Part I

A German Solution to Europe’s Problems?
The Early History of the
European Communities, 1950–1965
Introduction to Part I

A New Global Setting

The most formidable of the many great challenges facing statesmen of the West after V-E Day was to tie Germany into Europe and Europe into Germany, both economically and politically. Most of them knew from the outset that this must take place as part of a larger recovery process that would eventually restore a Europe wrecked by two world wars to economic conditions like those that had obtained in the nineteenth century – with open borders, convertible currencies, competition, and the free interchange of ideas, a place where re-knit commercial and financial ties between nations would create essential networks of prosperity and so prevent war. This was the aim of all liberals, including men like John Maynard Keynes, who (at least for the medium term) thought state intervention necessary in order to restore the social and economic conditions under which market recovery could take hold. ¹ There was, as he understood, a disjunction between means and ends. Sound ideas and effective action did not often go hand in hand in the ravaged Europe of 1945. Hope that self-sustaining growth could be set in motion through the market would remain only a dream until governments had been stabilized, institutions rebuilt, and laws enforced. Cooperation was called for between industry and commerce on the one hand and government on the other.

The situation at the end of the war gave rise to the state of mind, financial and commercial policies, and economic regulatory agencies for which the Columbia University political scientist John Ruggie coined the term “embedded” liberalism; they would provide a global institutional setting with interpenetration and interweaving of state power and market economy that would last for the next 25 years. ² This regime was not all-powerful; nor did it always function as intended, and often it worked at cross-purposes. Rigid though not inflexible, the embedded liberal regime could, up to a point, be reformed in order to accommodate change. Within this regime cohabitated uneasily two distinct approaches to integration policy: one favoring the working of the market, the other the intervention of the state. An unstable amalgam, embedded liberalism would provide a bridge to a revived liberalism sans phrase.

Jean Monnet, a master of the interventionist approach, was even a Great Power in his own right. Without this immense standing, which he uniquely possessed, the diplomatic breakthrough upon which the subsequent integration of Europe would rest might never have occurred. The breakthrough – the Schuman
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Plan announcement of 9 May 1950, which led to the founding a year later of the European Coal and Steel Community (ECSC) – brought about the reconciliation of France and Germany, the axis of political integration. Yet this accomplishment left an ambiguous legacy. Monnet’s methods were elitist, undemocratic, and intended to provide definitive, irreversible solutions. The institutions he created (or tried to create) in order to advance the political and economic union of Europe did not operate properly, were unstable, or did not work at all. Monnet was initially the indispensable man, but both he and his legacy have thwarted as much as advanced the integration process.

The perpetuation of Monnet’s legacy owes much to his German disciple, Walter Hallstein, the first president of the European Commission (the executive office of the European Economic Community). Hallstein laid the foundation stones of the Brussels Eurocracy, where his own presidency ended in tatters but in which the spirit of Monnet continues to dwell. The downfall of the German president would usher in a new period in which the states – rather than any single person, idea, or institution – took the lead in integrating Europe. The “Monnet myth” survived in the form of concepts, policy rationales, and a terminology that to this day influences thinking about the integration process.

Jean Monnet did not, however, “found Europe,” as related in his memoirs, after a moment of divine inspiration. Integration grew out of post–World War II liberalization. Progress was, to be sure, slow. The return to peacetime conditions did not bring “normalcy” but merely a gradual shift from warfare state to welfare state. Although this course would later be partly reversed with the onset of the Cold War, the success of the Marshall Plan and its offshoots – OEEC/EPU and GATT – made it possible to dismantle the regime of controls inherited from the war, open up markets, and restore the competition principle to operation. The results were still a far cry from anything that might have existed midway through the nineteenth century. They did not, however, point in the direction of a “neomercantilist” restoration, as Alan Milward has argued – this would be bowing the wrong way toward Mecca – but toward a re-founded liberal order.

In the early 1950s the former Reich became motor and model of the new Europe. Minister of Economics Ludwig Erhard’s policies triggered a boom in the German economy and created durable trading relationships between the Federal Republic and its European neighbors that disciplined their markets as well. The fundamental purpose of the 1958 Treaty of Rome was to strengthen and perpetuate the new economic and political relationship that had developed between the German nation and its former victims in Western Europe. Though of necessity it included side deals, the treaty created a customs union and established the rules needed to make the competition mechanism work properly.

The German-fired European boom was both cause and effect of the formation of the new customs union known as the European Economic Community (EEC). Yet all was not well in the organization of Europe. Only the members of the coal and steel community (“The Six”: Belgium, France, Italy, Luxembourg, the Netherlands, and West Germany) joined the EEC. Seven of the remaining nations
belonging to the Organization of European Economic Cooperation (OEEC—an offshoot of the Marshall Plan) did not join the EEC but instead formed an alternative body, the European Free Trade Association (EFTA). As the name implies, the EFTA was a free-trade area as opposed to a customs union with a common external tariff and a political agenda. The EFTA was less formal and more easy-going than the EEC and was also remarkably successful, so it constituted a dangerous competitor and a possible alternative institution upon which European integration might have been constructed. In the meantime, the audacious bid of President Hallstein to turn his little office in Brussels, the Commission, into a kind of capital for Europe antagonized and alienated the EEC member-states. In July 1965 the French delegation, upon order of General de Gaulle, walked out of the Council of Ministers. It agreed to return seven months later only upon the express condition that France, and each of the remaining “Five,” receive veto power. Blocked by the Council and immobilized in the face of impending economic turmoil, the Commission would remain on the sidelines for the next twenty years. The future of integration would hinge not on the initiatives of the Brussels Eurocracy but rather on developments within the member-states—developments that were both cause and effect of economic change.
The Liberal Project for an Integrated Europe

There was a liberal project for an integrated Europe, even one *avant la lettre*. Its author was the Austrian economist Friedrich A. Hayek. He ranks alongside Jean Monnet and many others as one of the founding fathers of the new era. Hayek’s work inspired both Ludwig Erhard, who turned West Germany into the engine and model of European economic growth, and Margaret Thatcher, the moving force behind the Single European Act, which restarted the integration process in the late 1980s, as well as many others who have followed their footsteps. Hayek discovered the logic underlying the integration process. It is as relevant now as ever. Hayek postulated that the competition principle, if allowed to operate, sets in motion a mutually reinforcing reciprocal process in which the market and self-government together reduce interstate conflict and promote economic growth.

It is not only Hayek’s devotees and admirers who hold that integration can proceed on the basis of such “negative integration.” The argument has been restated and confirmed by many specialists and practitioners, some of whose work will be discussed in these pages. The result may, however, simply reflect the diffuse and pervasive nature of Hayek’s influence. Not just economists but also political scientists, sociologists, and legal and constitutional scholars are all slowly becoming at least partly Hayekian, just as by the third quarter of the past century even President Nixon, as he famously announced, was a Keynesian.

The Legacy of Friedrich von Hayek

Friedrich von Hayek was born at the turn of the century and lived long enough to witness the fall of communism. His active career, begun after World War I, ended with the onset of senility in the mid-1980s. Hayek impressed people when still in his 20s as being serious beyond his years and, at 80, as being remarkably spry and alert. The sixty intermediate, grayish years of middle age were the most productive period of his life. Hayek was tall and slightly stooped, reserved, somewhat courtly, unmistakably donnish, and spoke English as a second language with accents that varied according to the time and place of his residence. The placid and unremarkable demeanor masked a personal life not always consistent with the image. Such matters are trifling by comparison to Hayek’s ideas. Hayek never held public office but operated instead on (or close to) the intellectual plane. A great economist and social scientist, he was also a brilliant...
promoter of think tanks dedicated both to reviving the tradition of classical liberalism internationally and providing guidance to policy makers who shared his views. Hayek's influence has been both pervasive and enduring – not merely as a technical economist but as a political visionary with a deep understanding of the historical process. His gifts as a publicist and intellectual entrepreneur should not be overlooked in any assessment of his importance in the history of integration.

The Mont Pèlerin Society, which he co-founded in 1947, has served as a central point of diffusion not only for his own views but also for those of related schools influenced by them, such as monetarism, public choice theory, and the new institutional economics. In addition, Hayek and other eminent members of the association have founded colonies of classical liberal intellectuals in the United States, throughout Europe, and, above all, in Great Britain. The Institute of Economic Affairs, despite its bland name, became a hotbed of policy formulation for the government of Margaret Thatcher, who – as has since been nearly forgotten – set in motion a new wave of liberal reform into the European Community in the early 1980s. The competition directorate (DG IV), the most influential branch of the eventually labyrinthine Commission bureaucracy, became its locus. Hayek also imprinted the thinking of the Freiburg School of so-called ORDO-liberals who devised the famous Soziale Marktwirtschaft (social market economy) associated with Ludwig Erhard and the German economic miracle of the 1950s. He thus played an important background role in turning the Federal Republic into the economic hub of the new Europe.

Friedrich A. von Hayek, as he was baptized, entered life in 1899 as the eldest son of a wealthy Viennese family of administrators and university professors ennobled, on both sides, in the late eighteenth and mid-nineteenth centuries. In 1919, the supposedly all-important three-letter particle disappeared by decree of the young Austrian Republic, to Hayek's apparent indifference. It should not be forgotten that Hayek spent a privileged youth as subject of the multinational and economically liberal Habsburg monarchy and belonged to the milieu of Karl Popper, the Polanyis, Ludwig Wittgenstein, the von Mises brothers, Hans Kelsen, Arthur Koestler, and Peter Drucker. Except for service as a lieutenant on the Italian front, where he received a minor head wound, Hayek never strayed far from the academy. The academies in question were located not only in Austria but also in Great Britain (London School of Economics), the United States (University of Chicago), and West Germany (University of Freiburg). Each of these great centers of learning had an impact on Hayek's intellectual development but was also, in turn, influenced by him. No thumbnail sketch can do justice to the complexity of the relationship between the man and the institutions, not to mention the individuals associated with each of them. The interplay of ideas was what bound them all together. Hayek's life centered on a continuous and immensely productive debate with other respected great minds – with none of whom he fully agreed and with many of whom, in certain respects, he fundamentally disagreed. Hayek's views also changed over time (as did those...
of many of his remarkably long-lived interlocutors), a welcome consequence of 
broadened inquiry. Hayek must be judged primarily on the basis of his impor-
tance as a thinker, but he was also a networker *par excellence* and both colleague 
and pupil of many prominent figures: from Vienna of the 1920s, Fritz Machlup, 
Gottfried Haberler, Josef Schumpeter, and his mentor Ludwig von Mises; from 
London of the 1930s, Edwin Canaan, Lionel Robbins, John Hicks, and Ronald 
Coase; from post–World War II Chicago, Frank Knight, Milton Friedman, and 
James Buchanan; and from Freiburg – both at the end of the war and in the last 
two decades of his life – Wilhelm Röpke, Walter Eucken, Alfred Müller-Armack, 
and Ludwig Erhard.3

Hayek's career witnessed plenty of ups and downs. His research arguing that 
business cycles stemmed from malinvestments due to the only partial liquidity 
of capital were hotly disputed at the time but, after his 1926 predictions of a 
coming financial crash, won him recognition as an economist of international 
stature by 1930. The following year he accepted a chair at the London School of 
Economics. Professor Lionel Robbins recruited Hayek for the specific purpose 
of counteracting the growing influence of John Maynard Keynes. Here he was a 
disappointment. The Austrian was bested during the Depression years, or so it 
seemed at the time, in successive and widely reported intellectual jousts – fought 
through the pages of academic journals – with his well-connected, better-known, 
and (since Hayek's English was not yet quite up to speed) far more articulate 
opponent. He was further denied any role in British wartime policy making 
because of his "suspect" origins. Hayek was drifting into obscurity until the 
sensational popular success of *The Road to Serfdom*, published in 1944 and ex-
cerpted the following year in the *Reader's Digest.*4 The impact of this powerful 
and disturbing political tract – a warning that the mixed-economy welfare states 
of the Western democracies were headed down the same route taken earlier by 
Stalin and Hitler – made him many lifetime enemies. It also turned him into a 
celebrity, figured in his decision to leave Britain and accept a position at the Un-
iversity of Chicago, and marked a turning point in his career. Henceforth the 
technical economist in Hayek would give way to the political philosopher, the 
legal theorist, and the historian.

A Hayek revival began in the late 1970s as the economic and political con-
sensus that had characterized the Western world disintegrated. The idea was 
no longer credible that economic growth, full employment, and a more or less 
stable price level could be achieved by macroeconomic management without fun-
damentally damaging both the micro-structure of a basically private enterprise 
system and the impersonal rule of law on which free economic transactions de-
pend. The existence of the new consensus signaled the end of ideological disputes 
between advocates of collectivist and individualist forms of social and economic 
organization. The Austrian had won his battles of the 1930s with Keynes. Since 
the fall of communism, Hayek's reputation has continued to soar. According to 
the inevitably hyped-up blurb on a recent biography, "many of his ideas have 
been vindicated … and Hayek's vision of a renewed classical liberalism – of free
markets and free ideas in free societies – has taken hold in much of the world.\textsuperscript{5}

The findings of the present study, an investigation of a subject that cuts across only a portion of his life’s work, adds to the weight and measure of his reputation.

An ambition to develop a universal science of society drove Hayek’s intellectual inquiry, as it had done that of Max Weber, to whom the Austrian is often compared and with whom he had at one time hoped to study. Hayek’s thinking also had important antecedents in the special traditions of the Austrian school of economics, in which he and Ludwig von Mises were recognized as leading figures. The Austrian notion of the market process provided Hayek with a precious insight into social and political development over time, a heuristic device for understanding the mechanisms of – to use an emotive word he would have avoided – progress. By any name, that is the end to which the Austrian concept of the market process points, a fact fundamental to its power and appeal.

The Austrian (as opposed to the classical or Walrasian) economist conceives of the market process as dynamic rather than static, as analogous to evolutionary biology rather than Newtonian physics, and as something that grows out of a discovery process. General equilibrium can never actually be reached in the Austrian view, as there is no such thing as pre-reconciling economic plans or “objective knowledge” of the market but instead only the personal and “subjective” competitive strivings of individuals entering into transactions. Transmitted through markets, price signals translate otherwise inexplicable and indigestible masses of data into the information needed to coordinate trade and production in a decentralized manner that then produces the greatest good for the greatest number and maximizes social adaptability. Markets create “spontaneous order” yielding sustained growth and optimizing positive welfare impact while embedding knowledge in institutions that in turn modify social behavior. Markets and institutions can thus be said to be both co-evolutionary and co-dependent, though the specific relationship between them in any given situation depends on the context.\textsuperscript{6}

The Austrian theory has powerful implications. It posits that constructive economic and political change can be self-sustaining if allowed to operate within the framework of its own laws and if unimpeded by government (or other) interventions that supplant or otherwise distort it. The contention makes epistemological presuppositions that can be neither proved nor disproved empirically and that hence must rest on hypotheses about how institutions can and should function. “History,” even a slice of it, does not offer acceptable evidence of its validity. But is it not more important to use history in order to understand economics than vice versa? Hayek’s mentor, von Mises, made the point most eloquently: “Economics is not about goods and services, [but] about the actions of living men. Its goal is not to dwell on imaginary constructions such as equilibrium. These constructions are only the tools of reasoning. The sole task of economics is the analysis of the actions of men, is the analysis of processes.” The question at hand is whether the Austrian theory of the market provides valuable insight into the historical process. European integration can be regarded as a test case.
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The integration of Europe is not an overarching theme in Hayek’s lifework. Yet it is a recurrent source of intellectual and moral concern raised by the problems of his age, which he tackled (at several different times in his career) with the formidable set of analytical tools at his command. Hayek developed the theory that is at the very core of the liberal project for Europe, but he remained vague about how the process of European integration could be set in motion. He did not delve deeply into specifics of implementation. Instead, one finds among the leading figures (ORDO-liberals) of the Freiburg School – men influenced by yet distinct from the “Austrians” – the clearest understanding of the fact that, in order to operate satisfactorily, the damaged economy of the war-torn continent had to be nested in a new set of “market-conforming” (Marktkonform) institutions that (a) guaranteed respect for property and contract, (b) was anchored in monetary stability, and (c) was designed to protect the competition principle. Such an institutional emphasis can be said to typify even liberal German economic thinking. ORDO-liberalism is also characterized by a profound moral revulsion to national socialism, deep ethical concerns and commitments, and a quite specific engagement with the problems of economic reconstruction in the remnants of the broken and occupied German nation. On the German issue, Hayek’s Freiburg associates would “pick up the ball and run with it.”

Hayek nonetheless first delineated the liberal integration project. In “The Economic Conditions of Interstate Federalism,” which appeared in print on 1 September 1939 (a surely unintended accompaniment to Hitler’s invasion of Poland), Hayek presents a compelling and, within his terms of reference, irrefutable explanation of why open markets and political union go hand in hand – that is to say, are both co-dependent and co-evolutionary. The logic of his explanation influences thinking up to the present. He opens with a verifiable hypothesis – that no instances can be found of successful political federations without counterpart arrangements for the unimpeded movement of labor, goods, and capital – and then posits that the absence of trade barriers stands in the way of an identification of economic and political interests and so limits the pursuit of independent policies by member-states of a federation. Consequently, it is difficult for any such state to manipulate prices, adopt independent monetary policies, “discriminate” against one producer in favor of another, levy harmful taxes, or impose social or regional policies having differential impacts. It would, moreover, be even harder for a federation than for member-states to make invidious distinctions between producer groups; economic planning at a higher level would likewise be more difficult. Rather than legislate poorly, he suggests, a federation should limit itself to the proscription of antemarket policies. The weakening of federal and state power in a market-based union, he concludes, would result in the devolution of functions to the regional or local level, where they can be carried out more efficiently. Competition between these small units would, in turn, provide a salutary check on excessive growth and also encourage innovation.
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stimulate innovation, bring about the devolution of political power to the level of government closest to the individual citizen, and in all these respects advance the human condition. But how should the process be initiated that would lead to such results? Here Hayek offered little more than a concluding plea for the abrogation of the “sovereignty principle” and the creation of an “international order of law” as “necessary complements and logical consummations” of his project. However, these preconditions for future integration are simply starting places.

The Classical Liberal Solution to the German Problem

The “German Problem” was of immense concern to Hayek during the war. His thinking about it reflects an otherworldliness like that of the most widely read scholarly book on the subject, The German Catastrophe, by the great Berlin historian Friedrich Meinecke. Hayek was an early advocate of political union as a solution to the German Problem. “The future of England,” Hayek told a King’s College (Cambridge) audience of historians in a speech delivered on 28 February 1944, “is tied up with the future of Europe and, whether we like it or not, the future of Europe will be largely decided by what will happen in Germany.”

A federation would be needed. The war, he said, had shattered many worthy German intellectual traditions even as others, too deep-seated to perish, had contributed to the rise of Hitler. German historical consciousness must therefore be revived, and even re-created, so as to enforce the acceptance of moral standards prevailing elsewhere in Europe. Since it would be difficult to arrive at a single policy among nations, Hayek proposed adopting a “flag under which men who agree could unite.”

The “figure who fits the bill as perfectly as if he had been created for the purpose,” he discovered, was the late nineteenth-century Anglo-German liberal Catholic grandee, Lord Acton, a man “half German by education and more than half German in his training as a historian [whom] the Germans almost regard as one of themselves … [and who] unites, as perhaps no other recent figure, the great English tradition with the best there is in the Liberal tradition of the Continent.” Hayek proposed to organize an “‘Acton Society’ … to assist in the task [of re-education faced by] historians of this country and of Germany and perhaps of other countries.” Unable to agree on whether to put the name of Acton, de Tocqueville, or some other hallowed figure on the masthead, the would-be founders of the proposed entity, something supposed to be “half-way between a scholarly institution and a political society,” a kind of “International Academy of Political Philosophy,” agreed to call it simply “The Mont Pèlerin Society” after the name of the site near Geneva where the first meeting was to be held.

Contrary to Hayek’s intentions, neither historians nor political philosophers would have a major voice in the new discussion club. The policies and programs it generated would thus be almost exclusively the work of economists. Hayek