

Austrian and German Economic Thought

From subjectivism to social evolution

Kiichiro Yagi



Routledge Studies in the History of Economics

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Acknowledgements

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On citations

In principle, quotations are in English or translated from the original non-English texts. In the event that no reliable English translation is available, I provide a translation, signifying the page number of the original text. Where I quote from existing English translation, two page numbers are shown: the first page number is that of the translation and the second is that of the original text. MGW refers to Menger, C. (1968-70) *Gesammelte Werke*, 4 vols. 'MS' refers to the pagination of an unpublished manuscript. In many cases the pagination is my own, since most of the unpublished texts lack it.

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General introduction

The emergence of the subjectivist value theory of Carl Menger in late-nineteenth-century Vienna (*Grundsätze der Volkswirtschaftslehre*, 1871) altered the constellation of social sciences in Austria and Germany. Menger and his two followers, Eugen von Böhm-Bawerk and Friedrich Wieser, established a new school in economics, the Austrian school, which has survived to the present day thanks to the works of Ludwig von Mises and Friedrich Hayek. Böhm-Bawerk founded a new theory of capital and interest, while serving the Habsburg Empire as an able administrator of public finance. Wieser extended Menger's value theory to the theory of cost and further to the theory of "natural value," which is valid in an ideal collectivist economy. The newly born school came into conflict with the Historical school that was prevalent in the academic world in Germany then. In this so-called debate on method, Menger proposed his interpretation of the "organic" origin of institutions that are not established with any collective will. Although it did not attract his opponent in the debate, it really anticipated Hayek's theory of "spontaneous order." If we extend the scope of our discussions to include Anton Menger's criticism against "power relations" as well as Wieser's reflections on power and history, the late-nineteenth-century discourse is extremely rich. Even the works of Max Weber can be regarded as an outcome of this conflict between the Austrian and the Historical schools in the late nineteenth century.

However, the early twentieth-century generation made a break with the passive subjectivism of the first-generation Austrians. Both Ludwig Mises and Joseph Schumpeter stood close to Max Weber in respect to their focus on the actions of individuals. Locating individual actions in the social and historical framework, a view of the social evolution is obtained. Thus, the quest of Austrian and German social scientists over a half century since the publication of Carl Menger's *Grundsätze* can be regarded as a journey to reconcile the newborn methodological subjectivism (or individualism) with the concept of social change, which modern readers could interpret as a concept of "social evolution." Now let me summarize each chapter.

In Chapter 1, I introduce Carl Menger's elder brother Max, a liberal parliamentarian in the old Austria. He aimed to revive liberalism in Austria founded on the German middle class. He was an expert in the Parliament on taxation and

2 General introduction

economic policies. From his political career as well as his decline under the shadow of fanatic German nationalism, one can understand the political undercurrents out of which emerged the ideas of the Austrian school of economists.

Chapter 2 deals with the journalistic activities of young Carl Menger. Before he turned to economics in the year 1867, Carl was a talented journalist. This chapter investigates the intellectual and political side of his activities in Viennese journalism in the late 1860s. It then explains how he became devoted to economics. Finally, it reveals that Menger assisted the journalistic activities of Crown Prince Rudolf, whom he had served as tutor during the period 1876–77.

After providing background information on the political milieu as well as personal history, we come to the formation of the *Grundsätze* in Chapter 3. Grounded on archival investigation in the Menger Papers at Duke University, as well as in the Carl Menger Library of Hitotsubashi University, this chapter explains the formation process of the classic works of Austrian economics. From the reading of K. H. Rau's *Grundsätze* in 1867, Carl Menger discovered his value theory, which consisted of the declining degrees of significance (utility) and available quantities. He applied this idea to production and exchange by drawing several inverted triangles. This geometric explanation was transformed into the famous scalar tables in the *Grundsätze*. This chapter follows Menger's plan for the construction of his work. Finally, it deals with Menger's methodological position at the stage when he wrote *Grundsätze*.

Menger's collision with the German Historical school is dealt with in Chapter 4. Menger's research into methodology was prompted by the reviews that his *Grundsätze* had received soon after its publication, including a malicious—at least to Menger—one by Gustav Schmoller. Although Schmoller would back off from Menger's challenge in the “debate on method” after a decade, a representative of the next generation of the historical school, Max Weber, adopted Menger's position and integrated it in his larger framework of social economics.

Chapter 5 deals with the formation of Böhm-Bawerk's theory of interest and capital. Böhm started his quest for a new theory of capital and interest in 1876 at Karl Knies' seminar in Heidelberg. This chapter, based on the manuscript discovered in the Hayek library at Salzburg University, clarifies Böhm's idea in its original form. It then follows Böhm's efforts to compile his *magnus opus*, *Kapital und Kapitalzins* (Volume 1, *Geschichte und Kritik*, 1884; Volume 2, *Positive Theorie*, 1989a). It also deals with the delicate problem of how and why the market solution of interest and wage was integrated in the final stage of the formation of the *Positive Theorie*.

Chapter 6 continues from where Chapter 4 left off regarding the view of history. Hayek discovers in Carl Menger the precursor of his idea of “spontaneous order.” However, according to Carl's brother, Anton, an accumulation of custom and habit produces a structure of social power relations. This debate between the two Mengers is still relevant to the modern discussion of the formation of order. Further, Friedrich Wieser grounded his view of history (anonymous history) in which not the will of individuals but a synthetic social power is

significant. He developed his sociological theory of power, which is separated from economics, in order to explain the historical change of society.

In Chapter 7, I deal with the Austrian economists' concept of value and equilibrium. In the 1980s the Austrians had a continuing correspondence with Léon Walras. In contrast to Walras, who deduced the value (price) from an equilibrium condition in the market (or in an exchange), the Austrians adhered to a subjective value concept that is independent of the existence of the market. In his book *Natural Value* (*Der natürliche Werth*, 1889), Friedrich Wieser extended this idea to an ideal communist society. From the present-day perspective, this must be interpreted as a thought experiment in the direction of a normative welfare economics. However, the criticism against the measurability of value caused the later generation to abandon this subjective value theory. While Ludwig von Mises stressed the indispensability of monetary calculation, Otto von Neurath turned to in-kind calculation.

In Chapter 8, we leave Vienna and move to Heidelberg. Both Böhm-Bawerk and Wieser gave the first presentation of their ideas in Knies' seminar at Heidelberg University. Knies' lecture in general economics was the only economics lecture that Max Weber took in his student years. I discovered a notebook of a student who attended Knies' course on General Economic Theory and wrote it down in a neat hand. On the basis of this lecture note, I put forward an argument that Knies taught the basic concepts and theory of social economics with some modification in historical and ethical direction, which may have contributed to Max Weber's view of economics. However, Knies could not integrate the new ideas of the Austrians into his system. This task was left to his student, Max Weber.

The hero of Chapter 9 was a rebel among the new-generation Austrians, Joseph A. Schumpeter, who adopted the Walrasian concept of general equilibrium. The idea of "general equilibrium" is the logic of determination of actions in a static situation. However, he wanted to move forward in the direction of dynamics and conceived the theory of economic development in which the innovation of entrepreneurs plays a pivotal role. He further extended the concept of "economic evolution" to "social evolution." This chapter explores the development of Schumpeter's idea of "social evolution" and maintains that a strain between "determinateness" and "indeterminateness" is inherent in his system.

Finally in Chapter 10, I present Max Weber as a social scientist with an evolutionary view of society. Although his judgment of the situation in the sciences (biology, psycho-physics, etc.) then was not mature enough for the establishment of an evolutionary view in social sciences, he believed that he could demonstrate some examples of unintended outcomes in the area of cultural history. My guess is that this is a distant repercussion of Menger's proposal in the "debate on method." From a careful reading of the basic categories of his interpretative sociology, I maintain that all of Weber's works are a valuable heritage for contemporary evolutionary social scientists. While presenting this conclusion, I also argued that Weber's effort can be interpreted as a response to the Marxists' materialistic view of history.

4 *General introduction*

Most of the chapters are based on my previous writings, published since the 1980s on different occasions. Even after the necessary revision, many traits that reflected the intellectual situation at their writing and my interests then are still retained. In the last chapter, I maintain that an evolutionary approach involving the subjective theory of Austrian economics and Weberian sociology could revive the ardent discussions that once took place among social scientists under the strain of the Marxian and/or Weberian problem. In my writings several years ago, I expressed my general views on these topics; I still stand by them. I reserved such passages for the final chapter of the book, which explains why the article on Weber appears as the last chapter. To the author, this study of Austrian and German economic thought has been inseparably linked to his positioning in the social sciences in Japan.

This study aims to revive the view of social sciences in the German-speaking world at the turn of the nineteenth century after the emergence of the subjectivist economics of the Austrian school.

First, it aims to lay the groundwork for research into Austrian economics on thorough archival methods. The true ideas of Austrians have been so often distorted by the ideological prejudices of Marxists, a narrow disciplinary approach by economists and sociologists, and the ardor of modern Austrians to revive Austrian traditions. Thus, it not only explores the formation process of the classical works of Austrians in details but also explains them against the background of the political liberalism and the peculiar constitution of the old Austria.

Second, as it maintains that Austrian economists were not confined to pure theory but had their own view of society and history, it would place the “debate on method” as well as the works of Max Weber in a wider context. Not only was a Hayekian theory of spontaneous order anticipated by them, but the criticism against such optimistic views was already provided. The sociological works of Friedrich Wieser and Max Weber are a part of the quest for an explanation of historical change, which was first begun by Menger.

Third, the final aim of this study is to explore the place of subjective rationality or methodological individualism in the total view of social evolution. In the author’s view, this was the core agenda of social scientists in the German-speaking world then. From the perspective of an evolutionary economist, this author obtains some answers from the works of Max Weber and Schumpeter. However, to work for this aim directly, I have to move into the domain of theory *per se*.

1 Portrait of an Austrian liberal

Max Menger's politics

The eldest of the three Menger brothers

Max Menger (1838–1911), a German Liberal parliamentarian in late-nineteenth- and early-twentieth-century Austria,¹ was the elder brother of two eminent Austrian scholars, economist Carl (1840–1921) and jurist Anton (1842–1906). It is well known that both Carl and Anton abandoned the nobility title in the family name (Menger, Edler von Wolfensgrün) because of their liberal convictions after attaining manhood. In so doing, they only followed their brother Max, who even at the age of 60 (December 1898) had no hesitation in rejecting the order of the Iron Cross, III class, on the ground that this honor was bestowed on the recommendation of the cabinet to which he resolutely stood in opposition.²

This chapter aims at giving the reader an overview of Austrian politics by focusing on the fate of liberalism in this monarchy in the latter half of the nineteenth century. As Carl Schoske (Schoske 1980) mentions, the decline of Austrian liberalism coincided with an extraordinary ferment of cultural ideas, not excluding the social sciences. All three Menger brothers lived in this age. While the youngest brother, Anton, a resolute socialist in conviction, kept a distance from Max, Carl continued a close relationship with Max up to the death of the latter. I will not say that Carl would have taken the same position as Max did, if he had been politically active. However, it is safe to say that Max's ideas on liberalism in Austria were some of those with which Carl was best acquainted.³ In the final part of this chapter, the relationship between Max, Carl, and Anton will be briefly discussed.

Emergence as a leader of the Young generation

Ernst von Plener (1841–1923), one of the most eminent leaders of the Liberals in the Austrian parliament in the 1870s and 1880s, counted Max, whom he met in the Taxation Reform Committee set up in 1874, as one of the most competent parliamentarians.

Another sincere supporter of the reform, although not always with our passion, was Max Menger, a man of enormous energy and continuous

6 *Portrait of an Austrian liberal*

diligence. He engaged in studies rather too intensely, and the papers he worked on were not always free from shallowness. He often assumed what he had gotten from his latest reading as his opinion. In political direction, he stood ahead of others and had a German nationalist tendency already at that time, but never followed this course to its extremes. I must admit his ability, although his way of dealing with others was not a pleasant one.

(Plener 1921: p. 56f.)

In the Taxation Reform Committee, Plener and Max Menger intended to establish a sound base for state finances through an overall reform of direct taxation, the core of which consisted of the introduction of a personal income tax. However, the majority of the committee finally chose to modify the already existing business profit tax (*Ertragssteuer*), and the reformers of the 1870s failed, just as their predecessors had in the 1860s. Taxation reform again came on the agenda of the House of Representatives (*Abgeordnetenhaus*) in 1892, and was passed in 1896.

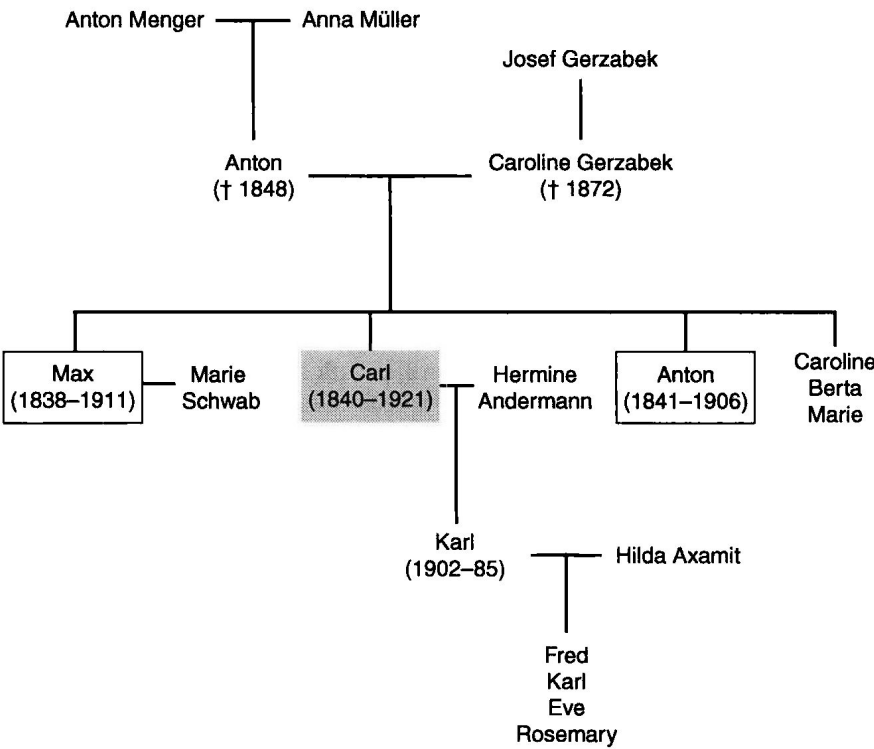


Figure 1.1 Menger family (source: First drawn by Akihiro Matoba in the early 1980s when he was the librarian in charge of the Carl Menger Library at Hitotsubashi University. Amended by Kiichiro Yagi according to the memorandum of Carl Menger's Diary).