

# Austrian Economics in Transition

From Carl Menger to Friedrich Hayek

Edited by  
Harald Hagemann,  
Tamotsu Nishizawa  
and Yukihiro Ikeda



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# Introduction

This book investigates both consistent and changing elements in the Austrian School of Economics since its foundation in the late nineteenth century up to the off-springs of this School at the end of World War II. The Austrian School of Economics has experienced various phases of transition when the flourishing place of this school, the city of Vienna and Austria in general, saw drastic changes in politics and in the economy, leading to the emigration of the leading members of the School in the 1930s. Representative examples are Friedrich August Hayek, Ludwig von Mises, Fritz Machlup, Gottfried Haberler and Oskar Morgenstern. We investigate the dynamic metamorphosis of the school, mainly with reference to its contact with other ideas and representatives of history of economic thought.

Part 1 begins with Carl Menger, the founder of the Austrian School of Economics. First, Yukihiro Ikeda investigates the economic liberalism of Carl Menger. Although later Austrians are known to be radical supporters of economic liberalism, it is an open question whether the founder of the School shared the same kind of radicalism. Using various materials, his published works as well as his unpublished papers now located at Duke University, Ikeda tries to tackle this riddle in the earlier phase of the development of the Austrian School of Economics. In the following paper, Kiichiro Yagi deals with Menger's methodological turn soon after the publication of the *Principles* (1871). The *Investigation* (1883), in which the 'principle of efficiency' determinates economic process in the idealized world, was only the middle point of his quest for the rational economic man. Menger was not content with the idealized world. He was interested in the economic action in the indeterminate world. Yagi also mentions Schmoller's review article and its influence on Menger in this context.

Part 2 deals with the German Historical School, which is often thought of as diametrically opposed to the Austrian School, particularly due to Schmoller's dispute on method with Menger. However, reality has been more diverse. In the first chapter of Part 2, Jun Kobayashi deals with 'substantial rationality' and 'formal rationality', two concepts playing important roles in Max Weber's methodological argument.

This is followed by Keith Tribe's contribution in which he shows that Weber was not only familiar with contemporary economic thinking in the 1890s, but that he had a special indebtedness to 'Austrian Economics'. According to Tribe, there was a lengthy process of reception reaching from the 1870s to the 1920s during which a 'new economics' became increasingly accepted, but without displacing historical or institutionalist economics. Finally, Tamotsu Nishizawa traces how German and Austrian ideas on economic theory and economic sociology exerted influence in Japan through the work of Ichiro Nakayama who had studied with Schumpeter at the University of Bonn in the late 1920s.

Part 3 consists of three contributions by Arena, Cangiani and Milford on the methodological problems of the Austrian School of Economics, with special attention to Menger. First, Richard Arena scrutinizes a transition of methodology from Menger to Wieser, the successor of the chair. In particular, Arena focuses on some aspects of Wieser's economic and social theory which are often ignored when his contributions on methodological individualism, power and institutions are discussed. Thus, Arena emphasizes that Wieser is more Wicksellian than Walrasian, and argues that in his analysis of money and credit Wieser in important aspects has anticipated Keynes's finance motive although no elaborated speculative motive exists in his theory. Next Michele Cangiani investigates the motives and results of Menger's revision of his 1871 book, by comparison with the posthumous edition of 1923. As the title indicates, a starting-point of the chapter is Polanyi's work and its relationship with Menger's new statements in the 1923 version of the *Principles*. Finally, Karl Milford, in analyzing Menger's problem situation, challenges the standard interpretation of Menger defending an Aristotelian essentialist position as counterintuitive, and instead emphasizes Menger's non- or even anti-essentialist approach to economics. Milford convincingly shows that Menger's methodological individualism conflicts with an essentialist approach to economics.

Due to the political developments of the 1930s most Austrian economists had to leave Austria and exerted a major influence in the hosting countries, particularly in the United States. Part 4 deals with this 'Dissemination of the Austrian School of Economics'. First, Harald Hagemann discusses the developments at the University of Vienna and the political developments which caused an enormous emigration of Austrian economists. He then gives a bird's eye view of important contributions of Austrian economists in the interwar period. Next, Arash Molavi Vasséi gives a thorough interpretation of Ludwig von Mises's approach

with which the Austrian theory of business cycles takes its starting point. Then Hansjoerg Klausinger presents Hayek as a leading international researcher of business cycle theory, which had been the main economic issue in the interwar period. Klausinger also points at Hayek's odd position as the Director of an Institute mainly dedicated to the task of empirical research on business cycles, relevant to business people, to which he had severe reservations. Finally, Chikako Nakayama focuses on Oskar Morgenstern in her analysis of the impact and the experiences of emigrated Austrian economists in the United States. Morgenstern's discussions with Frank Knight can be seen as part of the dissemination of the Austrian School, but also as a new impact coming from outside.

The book is concluded by Part 5. First, Kurt Leube, deeply involved with the Austrian tradition, informs us about the concept of '*Verstehen*' and related methodological problems with special attention to Menger and Hayek. By examining Hayek's *Sensory Order*, Susumu Egashira links Hayek's psychological argument to modern economics. Egashira argues that the Hayekian perspective might lead to a new paradigm in microeconomics. In dealing with the so-called 'Transformation Problem' of Hayek, Makoto Nishibe claims that Hayek drastically transformed his vision of the market in the 1930s and that there should be another dividing line between 1945 and 1946. Lastly, Tsutomu Hashimoto tries to answer the following questions: How did Mises and Hayek succeed Menger's methodological principles? How did they transform or reform them?

All in all, the chapters shed some light on the new developments and find fruitful contributions of the Austrian School to the evolution of economics in an international perspective. At the same time, we try to answer the ambitious question of whether there can be a School of Economics in the definite sense of the word. Indeed this is a problem with which Schumpeter was seriously involved with when he wrote his *History of Economic Analysis*.

The volume originated from the conference 'Carl Menger and the Historical Aspects of Liberalism' held at Hitotsubashi University, 17–19 December, 2004, organized by the Center for Historical Social Science Literature at Hitotsubashi University.

Some of the chapters in the volume were papers read at the above conference, but have been revised in many ways considering responses from the participants. Furthermore, we have extended the scope of the volume by inviting other contributions by colleagues who are experts in the field. We are grateful to Hitotsubashi University for their generous

financial support, without which the conference would not have been made possible. Particular thanks go to Professor Koichi Yamazaki, who organized the conference. Finally, we would like to thank Niels Geiger and Johannes Schwarzer for their support in adapting the manuscript to the publisher's guidelines and in preparing the index.

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## **Part I**

# **Carl Menger: Towards a New Image of the Founder**

# 1

## Carl Menger's Liberalism Revisited

*Yukihiro Ikeda*

### 1. Menger's liberalism: A myth?

Was Carl Menger a radical supporter of economic liberalism like the later members of the Austrian School of Economics? This is still an open question, even among scholars deeply involved with the study of the Austrian School in general and Menger in particular. There are good reasons for this: Menger's main works were in the fields of economic theory and methodology, published in 1871 and 1883 respectively. Although we have some other small pamphlets and papers dealing with specific topics, Menger did not have many opportunities to publish his works on economic policy while he was alive. Historians of economic thought are compelled to garner assorted comments that are scattered throughout the various papers and books that Menger did publish during his lifetime.

Fortunately, we are left with some hints that can help us to identify and interpret Menger's liberalism. After scrutinizing Menger's monetary theory, we are now inclined to answer this question in the following way: Menger was a moderate protagonist of economic liberalism, making him the odd man out among the later players of the Austrian School of Economics, such as Ludwig Mises and Friedrich Hayek (for details see Ikeda, 2008; see also Campagnolo, 2004, 2005). Our analysis is highly specific, in that it deals only with his monetary theories; yet, this chapter examines other aspects of Menger's liberalism as well, in an attempt to answer the aforementioned query.

In the next section, we examine Menger's lectures on Crown Prince Rudolf, who died tragically in Mayerling in 1889 (these shall hereafter be referred to as the Rudolf Lectures). Menger taught his pupils fundamental principles of economic policies. What are the agendas and

non-agendas of government in a market economy? What is necessary to promote the well-being of the subjects of a monarchy? By reading the materials Menger taught to Rudolf, one can get a bird's eye view of Menger's economic policies. This examination is followed by Section 3, in which I address his lectures on public finance. The transcription of the lectures, now available, thanks to the efforts of Takeshi Mizobata, enables us to read the contents of the lectures that he gave at Vienna University. Since Menger did not offer a detailed account of the discipline in his published works, this offers us a good way to identify his position in the history of public finance. This section, together with the previous one, contributes to the basic understanding of Menger's economic policies. In Section 4, we turn to a newspaper article that was written by Menger to commemorate Adam Smith. Although it was addressed to general readers, it gives us a clue to his interpretation of Smith in comparison with those by other German scholars of that era, which is another way to identify Menger's liberalism. In Section 5, we demonstrate that there are important differences in opinion between Menger and Rudolf concerning the problem of how to deal with the Enlightenment. While Rudolf shared a basic political stance with his mentor, he was more optimistic in his belief in the further development of human beings. In the final section, some concluding remarks will be made. Although we have tried to extend the scope of this analysis to include aspects of Menger's ideas other than monetary theory, this is still a tentative answer to the abovementioned problem.

## 2. Economic liberalism in the Rudolf Lectures<sup>1</sup>

As is indicated by Erich Streissler, the Rudolf Lectures are heavily based on Heinrich Rau and Wilhelm Roscher, but another important source is Adam Smith (see Streissler, 1994, especially 6–22). In this section we will demonstrate that Menger had relied upon arguments in the English Classical School represented by Smith, as well as those traditional discourses of German economics beginning with *Cameralwissenschaften*, of which the dominant player in the first half of the nineteenth century was Rau. In fact, these lecture notes are good examples of the reception history of Smithian economics and of a still-surviving tradition of typically German economic discourse.

Menger used the following simple two-stage theory with respect to the necessity of governmental intervention:



When a people is still uncivilized, the head of state may attempt to activate the sluggish economy on his own initiative; but where trade and commerce flourish because of a people's industry and education, the state can greatly harm the citizens' interests by interfering too much, while it will most definitely promote the interest of the national economy by allowing scope for individual action and lending support only in cases where an individual's strength is insufficient.

(Streissler and Streissler, 1994: 109, 111)

In developing countries waiting for takeoff where 'a people is still uncivilized', one badly needs a kind of state intervention; however, after takeoff, governmental intervention is more or less a disturbing factor in a market economy. Thus, in developed countries, the state must stop playing a definitive role in order to orient the economy as a whole.<sup>2</sup>

Menger supports his arguments in a typically Smithian or Hayekian way. In his own words:

However carefully designed and well-meant institutions may be, they will never suit everybody, since only the individual himself knows exactly his interests and the means to promote them. Innumerable influences, different for everyone, dominate man's activities, and only the individual knows the means for gaining his ends; from unhampered individual development there results a wide range of activities that permit an advanced stage of civilization to be reached. The individual citizen knows best what is of use to him and he will be most industrious when working for his own personal ends.

(Ibid.: 113)

Each economic player knows his own interests and the surrounding situations better than anyone else, Menger argues (see Rosner, 2008: 138; Wilke, 2008: 155). Furthermore, he works harder when promoting his own interests than when serving others to promote theirs. Broadly speaking, this argument reminds us of the well-known explications in *The Wealth of Nations*, whose ideas Friedrich Hayek shares with the great thinkers of the Scottish Enlightenment. Menger's standing point can be neatly summarized as follows:

Freedom (*Freiheit*) and self-reliance (*Selbstverantwortlichkeit*) in the economic efforts of citizens are the foundation of the overall

development of a state; therefore the state has to realize and defend these fundamental principles.

(Streissler and Streissler, 1994: 115)

As the above quotes show, Menger was supportive of economic liberalism, with some careful reservations. Let us look at government agendas from Menger's point of view.

Important roads, railways and canals that improve the general well-being by improving traffic and communication are special examples of this kind of enterprise and lasting evidence of the concern of the state for the well-being of its parts and thereby its own power; at the same time, they are/constitute major prerequisites for the prosperity of a modern state. The building of schools, too, is a suitable field for government to prove its concern with the success of its citizens' economic efforts.

(Ibid.: 121)

As is well known, roads and canals are included in government agendas in *The Wealth of Nations*. Smith did not mention railways, simply because they did not exist in England or in any other part of the world when he wrote his grand oeuvre. On the other hand, Menger did not refer to bridges and harbours either. It is difficult to determine whether he skipped them on purpose or if the omission has any substantial meaning.

Beyond these agendas, Menger goes so far as to say that the protection of forests must be provided by the government. He explains why this is necessary:

Quite often a forest owner in the mountains who is temporarily short of money will want to clear his high-lying forests; this can easily cause irreparable damage, since the rainfall will then run off in torrents and wash out the humus layer; floods in springtime, droughts in summer, and other kinds of damage to agriculture in the plains result from such deforestation of the mountain sides and tend to worsen over time. The Southern Tyrol, Istria, Dalmatia are sad object lessons of the blind greed of individuals and thoughtless negligence of former governments.

(Ibid.: 131)

This is an important proviso of economic liberalism. In general, Menger was of the opinion that the unconstrained behaviour of economic agents will lead to a socially desirable result; however, as is the case with forestry, this proposition is not always true. Greedy individuals tend to cut trees quite easily without any consideration of what will happen afterwards. Using the concrete examples of ‘Tyrol, Istria, Dalmatia’, Menger endeavours to show the exceptions to economic liberalism, where the government must step in:

Protecting forests is among the major duties of the state which, by virtue of their importance, justify government intervention in individual economic activity.

(Ibid.: 133)

While the case of forestry was not suggested in *The Wealth of Nations*, German scholars were eager to protect forests from various points of view. This leads to the conjecture that Menger took the above story from German textbooks, which are more or less concerned with the problem (see Rosner, 2008: 139–40). To demonstrate that this is indeed the case, we will briefly introduce the arguments of Rau, whose textbook Menger had studied eagerly in order to prepare for his *Habilitation*. Rau emphasizes the importance of governmental intervention in the field of forestry as follows:

Private forestry is not only the target of purely police activities, which attempt to keep it away from various damages, but also of people who were careful enough to see it from the standpoint of the national economy [...] From early on it has been thought necessary to make private industries subject to state control [...] And there was no hesitation to limit the freedom of forest owners when it was justifiable to do so from the viewpoint of the national economy.

(Rau, 1828: 154, author’s translation)

The quote here is, in a sense, typically German. The idea has its origins in *Cameralwissenschaften*, and through Rau and others it became a tradition in German economics, later finding an echo in Menger’s lectures to Rudolf.

Lastly, we examine Menger’s understanding of the labour market at that time. Since the latter part of the nineteenth century, it has continued to be an issue; some people have seriously begun to think that the labour market must be seen as an exception to the *laissez-faire* principle.

Indeed it can be safely said that one of the urgent problems of Menger's time was the degraded working conditions of factory workers. Their condition was vividly described, for instance, in chapters of *Das Kapital* by Karl Marx. Workers in the midst of rapid industrialization were often forced to work for long hours under bad conditions, such as in hot and humid factories. Even small children and women were hired at low wages. Menger did not avoid mentioning the problem in his lectures, saying that workers must be protected by various measures not only to improve their conditions but also to prevent the arrival of communism:

As mentioned above, we encounter this problem especially in factories; here the factory owner has the opportunity to further the intellectual and emotional development of many people by gentleness, benevolence, and good treatment and thus turn them into good citizens; by treating them roughly and overworking them, he can cause the workers, who are on a very low level any way, utterly to degenerate – to become the very scum of the population. Thus, the so-called proletarians and communists come into existence, as the result of the ill-treatment by the rich, who are now haunted by their spectre.

(Streissler and Streissler, 1994: 127)

By working under good conditions, workers become good citizens, whereas if entrepreneurs force them to work under bad conditions for long hours, they turn to radicalism, thus opening a way to communism. In order to avoid this, daily working hours must be shortened. Menger continues:

The factory owners may influence decisively even the physical development of the working class; and for this very reason, the state must pay close attention to life in the factories in order to prevent workers from degenerating physically as a result of their being overworked. Therefore, factory owners are not allowed to let their labourers more than a certain maximum [in the margin: 15 hours], even if workers were willing to submit to such disastrous treatment, pressed either by necessity or induced by a higher wage; the government prohibits, for example, a 15-hour day in factories since the worker's physical strength and health suffer if he spends that number of hours daily at hard labour, thereby having his mental faculties blunted completely and sinking to the state of a machine.

(Ibid.: 127, 129)

Although Menger supported factory legislation, it is astonishing to find his suggestion of a modest governmental intervention in the labour market. If one works for 15 hours, as is indicated here, he or she will be left with only nine hours in the day, which is almost equivalent to total sleeping hours plus a short time for breakfast, lunch and dinner. Indeed, this concept must be acceptable for almost all capitalists, including those seeking to exploit their workers up to 15 hours a day. We can compare the above passage with the case of the United Kingdom, where the Ten Hour Act was passed as early as 1847. Certainly Menger did not go too far in promoting further governmental intervention in the labour market.<sup>3</sup>

### 3. Lectures on *Finanzwissenschaft* at Vienna University<sup>4</sup>

We now turn to Menger's lectures on public finance (*Finanzwissenschaft*), which were given at Vienna University. Thanks to the efforts of Takeshi Mizobata, a Japanese researcher, we are able to read transcriptions of the lectures without difficulty. According to Mizobata, it is highly probable that the lectures were given around 1888, considering various historical data that Menger included in them. Together with the Rudolf Lectures analysed in the previous section, the *Finanzwissenschaft* provides a good opportunity to examine Menger's economic policies in detail.

After mentioning Adam Smith, David Ricardo, John Stuart Mill and John Ramsay McCulloch, Menger refers to eminent German scholars who greatly contributed to the discipline of public finance; these were Julius von Soden, Johann Friedrich Eusebius Lotz, Ludwig Heinrich von Jakob, Carl August von Malchus, Karl Heinrich Rau, Karl Umpfenbach, Lorenz von Stein, Carl Julius Bergius, Johann Friedrich von Pfeiffer and Adolph Wagner. The way in which Menger lectured to the university students was different from the manner he used when lecturing to the future king; in the lecture room at Vienna University, he gave detailed information on the published works of the discipline, a routine procedure in university lectures, but a process that he totally skipped in the Rudolf Lectures.

Menger's basic understanding of the history of public finance can be aptly summarized as follows:

In Germany, public finance was already well-developed even before Smith.

(Mizobata, 1993: 33, author's translation)

It is true that public finance was not given an independent role in the treatises on British economic thought. Adam Smith, the founder of economics – and at the same time a representative player in the Scottish Enlightenment – dedicated only a part of the last book of *The Wealth of Nations* to the discipline. This makes an excellent contrast to the German way of dealing with the problem: Rau's third book exclusively deals with public finance. As Menger said, this tradition was deeply embedded in the tradition of *Cameralwissenschaften* in German-speaking areas, which continues to play an important role in the development of the discipline, even after the introduction of Smithian economics in Germany. On the whole, German influences were apparently dominant in these lecture notebooks.

Menger explains the differences between the private and state economies after engaging in historical descriptions of the discipline. Among the three points he indicated, the first deserves to be mentioned here:

That the state has to have moral purposes. Not only the state economy but also revenue and expenditure must have this character. The state cannot concern itself with business that endangers morality. How stupid it is to receive revenue from, for instance, the lottery in order to promote moral purposes! The same can be said of expenditure. The state is not allowed to spend money for amoral agendas. If the expenditure is not adequately seen from this rule, it cannot be justified from an economic point of view.

(Ibid.: 35, author's translation)

For Menger, the state is an ethical being; for this reason, it is neither allowed to collect state revenue through amoral methods, nor use that revenue for purposes that are problematic from an ethical point of view. The characterization of state as an ethical being cannot be found in British economic thought.

The arguments in *The Wealth of Nations* were a starting point of the taxation theory for the later generation. Menger also refers to the well-known passages of Adam Smith, before coming to the following conclusion:

If one says that only those people who can pay the money can send their children to school, it is diametrically opposed to the essence

of the state. There are many people in the country who cannot pay this tax.

(Ibid.: 52, author's translation)

In the above quote, Menger criticized one of the taxation principles posed by Adam Smith: taxation based on the benefits that individuals enjoy under state control. Menger was against this principle, for there are many who cannot afford to pay certain taxes even if they are enjoying some of the benefits of state protection. Menger said that the principle was against the proper understanding of the state, implying that his is a community based on other values.

Furthermore, Menger advocated tax progression in a typical way:

With increase in income, one feels less sacrifice, even if the loss is the same amount. For this reason, we must not tax with the same proportion; but with increase in income, the percent rate must be also increased. This means that the percent rate must be progressive as in income tax, and there must be a tobacco tax whose price increases progressively.

(Ibid.: 52, author's translation)

The argument here is based on a well-known observation that for the rich, the marginal utility of a certain amount of money is much smaller than it is for the poor. In the history of economic thought, the foundation of this argument was severely criticized because it is based on an interpersonal comparison of utility; but Menger still stuck to the old-fashioned way of supporting the taxation progression.

#### 4. Economic liberalism in *Socialtheorien*

In this section we examine Menger's homage to Adam Smith, which he extended in a newspaper article entitled 'The social theories of classical economics and modern economic policies' (*Die Social-Theorien der classischen National-Oekonomie und die moderne Wirtschaftspolitik*). In this article, intended to commemorate the founder of economics, Menger defended Smith's arguments against the criticism of German economists in general and of the German Historical School in particular.

Menger's arguments run as follows:

In all cases of conflict of interest between the rich and the poor, A. Smith stands without exception on the side of the latter. I use the phrase 'without exception' very carefully. There are no places in *The Wealth of Nations* where A. Smith represents the interest of the rich and powerful against the poor and weak. While A. Smith quite positively recognizes the free initiative of individualism in economic matters, he supports in all the cases state intervention where the matter relates to the abolition of laws, and the application thereof, that suppress the poor and weak for the sake of the rich and powerful.

(Menger, 1891: 223, author's translation)

This is clearly intended as a critique of the popular interpretation of Smith in German-speaking areas in the nineteenth century. Quite often, Smith was believed to be standing on the side of rich people, thus ignoring the interests of the poor. Menger argues that this is contrary to what Smith actually said.

Furthermore:

When it comes to the protection of the poor and weak, the basic standpoint of A. Smith is in part more progressive than that of those modern politicians concerned with 'social policies'. His opinions, found in particular passages of his work, are similar to those of modern socialists. It is well-known that Louis Blanc, Ferdinand Lassalle and Karl Marx incessantly quote the theories of Smith and his pupils, but not those of his enemies.

(Ibid.: 224–5, author's translation)

Here Menger's standpoint is clear: He defended Smith, saying that the latter's position in policy-making issues is more progressive than that of the economists who advocated social policies in Germany. Thus, Menger endeavours to distance himself from economists in the *Verein für Socialpolitik*. On the other hand, Menger went too far when he said that Smith's position on policy issues is close to those of socialists. This is a bold statement; as Menger emphasizes, Blanc, Lassalle and Marx continued to mention Smith, employing a part of his economic system in their theories. Yet, it is unclear whether or not they followed Smith in policy-making matters. In some way, they tried to go beyond Smith's position.

Menger goes on to show that Smith was not a *laissez-faire* economist.



It is not true, indeed it is a forgery of history, to say that A. Smith was a dogmatic advocate of the 'laissez faire, laisser aller' principle and that he believed that the completely free play of individual interests would lead to the economic cure of society. In various parts of his work, he admits that the efforts and interests of individuals and entire social classes stand in direct opposition to public interests. Not only did he accept state intervention in most cases, but he believed it to be an order of humanity considering the public welfare.

(Ibid.: 230, author's translation)

Menger claimed that Smith did not believe that the individual interests of economic agents necessarily led to the economic interests of society as a whole. In many parts of his 1776 book, Smith indicated cases in which the individual interests of players are diametrically opposed to public interests. In these cases, some form of state intervention is necessary. Indeed, the members of the German Historical School were not united in criticizing Smithian economics; Karl Knies emphasized by direct quotations from *The Wealth of Nations* that Smith was not a dogmatic supporter of the *laissez-faire* doctrine.<sup>5</sup> In this sense, Menger's interpretation in the above quote was not new in the context of German economics at that time.

Next, we proceed to Part II of the same article, which concerns itself with the problem of distribution between capitalists and workers and the possible means to improve workers' conditions. In Menger's opinion, members of the English Classical School understood the distribution mechanism better than German economists of the Social Policy School:

While the economists of the Classical School are, in their sympathetic tendency toward workers, not inferior to the modern politicians concerned with social policies, it seems to me that the standpoint of classical economics is, when seen from another perspective, obviously better than that of the new politicians of social policies. What I mean is, their correct insight into the causes leading to the welfare of the working class.

(Ibid.: 239, author's translation)

Menger continues:

It is true that the distribution of income between capital and labour is a problem of the highest importance and that every measure to

increase workers' distribution in the result of production must be welcomed as a delightful improvement of society, if it does not lead to the problem of the existence of industries. But it seems also certain that the considerable increase in wages is only a result of accumulation and the productive use of capital. The employment of more workers with the same or higher wages goes hand in hand with the prosperity of productive industries and capital accumulation.

(Ibid.: 239–40, author's translation)

While Menger admits to the importance of the distribution between capital and labour, he emphasizes other factors determining the wage. One of them is an accumulation of capital and the productive use thereof, but the way in which to divide the cake between the two comes down to a distribution problem. Before dividing a cake, we must endeavour to have a bigger cake, thus making an absolute amount of each person's share larger. This is, in Menger's opinion, the crux of the matter. Whether or not the capitalist enjoys a lion's share in the relative sense is of secondary importance to Menger. It can be safely said that the above argument has one of its origins in Book 2, Chapter 3 of *The Wealth of Nations*.

Key terms in Part II of the article are *Kapital* (capital), *Unternehmungsgeist* (entrepreneurship), *individuelle Initiative* (individual initiative) and *Selbstverantwortlichkeit* (self-reliance). While Menger shares with most of the members of the Social Policy School the observation that the degradation of workers was an enormous social problem, he also realized that it can only be solved by relying upon further capital accumulation based on entrepreneurship. *Individuelle Initiative* and *Selbstverantwortlichkeit* are basic terms in the discourse of economic liberalism; Menger's belief that social problems can be relieved by policies based on classical liberalism is beyond doubt. It is also necessary to indicate that the above arguments are more or less a reproduction of what Menger taught to Rudolf in the 1870s. We encountered the same terminology of 'self-reliance' in the Rudolf Lectures. At the same time, the similarity suggests that the Rudolf Lectures are not just summaries of what was already known in the general scholarly circle, but really reflect what Menger thought to be valuable from his academic point of view.<sup>6</sup>

## 5. French enlightenment and beyond

Based on secondary literature, the political ideologies of Rudolf can be summarized as follows: (1) He was against anti-Semitism. (2) He was

basically anti-clerical. (3) He was cosmopolitan and against nationalism in the narrow sense of the word. (4) He was deeply involved with enlightenment, especially French Enlightenment; and was confident that people continue to improve and in the end reach perfection, mainly due to the development of the sciences.

This section first examines a part of Rudolf's political standpoint, with special attention paid to the fourth point above. After dealing briefly with Menger's careful reservations about enlightenment, we will argue that there are some fundamental differences in opinions between Rudolf and his mentor.

First, we take a look at his descriptions of Joseph II, the son of the well-known empress Maria Theresia. Joseph II is known as an enlightened king who greatly contributed to the modernization of the monarchy through the emancipation of serfs and Jews, generous religious politics and so on.<sup>7</sup> The king was highly appreciated by Rudolf because he embodied the spirit of the French Revolution, a new spirit of the age. Before turning to the king himself, we examine Rudolf's interpretation of the Revolution, which can be neatly summarized as follows:

These ideas were cherished and advocated by the prophets of the French Revolution. Against the amorality of the French court and the King who indifferently sees the fate of the people – sucking the country dry and paying too little attention to humanity – stood people like Montesquieu and the Encyclopedists. They constructed a philosophy of humanity that included human rights and the high position of human beings among God's creations.

(Hamann, 1979: 244–5, author's translation)

After he had emphasized the importance of the French Revolution, Rudolf went on to mention writers of the French Enlightenment, such as Montesquieu and the Encyclopedists. In Rudolf's opinion, these writers contributed to the basic understanding and popularization of the ideas of humanity and human rights.

Rudolf also appreciated the efforts of Joseph II, as follows:

Joseph II lived in this great age. We must see him as a supporter of the great ideas of his time, a supporter with a crown. The revolution that came from below against the establishment of society was realized by him, standing at the top of state power to promote the welfare of the whole.

(Ibid.: 245, author's translation)

For the people in the monarchy, Joseph II endeavoured to accomplish from above what had been done in France from below. It is not unthinkable that Rudolf would have liked to complete the agendas of Joseph II if it had been possible for him. The king was certainly an icon for Rudolf; it is true that Joseph II was a great friend of French writers, a passion that Rudolf shared. Both of them were interested in Voltaire, Rousseau, Diderot and d'Alembert.

Among the personalities with whom Rudolf regularly corresponded was Moriz Szeps, a figure who deserves to be mentioned within the context of this chapter. Szeps, a well-known publicist and the editor of *Neues Wiener Tagblatt*, was introduced to Rudolf by Carl Menger himself in 1882 (Szeps, 1922: XV). Menger was very close to Szeps, and the founder of the Austrian School of Economics was seriously concerned with journalism before the publication of his 1871 book.<sup>8</sup>

Szeps continued to be an important informant for the lonely prince, not only in Austrian politics but also in international political relations. In his letter to Szeps dated 19 November 1882, Rudolf wrote the following passage:

We owe France too much for all the liberal ideas and institutions of the continent. And in all the moments when great ideas come out, it serves us always as a model. Meanwhile Germany, which is nothing more than a huge Prussian military people, was a purely military state; only it has become bigger.

(Ibid.: 17, author's translation)

Certainly Rudolf was a Francophile. The above quote shows that Rudolf was deeply involved with French ideas and institutions. Those French ideas and institutions are, in his understanding, models of other continental nations, while Germany was thought to represent a military state in the true sense of the word. Thus, Germany makes an excellent contrast to France in ideas and in its politico-economic system.

Now we turn to Rudolf's mentor, who had a different opinion. Menger thought that the main problem of Adam Smith and the French Enlightenment lay in:

[...] the opinion appearing chiefly in their writings that the institutions of economy are always the intended product of the common will of society as such, results of expressed agreement of members of society or of positive legislation. In this one-sidedly pragmatic view of the nature of social institutions, the sphere of ideas of A. Smith and

his closest followers comes into contact with that of the writers of the French Age of Enlightenment in general and of the French physiocrats in particular. Adam Smith, also, and his school predominantly strive for the *pragmatic* understanding of economy, even where such understanding is not adequate for the objective state of affairs.

(Menger, 1985: 153)

Menger argues that both the writers of the French Enlightenment and Smith thought it possible to change society and its institutions as they wished. While it is difficult to believe in the basic similarity of the Scottish and French Enlightenment, this idea is definitely contrary to the Mengerian understanding of institutions as being developed without positive intervention from above. Those interested in the history of economic thought know that Menger's understanding of institutions has continued to play an important role in later Austrian thought, from Hayek to the modern members of the School in the United States.

The point here is that Menger, the mentor, had a different picture of the French Enlightenment from the one depicted by his pupil. Rudolf was not very far from the opinion that human beings can mould society as they like, and was firmly convinced that they continue to develop into better people largely by relying upon the further development of the natural sciences. Menger was less certain about the role of reason in interpreting and changing a human society.

## 6. Conclusions

Menger advocated liberalism in the Rudolf Lectures as well as in his public finance lectures at Vienna University. In the former, he supported economic liberalism by relying on two different tides of economic thought: Adam Smith and the German economics represented by Heinrich Rau and Wilhelm Roscher. As Streissler rightly summarized, the arguments there are far reaching: Menger was a market-oriented economist with some important reservations in his lectures. This standpoint goes hand in hand with his commemorative essay about Adam Smith that was published later on.

In his public finance lectures of the 1880s, Menger emphasized the importance of progressive taxation, denying the pay-to-benefit principle. In a manner slightly different from that of the Rudolf Lectures, Menger's arguments here are fundamentally based on German and Austrian sources. Moreover, his position in the Vienna lectures can be interpreted as opening a way to the welfare state. If this interpretation

is justified, it means that the two sets of lectures are not insignificantly opposed to each other on the problem of state intervention; however, his arguments in the Vienna lectures are concerned almost exclusively with state revenue, which makes it difficult to hazard a good guess about his thoughts on the possible ways to use money for various purposes. Although Menger indicated the importance of examining state expenditure in the lectures, he was essentially silent on that subject. Thus, the final words on Menger's welfare state, if any exist, are still missing.

As a small *détour* from the main story, the last section is dedicated to the differences between Rudolf and his teacher, concerning the problem of how to interpret the Enlightenment. This is a necessary step not only in an interpretation of Menger's liberalism, but also in an examination of the relationship between the two in detail.

This chapter is still merely a halfway house on the journey towards a complete understanding of Menger's liberalism. Much more research must be done using both published and unpublished materials in the near future.

## Notes

1. Sections 2 and 4 draw heavily on Streissler (1994), Rosner (2008) and Wilke (2008). Streissler's overall interpretation of the Rudolf Lectures, a starting point for all of the secondary literature, can be summarized as follows: 'The Rudolf Notebooks show Menger to have been a classical liberal of the purest water with a much smaller agenda for the state in mind than even Adam Smith' (Streissler, 1994: 14). Rosner follows Streissler by inclining to the view that Menger was more or less an advocate of economic liberalism: 'Although he was not as combative in favour of a market economy as Mises or Hayek in the twentieth century, it would be difficult to depict Menger having been a friend of intensive regulations of the economy' (Rosner, 2008: 127). See also Wilke (2008: 159) in the same volume, positively quoting Streissler's above-mentioned interpretation. The problem now is the exact extent and flavour of Menger's liberalism. A more detailed characterization of his politico-economic ideology is needed, with which the chapter is concerned. Sections 3 and 5 of the chapter are concerned with new material and a new way to look at Menger's liberalism, thus making it possible to draw a detailed picture of his economic policies.
2. Rosner emphasized the influences of Wilhelm Roscher on Menger's two-stage theory (2008: 138).
3. This point is already indicated by Streissler. In his words: 'The actual measures envisaged are, in contrast, extremely meager, e. g. limitation of hours of work to no more than 15 a day in the case of hard labour' (Streissler, 1994: 16). We share Streissler's scepticism and are strongly suspicious of the substantial meaning of the factory act proposed here by Menger. It obviously does not lead to an improvement in workers' conditions.