important precondition for the growth of cartels. Only after the compartmentalisation of the German market against foreign competition, national cartels could partition business among themselves.’<sup>28</sup>

Importantly, though, the cartels also fitted neatly into the new structure of organised capitalism. In his account of the history of competition policy in Imperial Germany, David J Gerber explained why:

The imperial bureaucracy often favoured cartels because they served its interests, providing a convenient and low cost means of acquiring information about and influencing economic developments. Moreover, for the Kaiser and much of the ruling elite, cartels were not only a means of control, but tools for the attainment of other political and military ends. Cartels predominated in those areas of the economy—heavy industry and chemicals, for example—that were most important for Germany’s international influence and for the development of its military potential.<sup>29</sup>

Seen from this perspective, it is little wonder that Germany became the 'classic country of cartels.'<sup>30</sup> It was not an accident, nor a case of market failure. The markets were only executing what was politically desired, namely to produce an economic structure conducive to push industrialisation in Germany to a higher level. Consequently, the highest courts, including the Imperial Court, gave cartel agreements their blessing. In a landmark case, the Reichsgericht not only allowed cartels in 1897 but it also expressly stated that they served public interests.<sup>31</sup> The judges were in line with public opinion and the economic profession of the time. Cartels were seen as a way to prevent 'ruinous competition,'<sup>32</sup> and they were welcomed by economists like Friedrich Kleinwächter as a way to replace the constructive but chaotic system of Adam Smith's 'invisible hand' with something more orderly.<sup>33</sup>

The cartels were only one expression of the principles of 'organised capitalism.' Others could be seen in the development of numerous industry associations, chambers of commerce, universal banks, employers' organisations, and the like. The state played a steering role in this complex arrangement of business relations, and it became increasingly interventionist, partly taking back earlier liberalisations. Trade and skilled labour were re-regulated in 1897, forcing craftsmen to join trade associations, which were allowed to prescribe prices.

A traditional interpretation of the change in economic policy that occurred from the 1870s was that the new interventionism was a return to old structures of economic organisations. According to Abelshausen, however, this is a misguided analysis. He rather sees it as the birth of a new kind of market economy that remained in place throughout the twentieth and into the twenty-first century.<sup>34</sup> It is hard to disagree with this analysis because the continuity in economic structures is indeed striking.

The peculiar kind of corporatism, the structure of industry, the social security system, and also the laws governing economic relations that were initiated in the final quarter of the nineteenth century survived both the German Empire and the Hitler regime to become essential parts of the so-called Rhineland Capitalism model of the Federal Republic after 1945. Generally speaking, there is much more continuity in Germany's economic order throughout the past 130 years

than appears at first sight. A large number of Nazi regulations were kept in place or even reinstated after 1945, as economic historian Albrecht Ritschl documented a few years ago.<sup>35</sup> But even these Nazi regulations were built on the foundations dating back to the German Empire.

All in all, the economic order of Imperial Germany moved far from the original liberal tendencies and paved the way for the development of an economy organised along corporatist lines. The model of Rhineland Capitalism, which towards the end of the twentieth century became regarded as a sclerotic arrangement of interdependent business and political interests (the so-called ‘Deutschland AG’), can be seen in its embryonic state at the turn of the nineteenth to the twentieth century. It is worth quoting Abelshausen’s poignant summary:

The Germany of Emperor William II—with its bureaucratic traditions and extensive administrative apparatus; its capitalist economic order of diverse ‘organised’ agencies, that is, large corporations, cartels, syndicates, trade associations, unions, cooperative associations, chambers, umbrella associations, and economic councils; its coexistence of pluralistic, state corporatist, and liberal corporatist interest intermediation (with the latter two forms ever more pronounced)—this Germany bore the features of the coming twentieth century more than it did the onus of the old order.<sup>36</sup>

The cornerstone of the country’s economic order had been laid in Imperial Germany. It is unsurprising that World War I put the economy under even more direct state control, and this was not a phenomenon limited to Germany. In other countries like Britain, too, World War I led to a significant increase in the size of the state and the role of government vis-à-vis industry, trade and commerce.

Economic structures in the Weimar Republic, which succeeded the German Empire in 1919, then continued where the Empire had finished. The state grew even stronger, especially because of increased spending on welfare and agricultural policy. Per capita state expenditure doubled between 1913 and 1932, and more and more government owned and run companies were founded.<sup>37</sup> On top of that, subsidies

for all sorts of industries became endemic, often lacking specific strategic vision.

Meanwhile, economic concentration continued and increased. By 1925, no fewer than 1,539 cartels were registered, compared to 367 only 15 years earlier. Although a first *Cartel Act* had been passed in 1923, it did not make forming a cartel more difficult and thus was no practical tool to reduce the degree of monopolisation in Germany's economy.<sup>38</sup> Quite the contrary, the *Cartel Act* in effect legalised existing cartel arrangements that had hitherto only been recognised by the courts. Now they were protected by a formal Act.<sup>39</sup>

It is not necessary to present further details in this essay, but the picture painted here with a broad brush is clear. Although Germany had been practising a variant of a market economy, it had never had a purely liberal economic order. Even where liberal reforms had been implemented in Germany, the stimulus usually came from above, that is from the political and bureaucratic rulers. This is not to say that there were no liberal reforms in German history—far from it—but that Germany has never been a purely liberal country, either. There has never been a 'Manchester capitalism,' turbo-capitalism or however else one might call a system of perfect liberty in place in Germany. It is important to keep this in mind when we will be dealing with the birth of 'neoliberalism'—the birth of a somewhat curious, but very German, ideological concept. A concept that certainly has its merits, but whose intellectual underpinnings appear weak in light of the historical analysis of German liberalism.

## **The birth of neoliberalism**

The world economic crisis of the late 1920s and early 1930s had a severe impact on Germany, not least because of war reparations. Unemployment peaked at more than six million people in 1932, which meant a rate of 16.2 percent. Poverty was widespread, and the Weimar Republic's political situation became more and more fragile. The parties found it impossible to secure parliamentary majorities for any of their policies, and Germany was governed by emergency decrees. The crisis also strengthened the National Socialist German Workers' Party, which would eventually sweep their Führer, Adolf Hitler, to power.

The belief in ‘eternal prosperity’ was shattered by the events that had been triggered by Wall Street’s ‘Black Friday,’ not only in Germany.<sup>40</sup> The global economic crisis was widely regarded as the failure of ‘liberalism’ and ‘capitalism.’ On the fifteenth anniversary of the Soviet Union, in 1932, their leaders celebrated the end of capitalism with monumental parades;<sup>41</sup> in the United States, President Franklin D Roosevelt had pledged ‘a new deal for the American people,’<sup>42</sup> moving his country towards more interventionist policies; in Britain, economist John Maynard Keynes was working towards his *General Theory* in which he meant to explain (and overcome) the inherent instabilities of the capitalist system. Around the globe, the mood of the time was set against liberalism and free markets.

The economic and political situation of Germany was dire and so was the spirit among liberal-minded academics and intellectuals. To most people, liberalism seemed to be a discredited set of beliefs, an anachronism from the eighteenth and nineteenth centuries, a failed ideology.

One of the few intellectuals still harbouring sympathies for the market economy was Alexander Rüstow.<sup>43</sup> Born in 1885, he had studied mathematics, physics, philosophy, economics, and psychology in Göttingen, Munich and Berlin. After receiving his PhD from the University of Erlangen in 1908, he first worked at a publishing house before becoming an officer in World War I. After the war, Rüstow was a member of a number of socialist groups, but he also was influenced by the economist Franz Oppenheimer, who proclaimed a ‘middle way’ between Marxist socialism and liberal capitalism.

In 1919, Alexander Rüstow joined the civil service. He became an adviser in the Ministry of Economic Affairs (Reichswirtschaftsministerium) where he dealt with cartel policy. Rüstow was directly involved in the preparation of the *Cartel Act of 1923*, mentioned previously. But while he argued for tougher anti-trust rules, the eventual *Cartel Act* was far weaker than Rüstow’s original recommendations. He blamed intensive lobbying on behalf of powerful interest groups for this (in his view) unsatisfactory outcome.<sup>44</sup>

Rüstow changed sides in the mid-1920s. First, he left his position at the Ministry in 1924 to become head of the economics department at the

‘Verein deutscher Maschinenbauanstalten,’ a lobby group of small- and medium-sized manufacturers that campaigned against the concentration of economic power by their larger rivals. Secondly, Rüstow’s economic philosophy shifted away from socialism and towards liberalism. According to his biographer Jan Hegner, Rüstow had become disillusioned with the reality of socialism in the Soviet Union. He also came to realise that economic planning was incompatible with liberty. On the other hand, he remained committed to socialism’s goals of reducing social and economic inequalities.

Throughout his own life, Rüstow had become a frequent ‘border crosser’ between liberalism and socialism. The only constant of his intellectual life, though, was a great scepticism of all sorts of power, whether they were of a political or an economic nature. Nevertheless, when we read Rüstow today, it is sometimes difficult to recognise him as a liberal simply because he often does not sound much like one.

This was the same Alexander Rüstow who invented the term ‘neoliberalism,’ who popularised it first among his German colleagues, and who eventually even managed to have an international group of liberal thinkers, including the liberal/libertarian icons of Ludwig von Mises and Friedrich August von Hayek, agree on this new term to describe their intellectual movement.

The obvious questions, then, are what was Rüstow’s understanding of neoliberalism? Where did neoliberalism differ from the old term liberalism? Why did Rüstow feel the need to invent a new term at all? And what happened to neoliberalism over time?

The year in which Rüstow first formulated the neoliberal program was 1932. Germany’s leading economics association, the *Verein für Socialpolitik*, had invited him to its annual conference in Dresden. The *Verein’s* long-serving president was Werner Sombart, the leader of the so-called *Kathedersozialisten* (‘catheder socialists’) from the Historical School of Economics. Sombart, an open supporter of national-socialism, lacked any sympathies for liberalism. He had planned to make the Dresden meeting a rallying cry for his cause. But to his dismay, the relatively little known Rüstow delivered the most noticed speech at the conference, which was later published and republished many times. Until the present day, it is widely regarded as the founding document of neoliberalism.<sup>45</sup>

The speech was titled '*Freie Wirtschaft, starker Staat*' (Free Economy, Strong State), and in these four words we can already see Rüstow's basic economic creed. Far from supporting Sombart's national-socialist visions, Rüstow blamed excessive interventionism for the economic crisis. He also warned of burdening the state with the task of correcting all sorts of economic problems. His speech was the clear rejection of a state that gets involved with economic processes. In its place, Rüstow wanted to see a state that set the rules for economic behaviour and enforced compliance with them. It was a limited role for the state, but it required a strong state nonetheless. Apart from this task, however, the state should refrain from getting too engaged in markets. This meant a clear 'No' to protectionism, subsidies, cartels—or what today we would call 'crony capitalism,' 'regulatory capture,' or 'corporate welfare.' However, Rüstow also saw a role for a limited interventionism as long as it went 'in the direction of the market's laws.'

Throughout his later life as an academic Rüstow further developed this vision of neoliberalism, as he himself called the idea, and published numerous books and essays in which he elaborated the system of a market economy under the rules of law and limited government. Many of them were written in exile: After the Gestapo, Hitler's secret police, had searched Rüstow's home in 1933, he decided to leave Germany and accepted a teaching position in Istanbul. He remained in Turkey until he returned to (West) Germany in 1949 to lecture at the University of Heidelberg.

### **Rüstow's 'Third Way'**

If we want to understand Rüstow's neoliberalism, we need to understand his basic interpretation of economic history. Throughout the 1920s he had been dealing with market structures and cartels. As we had seen earlier, Germany had become a country of corporatist capitalism, and the hundreds of cartels were a central part of this system.

As we have seen, there are good reasons to treat the cartels and the degree of concentration in late nineteenth and early twentieth century Germany as a direct result of public policy. That markets became monopolised, that big companies could collude with their supposed competitors without being disturbed by anyone, did not happen by accident. It was only possible because cartels were shielded from

international competition through Germany's protectionist system, which had been in place since 1879. The courts had upheld contracts in restraint of trade with reference to their desirability from a public policy perspective. Furthermore, concentrating Germany's industrial structure was in the interests of the Kaiser and his government, who were aiming to steer the country's industrial development. Their ultimate political goals were to catch up with Britain's industrial power, rival her military might, and find Germany's 'place in the sun' in the era of Imperialism.<sup>46</sup>

The period in which monopolisation in Germany's industrial structures took off was a time of (political) mobilisation, not of unfettered capitalism. Where economically liberal laws like the *Civil Code* were put in place after 1873, their ultimate goal was to assist in Germany's economic process of catching up with the British Empire. Among today's economic historians there is widespread agreement that Germany was practising a system of 'organised capitalism,' i.e. a politicised version of capitalism that was using markets to reach political goals.

Rüstow's analysis differed from this view of Germany's economic history. He also saw Germany's development into a degenerated market economy: heavily cartelised, dependent on subsidies, subject to frequent interventions. But to Rüstow, all these phenomena could be ascribed not to some government policy, but to unregulated markets. He perceived an inevitable tendency of markets to degenerate if left to their own devices while ignoring the pernicious influence of the closed economy.

In his book *The Failure of Economic Liberalism*, Rüstow sounded totally deterministic, like Marx:

We [i.e. the neoliberals, OMH] agree with Marxists and socialists in the conviction that capitalism is untenable and needs to be overcome. And we also think that their proof that exaggerated capitalism consequently leads to collectivism is correct and an ingenious discovery of their master [i.e. Karl Marx, OMH]. To acknowledge this seems to be required by intellectual honesty. However, we reject the errors which Marx has adopted from historic liberalism. And if we, together with the socialists, reject

capitalism, then we reject the collectivism which grows out of exaggerated capitalism even more. Our most severe accusation against capitalism is just this: that it (just as the collectivists teach themselves) sooner or later must lead to collectivism.<sup>47</sup>

In his essay ‘Between Capitalism and Communism’ (originally published in *ORDO*, the journal of the German neoliberal movement, in 1949), Rüstow explicitly argues for a ‘Third Way’ between the two ideologies.<sup>48</sup> He acknowledged that markets generally worked well under complete competition. However, he accused Adam Smith of holding a polemical grudge against the state that had made him neglect the necessary state-determined institutions of markets. This, so Rüstow claimed, caused the degeneration of the market economy into a system of untenable capitalism. In a long footnote, he went on to explain that he needed to insist on a differentiation between ‘the truly free market economy of complete competition’ and its ‘subventionist-monopolist-pluralist degeneration,’ which he thought of as a ‘pathologically degenerate variety’ of true market competition and for which he suggested the term ‘capitalism.’

If *laissez faire* and Adam Smith style liberalism were so bad according to Rüstow, would he then have preferred a planned economy? His answer was a resounding no. With the same rhetorical verve he used to condemn capitalism, he equally rejected the promises of socialism and communism. They were no viable economic systems, and they were also incompatible with democracy, freedom, and human dignity.

All of this led him to call for a middle way between *laissez faire* and socialism, a ‘Third Way.’ ‘We should be happy,’ Rüstow wrote, ‘that we do not have to make a difficult choice between “capitalism” and “communism”, but that there is a “Third Way”.’<sup>49</sup> Ironically, it is the very same logic that makes today’s critics of neoliberalism claim that one no longer had to choose between Hayek and Brezhnev, as Prime Minister Kevin Rudd expressed it in an address to the Centre for Independent Studies in 2008.<sup>50</sup>

Although contemporary supporters of a ‘Third Way’ claim to be fighting neoliberalism, to Rüstow this very same ‘Third Way’ *was* neoliberalism. He called it neoliberalism to differentiate it from earlier

liberalism, for which Rüstow frequently used derogatory terms such as ‘vulgar liberalism,’ ‘Manchester liberalism,’ or ‘paleo-liberalism.’ Rüstow wanted to break with this old liberal tradition to put a new liberalism in its place—hence the prefix ‘neo’.

## The neoliberal program

What would neoliberalism according to Rüstow look like? In his writings, we find the sketch of an economic order that is indeed somewhere between liberalism and socialism. It is a political and economic system that shows characteristics of both worlds. Usually, such mixed economy systems are described as social-democratic, and maybe this would have been a more appropriate term to use for Rüstow’s neoliberalism as well. In any case, it is light-years away from a free-for-all market economy. In fact, it combines elements of German social romanticism and socialist ideals with a general scepticism of power. As such, it is a complex (if not to say somewhat muddled) political philosophy, as the following overview over Rüstow’s neoliberalism will show.

The core of neoliberalism comes directly from Rüstow’s rejection of power. To him market power was as bad as political power and needed to be curtailed by a ‘Marktpolizei’ (market police). In *Between Capitalism and Communism* we find the following demand:

Strict state-run market police in every area of economic activity in which market freedom and market laws apply, to secure a fair performance competition and avoid any impediment competition directed against one’s market comrades.<sup>51</sup>

To Rüstow, such market police measures went beyond a simple anti-trust Act. On the contrary, he assigned the state a far greater role in shaping market structures. For example, any kind of advertising in newspapers, radio or cinema should be banned. Not only, as he wrote, because they were vulgar, unproductive, and playing to the masses, but also because these marketing tools favoured the big advertisers at the expense of smaller businesses.<sup>52</sup> He also argued for corporate taxation to be progressively linked to business size. In this way, he wanted to make large companies unviable and reduce them to smaller (or what

he presumed to be optimum) sizes.<sup>53</sup> Furthermore, Rüstow suggested forcing large companies holding patents to license them to their smaller competitors.

All of this does not quite sound much like a program that we would call neoliberal today, but Rüstow had even more astonishing ideas for a neoliberal. All utilities, all rail companies, all companies with an alleged natural or technical monopoly should be nationalised. The armaments industry should also be nationalised, but for different reasons.<sup>54</sup>

For agriculture, Rüstow's ideas were no less radical. He thought that Germany was 'violently overpopulated' (which he bitterly regretted), but it should nevertheless switch to a system of small, healthy, and highly productive farming units. In order to achieve this, he called for 'a big, planned and developed network of institutes for teaching, researching and consulting the entire agricultural sector; a comprehensive and tight organisation of down-to-earth farming education.'<sup>55</sup>

Rüstow's attitude to farming shows a strong sympathy for small units, but also for a quite conservative, romantic lifestyle. Joachim Zweynert recently pointed out that Rüstow's ideals were stuck in the past when he remorsefully agreed with the romantic poet Novalis that today's society was only 'living of the fruits of better times.' Also, Rüstow's open hostility to technology is odd. In one place, he calls the medieval period 'the optimum of social conditions so far' and complained that technological progress had not served humanity but only resulted from a blind cult of progress.<sup>56</sup>

In the fields of social and employment policy, too, Rüstow hardly lives up to today's image of a neoliberal. Although he argued against minimum wages, he supported temporary wage subsidies (financed through taxes on high wages in boom times), compulsory unemployment insurance, a government run employment service. Perhaps even more surprisingly, he called for an active industrial policy in crises to assist and moderate sectoral and structural changes. On top of that, he was committed to greater social equality, which he wanted to achieve through high inheritance taxes that should be used to finance some redistribution and free education for all.<sup>57</sup>

Although Rüstow clearly had an idea how he wanted to organise the economy, he thought that economic questions, ultimately, should not be

the priority of his neoliberal project. He insisted that ‘our neoliberalism differs from paleo-liberalism by not reducing everything to an economic question. On the contrary, we believe that economic affairs must be subordinated under supra-economic matters.’<sup>58</sup> In another paper he wrote that ‘the economy must be in a serving position,’ which meant that ‘the economy is there for people’ and not the other way around.<sup>59</sup> Finally, his system of neoliberalism could work best under the roof of a Christian theology. ‘So it is important to see,’ Rüstow said, ‘that there is no incompatibility between Christianity and neoliberalism and that together they could form a united front against paleo-liberalism, but especially against communism and bolshevism.’<sup>60</sup>

### **Neoliberalism and the Colloque Walter Lippmann**

The 1930s were a difficult time for liberal-minded thinkers in Europe. The mood was decidedly anti-liberal and collectivism widespread. But a small group of liberals wanted to keep the idea of freedom alive and organised an international meeting that took place in Paris in August 1938.<sup>61</sup>

The French philosopher Louis Rougier had invited like-minded liberal intellectuals to discuss the ideas of the American journalist Walter Lippmann. Lippmann had just published his book *The Good Society* in which he criticised all variants of collectivism such as socialism, national-socialism, fascism, but also Roosevelt’s New Deal policies.

A group of 25 intellectuals followed Rougier’s invitation, among them Lippmann himself, French philosopher Raymond Aron, Austrian economists Friedrich August von Hayek and Ludwig von Mises, British-Hungarian philosopher Michael Polanyi, and the two German economists Wilhelm Röpke and Alexander Rüstow.

The discussions in Paris revolved around the question how liberalism could be renewed. Participants like Rüstow, Lippmann and Rougier agreed that the old liberalism of *laissez faire* had failed and that a new liberalism needed to take its place. This was very much the core message of Lippmann’s book, as Jörg Guido Hülsmann points out:

The book appealed to European neo-liberals because Lippmann gave eloquent expression to their own deeply held views about the roots of the present political and

economic crisis. Those who still called themselves liberals rejected socialism but did not want to be too strongly associated with the Manchester doctrine of *laissez-faire*. Lippmann placed himself in opposition both to the old liberals and to the contemporaneous socialist agitators. Lippmann's middle-of-the-road position suited the pragmatic mentality of his countrymen. Americans tended to take a businesslike approach to political conflicts, seeking to solve them through negotiation and compromise. Lippmann shrewdly presented both the socialists and the Manchester men as stubborn doctrinaires. He contrasted these 'extremists' with his own practical-minded scheme. This resonated with the neo-liberal continental European economists of the interwar period, who differed from Lippmann only in the details they envisioned for the Good Society.<sup>62</sup>

Other participants like Mises and Hayek were far less convinced, but in the end the Colloque Walter Lippmann was united in their call for a new liberal project—a project that still needed a name. 'Liberalism from the left' was one idea; others were 'positive liberalism' or 'social liberalism.' But the term on which the participants actually agreed was 'neoliberalism'—Rüstow's original recommendation.

The Colloque Walter Lippmann was for some a farewell to classical liberalism, which was thought to have failed. Rüstow had delivered a speech to the conference under the telling title 'The psychological and sociological, the political and ideological reasons for the decline of liberalism,' on which the protocol of the proceedings recorded much agreement. After the speech, Lippmann apparently passed his business card to Rüstow with just one word written on the back: 'Bravo.' Only Ludwig von Mises accused Rüstow of showing a 'romantic spirit' by glorifying pre-capitalist times.<sup>63</sup> Yet not even Mises initially objected to being part of a 'neoliberal' movement, breaking away from the old tradition of liberalism.

The neoliberalism that came out of the Colloque Walter Lippmann was much in line with Rüstow's political and economic theories. It was no longer a conception of unrestricted liberty, but a market economy

under the guidance and the rules of the state. To quote Rüstow's seminal 1932 speech, it was the idea of both a free economy *and* a strong state.

To continue the neoliberal project, it was decided to turn the Colloque Walter Lippmann into a permanent think tank. The new Centre International d'Études pour la Rénovation du Libéralisme (CIRL) was meant to be based at the Musée Social in Paris, and British, American and Swiss branches of the CIRL had also been planned. Furthermore, it was intended to open the new neoliberal movement to a wider audience, including Catholic corporatists and trade unionists.

However, World War II rendered all such plans impossible. Apart from a few meetings in Paris, the CIRL did not manage to establish itself. It is nevertheless interesting to note that the neoliberals of the late 1930s were not afraid of reaching out to a non-liberal audience. They were certainly not very dogmatic when it came to spreading their new vision for liberalism.

The unity among the new neoliberals was as short-lived as the plans for their Paris-based think tank. At the Colloque Walter Lippmann, the differences between the 'true neoliberals' around Rüstow and Lippmann on the one hand and rather 'old-fashioned' liberals around Mises and Hayek on the other were already quite visible. Mises and Rüstow, who were friendly on a personal level, showed irreconcilable differences in their philosophies.<sup>64</sup> For example, Mises directly contradicted Rüstow's claim that monopolisation was a consequence of liberalism. For Mises the state was to blame for monopolies and cartels because such market structures could only develop under interventionist and protectionist policies. While neoliberals like Rüstow demanded state intervention to correct 'undesirable' market structures, Mises had always insisted that the only legitimate role for the state was to abolish barriers to market entry. Such differences, Philip Plickert writes, were 'not just gradual, but fundamental. They touched the very core of the neoliberal research agenda.'<sup>65</sup> Similar differences of opinion also existed in other questions such as social policy and the scope for interventionism.

It only took a few years for the insurmountable differences between old liberals and the neoliberals to become unbearable. In particular, Rüstow and Mises realised that they shared fewer beliefs than the Paris meeting may have suggested. Rüstow was bitter that Mises still adhered

to an older version of liberalism that he, Rüstow, thought had failed spectacularly. This he labelled ‘paleo-liberalism,’ as if Mises was a kind of dinosaur from a long-gone age. In a letter to Rüstow’s close friend Wilhelm Röpke, he wrote that Hayek ‘and his master Mises’ deserved to be put in spirits and placed in a museum as one of the last surviving specimen of the extinct species of liberals which caused the current catastrophe.<sup>66</sup>

Ludwig von Mises, on the other hand, became equally critical of the neoliberals around Rüstow.<sup>67</sup> ‘Ordo-liberalism,’ as the neoliberal theory became known in Germany, amounted to not much more than ‘ordo-interventionism,’ Mises complained. In *Human Action*, Mises’ opus magnum, he deals with the fallacies of such Third Way policies in unambiguous words:

[A]ll these advocates of a middle-of-the-road policy emphasize with the same vigour that they reject Manchesterism and laissez-faire liberalism. It is necessary, they say, that the state interfere with the market phenomena whenever and wherever the ‘free play of the economic forces’ results in conditions that appear as ‘socially’ undesirable ... That means the market is free as long as it does precisely what the government wants it to do. It is ‘free’ to do what the authorities consider to be the ‘right’ things, but not to do what they consider the ‘wrong’ things; the decision concerning what is right and what is wrong rests with the government. Thus the doctrine and the practice of interventionism ultimately tend to abandon what originally distinguished them from outright socialism and to adopt entirely the principles of totalitarian all-round planning.<sup>68</sup>

In the quotes of Mises and Rüstow we see reflected a schism of liberalism: To Rüstow, old school liberals like Mises were dangerous extremists; to Mises, neoliberals were not much better than totalitarian socialists. In any case, neoliberalism as a concept was clearly established as something quite different from the ‘free market radicalism’ with which it is usually associated today. Neoliberalism, from Rüstow’s 1932

speech to the Colloque Walter Lippmann of 1938, had been the attempt to formulate an anti-capitalist, anti-communist, but half-socialist Third Way.

## **Whatever happened to neoliberalism?**

World War II brought an abrupt end to the international attempts to establish a network of liberal/neoliberal thinkers. CIRL did not become the centre of a new liberalism, as its founders had hoped. Meanwhile, it became ever more dangerous for the German neoliberals to work on their political conceptions. Some of them, like Rüstow and Wilhelm Röpke, left Germany to work in exile. Others like the members of the Freiburger Kreis (the Freiburg Circle)—Franz Böhm and Walter Eucken, a close friend of Rüstow—remained in Nazi Germany.<sup>69</sup> They lived under constant surveillance by Hitler's secret police, and some of their members were eventually arrested and sentenced to jail terms. One of them, Friedrich Justus Perels, was executed for his involvement in the preparations of plans for a post-war Germany.

The Protestant theologian Dietrich Bonhoeffer is well known to an Australian audience since Prime Minister Kevin Rudd had named him 'without doubt, the man I admire most in the history of the twentieth century' in an essay Rudd published in *The Monthly* in October 2006.<sup>70</sup> Therefore it may be of some interest to Rudd that Bonhoeffer, too, was connected to the German neoliberal movement.

It was Bonhoeffer who, on behalf of the provisional governing body of the Confessing Church, asked the neoliberal economists from Freiburg for a concept for both domestic and foreign policies in Germany after the end of National Socialism.<sup>71</sup> The chapter on economic and social order was written by the Freiburg economists Walter Eucken, Constantin von Dietze, and Adolf Lampe (all of whom were deeply religious Protestants<sup>72</sup>), and it already contained many ideas that would later influence the 'social market economy' in post-war West Germany.<sup>73</sup> After the failed assassination of Hitler on 20 July 1944, parts of this economic memorandum were obtained by the Gestapo. Eucken was repeatedly interrogated, Dietze and Lampe arrested and tortured.<sup>74</sup> Bonhoeffer himself had been arrested in 1943 and was executed shortly before the end of the war, also for his involvement in these post-war plans.

It may seem ironic that Kevin Rudd's most admired man in recent history had sympathies for neoliberalism, when the same Rudd has subsequently denounced neoliberalism as an empty philosophy.

After World War II, the neoliberal movement rose from the ashes and gathered once again, but this time in Switzerland. Just as Rougier had invited liberal intellectuals to Paris in 1938, Hayek organised a similar meeting in Switzerland. It took place at Mont Pèlerin in 1947, and among the participants of the initial meeting were a number from the Colloque Walter Lippmann, including Ludwig von Mises and Wilhelm Röpke. They were joined by the up-and-coming American economists Milton Friedman and George Stigler, who would (like Hayek) both win the Nobel Prize for Economics, but also by Walter Eucken, the head of the Freiburg School. The tensions between the old liberals and the neoliberals remained. At one stage, Mises famously stormed out of a meeting shouting angrily 'You're all a bunch of socialists.'

Shortly after the Mont Pèlerin Society was established (named after the location as the participants could not agree on anything else), Alexander Rüstow joined the group.<sup>75</sup> He became an active contributor to the meetings of the Society, speaking at its events in 1950, 1953, 1956, 1957, 1960, and 1961.<sup>76</sup> Ludwig Erhard, the German economics minister and later Chancellor, also became a member. It was Erhard who had made neoliberal ideas popular in post-war Germany, where they were promoted under the label 'Social Market Economy' (Soziale Marktwirtschaft). The term 'social market economy' was invented by Erhard's adviser Alfred Müller-Armack—who also became a member of the Mont Pèlerin Society.

It was in West Germany where 'neoliberal' ideas were first implemented. The neoliberal economists around Erhard, Rüstow, Eucken, and Müller-Armack could draw on the theories they had developed in the 1930s and 1940s and contribute to West Germany's reconstruction after the War.<sup>77</sup> Price controls were abolished by Erhard when he was Director of Economics for the British and American occupied parts of Germany. Later in the 1950s, the Gesetz gegen Wettbewerbsbeschränkungen (Law against Restraints of Trade) was introduced by Erhard, fulfilling the neoliberals' demand for tough measures against market power. The result of all these policies was

impressive: The West German economy grew at a remarkable pace in the first two decades of the Federal Republic—a convincing vindication of free markets and ordo-liberal policies.

However, the Social Market Economy became more and more ‘socialist (i.e. redistributionist)’ over time. Whereas Erhard had always insisted that the market was inherently social and did not need to be made so, in political practice the German welfare state grew bigger—much to the dismay of Rüstow. He complained that the German welfare state had developed into an overly complicated system since it was started under Bismarck.<sup>78</sup> Rüstow also called for a more restrictive social policy as a prerequisite of the Social Market Economy. A social policy, he warned, could well turn into an anti-social policy if it burdened the public with excessive taxes.<sup>79</sup>

In Germany, neoliberalism at first was synonymous with both ordo-liberalism and Erhard’s Social Market Economy. Over time, however, the original term ‘neoliberalism’ gradually disappeared from public discourse. In particular, the Social Market Economy was a much more positive term and fitted better into the *Wirtschaftswunder* (economic miracle) mentality of the 1950s and 1960s. Ordo-liberalism, on the other hand, probably better described the institutional research agenda of those academics working in the tradition of the Freiburg School (which Hayek joined when he returned from Chicago). While both ordo-liberalism and the Social Market Economy are until the present day well-established and clearly defined concepts in Germany, neoliberalism has almost been forgotten as their common, original root.

Outside Germany, neoliberalism was forgotten even sooner. Although the Mont Pèlerin Society in some way continued the work started at the Colloque Walter Lippmann, the focus shifted from a radical redefinition of liberalism towards keeping liberal (i.e. classical liberal) ideas alive and spreading them around the world.

The result was that nobody wanted to self-define as a neoliberal anymore. The Germans had found other words to express the middle-of-the-road philosophy of neoliberalism, while the liberals outside Germany returned to dealing with classical liberal propositions, reducing the need to talk about ‘neo’-liberalism.

Whereas in academic literature from the 1930s to the early 1960s neoliberalism was quite a well-known idea, it sank into almost complete obscurity in the 1970s and 1980s. It remained there until the opponents of liberal reforms started using 'neoliberalism' as a tool of political rhetoric, clearly unaware of the real meaning of the word. Some authors have argued that the word neoliberalism resurfaced in Latin America where pro-market reformers were influenced by German neoliberal thinkers.<sup>80</sup> For the Latin American left, 'neoliberalism' became a synonym for everything they despised, and this may well be how 'neoliberalism' eventually turned into a political swearword. However, a survey of the more recent usage of the term 'neoliberalism' is not the aim of this paper.

### **Rediscovering neoliberalism**

As was mentioned earlier, it is times of crisis that usually trigger debates about economic systems. The banking crisis of the 1870s shifted Germany from a free market path towards protectionism and interventionism. The Great Depression of the 1930s led to the development of neoliberalism and revived socialism and Keynesianism. The global financial crisis of our times has led to a renewed criticism of the market economy.

We should see the current attacks on neoliberalism in this wider historical context. It seems to be a reflex to blame problems *in* the markets as problems *of* the markets. On closer inspection, some of the perceived market failures may well turn out to be failures of economic policy. Where Rüstow and the German neoliberals, for example, thought that cartelisation and monopolisation of the economy were the result of a degenerate market economy, historical analysis rather shows that they were the direct consequences of protectionism and interventionism—which Rüstow and his colleagues heavily criticised.

In a similar way, we ought to be careful when it comes to identifying the causes of the current crisis. Again, there are good reasons to look at both suspects, the government and the market. While there are good reasons to assume that there was indeed some market failure leading up to the crisis, there are at least as many reasons to think that they were preceded by government failures. Even where and when markets fail, however, this does not give governments a blank cheque to correct

market results. First, it would need to be demonstrated that corrections can actually improve the situation.

It is a fine balance that needs to be found between the state and the economy. Although there are good reasons to be critical of the German neoliberals' original historical analysis, their policy prescriptions nevertheless remain valuable discussion points. One need not agree with Rüstow's policy recommendations where they are the result of his social romanticism. However, his differentiation between the state as the guarantor of economic order, as the rule-giver that stands above economic processes, and the failed interventionist state that meddles with economic processes and gets easily captured by special interests, are still valid. It would be worth to rediscover them, especially today.

The discussions about the proper political reactions to the global financial crisis are, sadly, not as nuanced as they could be. For example, when we read Kevin Rudd's 'anti-neoliberal' essay we find some strong language right from the first paragraph where he blames 'free-market fundamentalism,' 'extreme capitalism,' and 'excessive greed' for our economic problems.

Nevertheless, if we look behind this rather shrill rhetoric, we can read in Rudd's essay about his recognition of 'the great strengths of open, competitive markets.' In fact, Rudd explicitly warned not to 'throw the baby out with the bathwater' as 'the pressure will be great to retreat to some model of an all-providing state and to abandon altogether the cause of open, competitive markets both at home and abroad.'

Taken together, the criticism of laissez faire plus the recognition of the power of markets and scepticism of state power is the core of the neoliberal project as it was once formulated. This would almost make the Prime Minister a neoliberal in the original meaning of the word, although he would probably be surprised if he found out. However, Rudd's policies suggest that he is less aware of the limits of government than he is aware of the limits of markets.

If there is one lesson that we could draw from dealing with the early history of neoliberalism for our political debates today, it is this: Neoliberalism is a far richer, more thoughtful concept than it is mostly perceived today. First and foremost, it emphasised the importance of sound institutions such as property rights, freedom of contract, open

markets, rules of liability, and monetary stability as prerequisites for markets to prosper and thrive. It seems that the global financial crisis has once again demonstrated how important these core insights of neoliberalism are.

To those criticising neoliberalism today, the answer may well be just that: We need more of this kind of neoliberalism, not less. What we would need less of is only the rhetorical abuse of neoliberalism for political purposes.

## Endnotes

- 1 Robert H Bork, *The Antitrust Paradox—A policy at War with Itself* (New York, 1993), 15.
- 2 See Michael Wohlgemuth, ‘Das Gespenst des Neoliberalismus,’ posted on *Wirtschaftliche Freiheit—Ordnungspolitischer Blog* (Economic Freedom—The Order Policy Blog), 2 September 2007, <http://wirtschaftlichefreiheit.de/wordpress/?p=69>.
- 3 Taylor C Boas and Jordan Gans-More, ‘Neoliberalism: From new liberal philosophy to anti-liberal slogan,’ *Studies in Comparative International Development* (forthcoming).
- 4 <http://andrewnorton.info/2009/04/non-existent-neoliberals-and-neoconservatives/>.
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