

Carl Menger

Richard E. Wagner

Carl Menger would surely occupy a secure place in anyone's pantheon of influential economists. Along with William Stanley Jevons and Leon Walras, his work in the early 1870s initiated the neoclassical or marginal utility approach to economics. This approach continues to dominate economics even today. Menger was also one of the three founders of what came to be known as the Austrian school of economics, the other two being Eugen von Böhm-Bawerk and Friedrich Freiherr von Wieser. Recognition of a distinctive Austrian school emerged in the 1880s, flourished until the 1930s, then entered a period of quiescence, though has shown some signs of revival, primarily in the United States, over the past two or three decades.

Life and Work

The basic facts of Menger's life are simple and few. He was born in Galicia, which now lies mainly across Poland and Ukraine, in what normally would be the last day of February, save that his birth-year, 1840, was a leap year. His life as a university student commenced in 1859 with a year in Vienna followed by three years in Prague, and then to Krakow where he wrote his dissertation. He was appointed to the University of Vienna in 1873 where he remained until his retirement in 1903, save for the 1876-78 period he spent tutoring and traveling with the Crown Prince Rudolph. Menger retired from his teaching duties at the early age of 63 so he could devote more time to his scholarship. While his post-retirement life lasted 18 years until 1921, and while from all reports he kept busily

engaged with reading and note-taking, he wrote little after his retirement. Menger's reputation is almost wholly based on work he published between 1871 and 1892. Had Menger published nothing after 1892, his intellectual standing would have been little affected, if, indeed, it would have been affected at all.

The vast preponderance of Menger's works were collected in four volumes by F. A. Hayek and published by the London School of Economics between 1934 and 1936, as part of a "Series of Reprints of Scarce Tracts in Economics and Political Science." Most of the excluded writings can be ascertained by consulting the bibliography appended to Volume IV, though there are some writings, particularly anonymous journalistic offerings, that have not been included. A second edition of this collection was issued by J. C. B. Mohr between 1968 and 1970, unchanged from the first edition save that Hayek's original English introduction was translated into German. (There was also a brief amusing note where Hayek retracts the statement in his original introduction that Menger was a tall figure, and notes instead that Menger was barely of average size.)

Volume I contains the first of Menger's two books (1871), which appeared in English as *Principles of Economics* (1950). Among other things, this book shifts the explanation of prices from cost of production to consumer marginal valuation, a shift that is generally regarded as the key distinction between classical and neoclassical economics. Volume II contains the second of Menger's books (1883). This was published in English as *Problems of Economics and Sociology* (1963). This book is best known for its initiation of what came to be called the *methodenstreit* between Austrian and German economists, a clash that in turn helped to solidify the impression of a distinctive Austrian school of

economics. Beyond this, an important accomplishment of *Problems* is its elaboration of the theme that there are many beneficial social institutions that arise not through plan or intention but as unintentional by-products of people pursuing their individual interests and plans. While Menger mentioned a number of examples briefly, most of his effort in this regard focused on money. In this respect, Volume IV of his collected works contains Menger's monetary writings, and opens with the third edition of his famous (1892) monograph "Geld" that appeared in the *Handwörterbuch der Staatswissenschaften*, a few glimpses of which were also published in English as "On the Origins of Money" (1892). Volume III of Menger's collected works mostly contains further writings of methodological disputation, comprising his contribution to the *Methodenstreit*. It also contains five biographical essays, two of them in commemoration of 100th anniversaries of births, Friedrich List and John Stuart Mill, and three of them obituaries, Lorenz von Stein, Wilhelm Roscher, and Eugen von Böhm-Bawerk.

Marginal Utility, Economic Order, and Economic Process

Prior to the 1870s, economists typically attributed differences in product prices to differences in the costs of producing those products. Products command higher prices because they are more costly to produce, according to this line of explanation. While each of the neoclassical triumverate had his own mode of presentation and expression, they were united in replacing this cost-of-production theory of pricing and resource allocation with a marginal utility theory. Each member of the neoclassical triumverate explained prices in terms of the utility that consumers derived from a marginal addition to their stock

of an item. It was not a high cost of production that elicited high prices from consumers, but rather it was the high consumer valuation of additional output that justified large expenditures by producers to bring such products to market.

John Stuart Mill's *Principles of Political Economy*, which was originally published in 1848, was probably still the most widely referenced statement of the economic principles of pricing and resource allocation when it appeared in revised edition in 1871. Shortly after he remarked that "there is nothing in the laws of value which remain for the present or any future writer to clear up; the theory of the subject is complete," Mill waded into a presentation of the diamond-water paradox, and in much the same fashion that Adam Smith had done nearly a century before. Diamonds are expensive, water is not. Yet people can live without diamonds, but not without water. This formulation appeared to present a paradox, which was resolved by invoking a distinction between use value and exchange value and by limiting the economic explanation to exchange value. Yet the paradox dissolves instantly under the neoclassical formulation. Market prices depend on the values that consumers place on one more diamond or one more bottle of water. Until diamonds begin to sprout like dandelions in the Spring or until people come to think that beautiful is ugly, diamonds will fetch much higher prices than water. Yet if one monster monopolist could control the entire stock of water and another the entire stock of diamonds, the water monopoly would be far more valuable. Relative market prices depend on relative marginal utilities, but this says nothing about relative total utilities.

The marginal utility apparatus represents a clear advance over the cost of production approach for explaining prices and resource allocation. It is clear that Menger

shared with his neoclassical brethren this focus on explaining variations in prices by variations in consumer valuation of the marginal unit. Yet it is also clear that he used his analytical apparatus differently than did the other neoclassicals. For those economists, economics was centrally concerned with the explanation of prices and resource allocation. To this day, this centrality is illustrated by a vocabulary that makes repeated references to economic theory as being price theory or price and allocation theory. For Menger, however, pricing and allocation were of only secondary interest, and for this reason Menger stands apart from his neoclassical brethren. For Menger, price and allocation theory was only a small part of economic theory.

In the Walrasian orientation that came to dominate neoclassicism, the central analytical problem is to explain the structure of relative prices and the allocation of resources among competing uses in a setting where knowledge is frozen and time is suspended. In this analytical schema, changes in knowledge are sources of exogenous shocks when time is allowed to elapse. In sharp contrast, Menger sought to develop an analytical framework where the passing of time and the development of knowledge, institutions, and organizations that accompanied the passing of time occupied the analytical foreground, and were not injected as exogenous shocks. Consumer valuations and prices were always present, to be sure, but so was the acquisition of knowledge, the development of new products, and the emergence and creation of new institutions and organizations.

This point is illustrated nicely by Menger's treatment of pricing, particularly his emphasis of price formation over price determination. Where Walras sought to explain

some equilibrium pattern of prices in terms of a logic of marginal utility, Menger refused even to impose the requirement that the same product sell everywhere for the same price. Such price uniformity might arise in some historical settings, Menger would surely acknowledge, but the central analytical task would be to explain the formation of such uniformity, and not to impose it by assumption. Menger's central concern lay with explaining the formation of actual prices, and not with expounding a logic of assumed equilibrium prices. This interest in a process of economic evolution through time led to a treatment where competition evolves from monopoly, and where one of the central features of the economic process is the generation of new knowledge and products, not as exogenous shocks to some logic of equilibrium, but as a natural feature of a scarcity-induced competition through time.

Spontaneous Order, Institutional Evolution, and Legislation

An important part of Menger's view of social and economic processes as centrally involving movement through time, as against being denoted by a structure of relationships at some point outside of time, is his treatment of spontaneous order and the evolution of institutions. There is an important distinction between what are direct objects of individual choice and what are unintentional consequences of the interactions among such individuals and their choices. Patterns of economic activity are generally orderly and apprehensible, but that orderliness is no one's intention, responsibility, or creation, and rather is simply a by-product of social interaction.

A primary task of economics thus involves the explanation of the evolution and

emergence of institutional arrangements that are socially beneficial but yet which result from no one's plan or intention. Menger gave a number of examples, among them money, language, and law. By far his greatest efforts were given to the explanation of the emergence of money, with other examples more mentioned or listed than developed or elaborated.

Menger explained the emergence of money out of barter as his paradigmatic example of institutional evolution. Money was not created through legislation, after which the economic process began. Rather, money emerged as an unintentional by-product of people's efforts to promote their economic interests. Without money, opportunities for trade were confined by the double coincidence of wants that barter required. Gradually, people came to recognize that some objects were more readily saleable than others. People would accept these items in trade, rather than refuse to trade, even if they had no immediate need for them, because those highly saleable items could be traded relatively easily at a later time for something that was desired. While history has seen many objects occupy such positions of easy saleability, such precious metals as gold and silver are the most prominent, along with certificates that represent title to such metals.

To attribute an invisible hand explanation to the emergence of institutions is not, however, to say that the results of evolution are incapable of improvement through legislation, Menger also argued. In particular, Menger argued in Appendix 8 of *Problems* that the spontaneous emergence of legal rules sometimes generated rules that were detrimental to the common welfare, and the correction of which was a task for legislation. Menger would not have argued for any efficiency of common law, to pick one instance

where a large literature now exists. He would have denied that people need consciously to adopt some legal framework before economic life can proceed, and would have claimed instead that such a framework will emerge spontaneously and conterminously with economic activity. At the same time, however, he would have held out the possibility that in some instances rules that emerged spontaneously might be susceptible to improvement through legislation.

As a conceptual matter this is certainly an entertainable proposition. Yet Menger did not elaborate on concrete illustrations nor did he develop any schemata that would make it possible to judge when legislation might truly be corrective and when it might accomplish something other than correction, say as illustrated by the contemporary literature on rent seeking that Gordon Tullock (1967) initiated. While Menger showed clearly how money emerges spontaneously, it is also the case that the free banking that accompanies the spontaneous or market generation of money has not been competitively robust against central banking created through legislation. Is the historical dominance of central over free banking an example of what Menger had in mind by the legislative correction of what he would have regarded as deformities in the outcomes of the evolutionary process? It would have been good to have seen Menger's mature thoughts on the relation between spontaneous evolution and deliberate legislation in a variety of concrete instances. Menger retired from the University of Vienna to devote his remaining years to reading and writing. The reports from his various unpublished notes and fragmentary manuscripts, however, suggest that no significant progress was made, though such efforts are now at the forefront of various research programs in law and economics,

new institutional economics, evolutionary economics, and public choice.

The Methodenstreit as Destructive Spontaneous Evolution?

Perhaps the methodenstreit itself can serve as an illustration of how social deformity can arise through spontaneous evolution. The course of the methodenstreit was clearly a product of spontaneous evolution, and was not the result of some deliberate design. One significant consequence of the methodenstreit was the generation of the presumption that there is something that can meaningfully be called Austrian economics. Without the methodenstreit, there almost surely would never have arisen the sociological phenomena of an Austrian school of economics, or of a German historical school, for that matter—and particularly the notion that the one is the antithesis of the other.

The methodenstreit, set in motion by Menger's 1883 book became a nasty and passionate battle that spanned the better part of two decades until its participants tired of the controversy. To be sure, there were significant differences between the thinkers and the approaches they represented, yet these were minor as compared with the differences between the commonalities shared by those participants and the growing neoclassical emphasis on economic theory as price and allocation theory outside of time. Carl Menger's orientation toward economics and social science similarly characterized the Germanic tradition of economic scholarship in the 19th century, and whose principal exemplar was Gustav von Schmoller, who was also nearly Menger's exact contemporary. While Schmoller lacked Menger's theoretical acuity and decisiveness, it is clear that Schmoller's *Grundriss der allgemeinen Volkswirtschaftslehre* reflects an orientation

similar to Menger's in its animating spirit and its central concern with the evolution of institutional arrangements through time.

The *methodenstreit* would have to be classified as a family feud, though it should also be noted that most murders are committed among family or friends. In this respect, Joseph Schumpeter (1954, p. 815) argues that the *methodenstreit* was primarily a clash of temperaments, and this is surely has considerable plausibility. In terms of Isaiah Berlin's distinction between the hedgehog and the fox in his famous essay on Tolstoy by that name, Menger was more the hedgehog who was seeking for one unifying principle, a universal solvent of the social world, so to speak. In contrast, Schmoller was more the fox, who emphasized variability and singularity, so much so that general organizing principles conducive to conceptual clarity tended to be slighted. Such differences in temperament may in turn have been magnified against the background of Prussian and Austrian hostility that included a short war in 1866, and which helped a passionate family controversy to turn bloody.

Family feuds can have enduring consequences, and the *methodenstreit* would seem to be no exception. While there ceased to be any identifiable Austrian-oriented approach to economics by the late-1930s, a resurgent interest in Austrian economics has emerged over the past two or three decades, particularly in the United States, and which has been chronicled crisply by Karen Vaughn (1994). While the main intellectual figures in this resurgence were Ludwig von Mises and Friedrich A. Hayek, Vaughn quite correctly locates Carl Menger as the central inspirational source behind these two figures.

Also published in 1994 was Nicolai Foss' *The Austrian School and Modern*

Economics. As with Vaughn, Mises and Hayek are the two central figures in Foss' narrative. Only Foss does not write of a resurgence of Austrian economics, but rather writes of it as a degenerating research program, primarily because its practitioners offer more by way of critical commentary than constructive example. Foss is writing for people who are interested in such currently robust research programs as law and economics and the new institutional economics. He argues that Mises and Hayek still have many valuable insights to offer such scholars, and he counsels such scholars not to let the Austrian identification that is commonly attached to Mises and Hayek interfere with a recognition of the value of their insights.

Foss and Vaughn share an admiration for Mises and Hayek, as well as for Menger, only they differ sharply in their projection of the future of Austrian economics. That such an issue would even be discussed today is a product of the *methodenstreit* and the social formations that emerged in its aftermath. The *methodenstreit* surely aided the Walrasian ascendancy in economic theory, and has also generated an inadequate appreciation of the intellectual heritage of that which has been displaced by that ascendancy. Had the family controversy between Menger and Schmoller not erupted in the manner it did, it is arguable that we would find ourselves speaking today neither of an Austrian nor of a German historical school of economics, yet at the same time we would find before us a robust alternative to the Walrasian type of neoclassicism. That alternative would have been centrally concerned with the development of organizations and institutions through time rather than with a logic of prices and allocations outside of time, and it would have incorporated the progressive components of what now are fragmented under such rubrics

as the new institutional economics, evolutionary economics, law and economics, and Austrian economics.. But the methodenstreit did happen, and as a result economics took on a different history in the 20th century than it might have taken had cooler heads prevailed in Vienna and Berlin in the closing decades of the 19th century—and, moreover, a history that has made more difficult the articulation and implementation of an alternative to Walrasian neoclassicism, one that could very well be called postclassical economics, even though that alternative was already in place prior to the methodenstreit.

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