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What Carl Menger Can Teach Us 150 Years after His *Principles of Economics*

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Abstract
Carl Menger's *Principles of Economics* (1871) marks the birth of the Austrian School; it was revolutionary, introducing new insights to the economic discipline that are now mainstream. One hundred fifty years later, Menger is still important. His work covered several topics: economic exchange, trade, market mechanisms, and the price system. His methodology emphasized that permanent principles and economic laws are true regardless of what politicians think is fair or just. Menger proved that most institutions are created via bottom-up processes through the voluntary interactions of individuals. He explained why it is so important that money remain connected to the real world.

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I. Introduction

The world has drastically changed in the last thirty years. Long gone are the years in which politicians across the West—on all sides of the political spectrum—hailed, or at least paid lip service to, the benefits of free trade, open markets, and limited government based on the rule of law. At least since the financial crisis of 2007 and the euro crisis in the ensuing years, many promarket ideas have largely vanished in the policy world. All this merely deteriorated in 2020—and dramatically, as the COVID-19 crisis emboldened governments to exercise powers never seen before or imaginable in peacetime. Businesses, stores, restaurants—practically all of public life—have

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been closed by governments to control the spread of the virus. The Great Lockdown has removed any thought so deeply ingrained in the Western psyche that political power needs to be constrained and that individuals have rights and liberties that no government can infringe upon.

Ironically, then, there might not be a better time for an anniversary celebration of Carl Menger than this year. Menger, who published his magnum opus, *Principles of Economics*, 150 years ago, is considered the founder of the Austrian School of economics. His contributions to the economic discipline should not be underestimated, as he made great advances in methodology and in understanding basic economic phenomena, institutions, trade, and monetary theory, to name just a few topics.

What can we learn from Menger for our world today, though? This paper explores this question. First, I take a short look at Menger's life. Second, I analyze Menger's notion of economic laws and his theory of subjective value—two different theories that nonetheless have similar implications for our political climate. After that, I dissect his theory of organic institutions. Finally, we will see what Menger's monetary theory can teach us regarding money today.

II. Carl Menger: A Biographical Sketch

Carl Menger was born on February 23, 1840, in Novy Sacz in today's Poland. Despite noble birth, he would eventually forgo his family's noble title. From 1859 to 1863, he studied *Rechts und Staatswissenschaften* (law and governance studies) in Vienna and Prague. Here he engaged with the work of several thinkers that would influence him for the rest of his life, such as Montesquieu, Smith, Ricardo, and Say.

After graduation, Menger started journalistic work, which lasted a few years. First an editor at *Lemberger Zeitung* (which went bankrupt), he started working for newspapers such as *Der Botschafter*, *Die Presse*, and *Wiener Zeitung*. For *Wiener Zeitung*, he would track and analyze the market. For *Neues Wiener Tagblatt*, which he co-published, he wrote regular economic columns. Menger founded this paper to be "a truly democratic paper for the masses" and with a low-enough price tag to make it accessible to the working class. Through his journalistic activities, Menger was first faced with the practical realities of the economy rather than theoretical musings. Indeed, as Friedrich von Wieser ([1923] 2019) recalled, "in preparing these reports, he came to realize that the facts to which the most knowledgeable experts attributed the greatest influence for explaining the formation of prices had little in common with the cost-theories taught by the Classical economists. By following the process of price formation in markets, Menger was gradually led on to the right track."

Thus, Menger's economics was closer to the realities of our world: "While Menger shared his contemporaries' preference for abstract reasoning, he was primarily interested in explaining the real-world actions of real people, not in creating artificial, stylized representations of reality" (Klein 2007, p. 7).

In 1867, Menger graduated with a PhD in law from Jagiellonian University of Krakow. He habilitated in 1872 in Vienna—the same year he met Eugen von Böhm-Bawerk and Friedrich von Wieser, who both shared similar concerns to Menger about the economic discipline. Later that year, Menger became a professor at the University of Vienna. In 1878, he was promoted to chair of political economy. As a tutor of Crown Prince Rudolph, Menger was also in contact with the Austro-Hungarian royal family. On several occasions, he played an active role in the governments of that time, including in the Ministerialpräsidium and in the Währungs-Enquete-Kommission, where he worked on monetary theory.

Menger's last published work appeared in 1914: an obituary after the early death of his friend Böhm-Bawerk. On February 23, 1821—one hundred years ago—he died in Vienna.

Aside from his *Principles of Economics*, his other main works are *Investigations on the Method of the Social Sciences* (1883), *The Errors of Historicism in German Economics* (1884), and—much shorter yet influential—*On the Origins of Money* (1892). Many of Menger's most important contributions to economics—from his opposition to historicism and positivism, to his theory of marginal value, to subjectivism, and more—may seem relatively unimportant, but that is so merely because these insights have so penetrated mainstream economics that they don't seem special to our modern eyes. How momentous Menger's insights were at his time, however, seems clear when listening to his contemporaries. For Joseph Schumpeter, "Menger is nobody's pupil and what he created stands." For Friedrich Hayek, all "fundamental ideas [from the Austrian School] belong fully and wholly to Carl Menger" (quoted in Salerno 2000).

Undoubtedly, Carl Menger lived in an interesting period of Austrian history: on the cusp of World War I and the breakdown of the Austro-Hungarian Empire, which was, however, during his university career unusually liberal and pluralistic (*Economist* 2016)—quite in contrast especially to the climate in the German social sciences, which would occupy Menger for many years in his (in)famous *Methodenstreit* with Gustav von Schmoller and the German Historical School. It is in this "battle of methods" that we shall find the first insight Menger has for us.

III. Economic Laws

It is not necessary to rehash the exact details of the *Methodenstreit* between the Austrians and the Germans again; this has already been done in great detail on other occasions.[1] However, the gist is summed up by Boettke and Coyne (2020, pp. 2ff) as follows: "The German Historical School held that economic science is incapable of producing universal principles that apply across time and geographic space. Because of this, they held that the best that economists can do is to engage in the historical study of particular circumstances, with the hope of identifying some particular patterns that are specific to the context being studied. In contrast to this view, *Menger argued that universal economic laws apply across contexts*" (emphasis added).

Indeed, much of Menger's scholarly work comes down to the argument that permanent principles, even such things as "economic laws," hold true regardless of the realities on the ground. Whereas the German Historical School focused on looking at data and history to attain certain patterns and principles, Menger and the Austrians replied that one first has to have principles to even know what to look for in the data and history. As in nature, there are principles or laws that are simply true a priori—that is, derivable from deductive thought processes independently of the data. Thus, it became one of the tasks of the early Austrians to find out what these laws are. As Friedrich von Wieser ([1923] 2019) explained, when he and Eugen von Böhm-Bawerk became acquainted with Menger's work, "we set aside our law books and we turned to the unwritten economic 'laws' of society." And, indeed, Menger started off his *Principles of Economics* ([1871] 2007) with such a law, stating clearly without allowing any doubts or loopholes, "All things are subject to the *law* of cause and effect. This great principle *knows no exception*, and we would search in vain in the realm of experience for an example to the contrary" (emphasis added).

Another such law is, for instance, the one of supply and demand—or the "market law of supply and demand" (Wieser [1923]

[1] See Bostaph (1978), Mises ([1969] 1984), and Schulak and Unterköfler (2011) for more information.

2019). It is not dependent on our worldview, on what we think *ought* to happen, or on the data of a specific time and place: If supply increases, prices go down. Or if demand increases, the price of a good goes up. There is nothing we can change about this. It simply is what it is, and when it comes to public policy, we need to take this universally applicable law into account and base our policies on this law. Ignoring it may have detrimental effects and unintended consequences, even some contrary to the goal.

This insight seems to be straightforward but is regularly ignored by governments and political figureheads around the world today. Policies are introduced that clearly violate the laws of economics. Those that point to the existence of these laws and the resulting inefficacy of policies are attacked for merely wanting to defend "class interests" or the like. Furthermore, the negative repercussions in other areas of the economy are often difficult to track (Hazlitt 1946). The list of the policies that have been introduced in recent years or are currently considered around the world that either ignore or trample on economic laws is endless, but to name just a few: minimum wages, price controls, tariff schemes, subsidy programs, regulations, and increases in market barriers (such as occupational licensing).

Menger's insight of the existence of economic laws does not call for a full abolition of all these policies. It also does not mean that we should totally discount real-world phenomena and build our theories and models merely on our a priori deductions—quite the contrary (Kolev 2019). It should, however, teach us to not ignore the implications these economic laws may have, and it shows that we should introduce government laws only if taking these economic laws into account. As Menger himself indicated in a hearing of the Austrian currency commission on March 17, 1892, these laws are inviolable. Whereas opponents may describe them—as was the case with Menger's opponents—as one's own "laws" (as in "my and your truth"), they are not subjective. They exist for us all: "In truth, these are not my laws, but, as I showed, the universal laws" (Menger [1892] 2009, p. 285).

IV. The Subjective Theory of Value

One such law—and one of Carl Menger's most substantial contributions to the economic discipline[2]—is that of the subjective theory of value. In Menger's era, there was still a lot of confusion surrounding the question of how a good attains its value. Why, for instance, is water so much cheaper than diamonds when water is essential for life but diamonds are not? Some explained that a good has an inherent value, a value unto itself. Meanwhile, the most prominent theory discussed at the time was the labor theory of value, put forth by a wide variety of economists, from Adam Smith, to David Ricardo, to Karl Marx. The labor theory of value stated that a good gains value as more work is invested in the production of the good. But would a highly technical pencil that a whole production crew has worked on for months be more valuable than a Ferrari merely because more work was invested in it? Just because more work goes into a product does not justify a higher price on the market for that product.

Menger's theory instead started with the individual, their own judgments in their economizing, and how their human choice corresponds to the relationship between means and ends (Klein 2007, p. 7). This *methodological individualism*, "which holds that people, with their unique purposes and plans, are the beginning of all economic analysis" (Boettke and Coyne 2020, p. 5), is at the forefront of Austrian economics. Or, in Menger's ([1871] 2007, p. 108) own words, "man, with his needs and his command of the means to satisfy them, is himself the point at which human economic life both begins and ends."

It is the individual, trying to find the best means to reach his or her ends and valuing goods as they are worth to him- or herself, that determines the value of a good: "The order of a good is nothing inherent in the good itself and still less a property of it" (Menger [1871] 2007, p. 58), and it is "neither the quantity of labor or other goods necessary for its production nor the quantity necessary for its reproduction" (p. 147). Value comes into being, rather, by "the importance that we first attribute to the satisfaction of our needs, that is, to our lives and well-being, and in consequence carry over to economic goods as the exclusive causes of the satisfaction of our

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[2] Joseph Salerno (2000) calls it "Menger's greatest achievement and the essence of his 'revolution' in economics," namely "the demonstration that prices are no more and no less than the objective manifestation of causal processes purposefully initiated and directed to satisfying human wants."

needs" (p. 116). Or, to put it differently: depending on how we value a good and on how much and at what price we strive to buy or sell it, the market value of the good will be set. In the marketplace, market participants come into one place with all their different value judgments and the price mechanism reflects these judgments as a price set by the subjective values of all market actors.

Once more, this should make policymakers pause to think about how much they can intrude in the market. The price system is an intricate and complex system that should only be meddled with if absolutely needed. More importantly, we should refrain from making objective value judgments in the policy world. How often do political figureheads argue that a good is "too expensive," that the salary of a worker is "too low," that we should try to make all prices in the economy "just" and "social"? No such statements can be made; the only "just price" is the one set by the economy. No good or work has an objective value. The "fair price" depends on how highly market participants value the good or service.

V. Organic Institutions

If Menger's economic laws and subjective theory of these laws already set limits to what governments can do, then his ideas of "organic institutions" should only dampen our ambition to remake the world through legislation. In this, Menger not only follows Adam Smith's invisible hand but also foreshadows Friedrich Hayek's theory of spontaneous order (Horwitz 2001): "Indeed, it is a rich tradition, going back centuries, if not even millennia, and across disciplines. . . . This tradition encompasses thinkers like Adam Smith, Edmund Burke, Carl Menger, and Roger Scruton. And this tradition has highly relevant lessons for today's world" (Weiss 2020).

Menger's theory of organic institutions attempts to answer his own question: "How can it be that institutions which serve the common welfare and are extremely significant for its development come into being without a common will directed toward establishing them?" (Menger [1883] 1985, p. 146). While the "organic view cannot be a universal means of consideration" (p. 135)—there are plenty of institutions in society that came into being by legislation—a remarkable number of institutions and processes in our political, social, and economic lives arose not from governments, and not even from the plans of voluntary communities and groups, but unintentionally from the actions of individuals working together. This includes "language, religion, law, even the state itself, and, to mention a few economic social phenomena, the phenomena of markets, of competition, of money, and numerous other social structures" (p. 146). Indeed, these institutions "in their various empirical forms and in their constant change are to no small extent the unintended result of social development" (p. 147).

If we recognize that most institutions in the world have grown throughout history through a bottom-up process, and consider not just the living but also the past and future generations, we may find that the spontaneous process of institution building is more effective and more democratic—as everyone is involved and is "voting" with his or her actions, whether he or she knows it—than top-down, one-size-fits-all planning. As Menger's followers have shown, top-down planning fails if only because of the problem of gaining the knowledge necessary to make decisions that are superior to market results (Hayek [1945] 1948). In contrast, private actors--simply pursuing their economic interest "with increased knowledge of their individual interests, without any agreement, without legislative compulsion, even without any consideration of public interest" (Menger [1883] 1985, p. 154)—may be part of beneficial processes for all of society.

This insight has largely been lost in our world, in which centralized decision-making by technocratic officials has become the primary way of policymaking. Take as an example the European Union, in which grand new schemes are envisioned every day instead of leaving local and private elements of society to pursue their own path. Take the eagerness to introduce New Deals to protect the environment and fight global warming—a strategy destined to fail—instead of leaving entrepreneurs, innovators, and private groups and communities to tackle environmental challenges (Barnard and Weiss 2020). In the coronavirus crisis in particular, there has been no thought of leaving any decisions to self-responsible citizens and communities. Rather, the technocratic idea has taken over in a singular focus on health expertise.

In this, it needs to be particularly noted that for Menger ([1883] 1985, p. 157), the state itself could be an organic institution in an ideal case too: "The state has been the unintended result of efforts serving individual interests, at least in its most original forms." Indeed, "no unprejudiced person can doubt that under favorable conditions the basis for a community capable of development can be laid by the agreement of a number of people with a territory at their disposal" (p. 156). This implies that government, under the right circumstances, can also become part of the social order if it grows organically from the community (Weiss 2020). However, for that to happen, it actually needs to be bottom-up, decentralized, truly democratic decision-making rather than a centralized approach from a capital city many hundreds of miles away from those actually affected by the policies.

VI. The Origins of Money

Menger's favorite example of an organic institution needs to be singled out for the purpose of looking at today's world: monetary policy and the origins of money (Menger [1892] 2009). We live in a world dominated by fiat paper money, which is legislated by governments and not backed by a good but merely by law. The money supply can be increased at a central bank's discretion for any spurious reason. In the eurozone, annual inflation of the true "Austrian" money supply stood at 8 percent over the two decades *before* COVID-19 even came along (Austrian Economics Center 2018). In the US, 39 percent of all money was created in 2020 (Austrian Economics Center 2021). This is not necessarily the best sign of a stable money. Overall, monetary policy has developed into a top-down tool of policymakers to direct the economy through money production, interest rates, bond purchasing, green finance, and similar policies.

But, as Menger ([1871] 2007) explains, "money is not an invention of the state. It is not the product of a legislative act. Even the sanction of political authority is not necessary for its existence. Certain commodities came to be money quite naturally, as the result of economic relationships that were independent of the power of the state."

Menger's description of how money came into being is illuminating—so much, in fact, that Menger explained it in all of his major works ([1883] 1985; [1871] 2007; [1892] 2009). Starting from the barter economy, in which goods are exchanged for goods, Menger goes step by step, showing how money comes into being without any market participant being aware of it or knowing what money is. Some goods that are simply particularly "saleable" (Menger [1892] 2009, p. 21)—they have certain qualities that will eventually make for good money—are being used by market actors not primarily for consumption but for further exchange. Thus, they become exchange goods: "Initially, according to varying conditions, these are heads of cattle, hides, cowrie shells, cocoa beans, tea tiles, etc.; with advancing culture they are metals in the uncoined state, then in the coined state. They are, indeed, accepted even by people who have no immediate need for these goods or have already covered this need sufficiently. In a word, in trade markets certain wares emerge from the sphere of all the others and become means of barter, 'money' in the broadest sense of the word" (Menger [1883] 1985, p. 152).

Of course, "it is not impossible for media of exchange . . . to be instituted also by way of legislation, like other social institutions" (Menger [1892] 2009, p. 38). But generally, moneys come into being as an "establishment of social procedure . . . as the spontaneous outcome . . . of particular, individual efforts of the members of a society" (p. 38).

Thus, market participants choose their currency without actually realizing it simply because they find it particularly useful for the purpose of exchange. This may be based on factors such as how easy it is to carry and exchange, whether it is durable, whether it could also be used as an actual good after all (or is at least backed by a good), whether it is stable and decentralized (so that it is difficult to simply increase or decrease the money supply by the producer or by diktat), and whether it can be broken up into smaller parts easily. It may also be based on social and cultural factors (for example, cigarettes may work well as money in prisons, but not in our culture today).

Our moneys today are far away from this: they are not the result of bottom-up, organic processes; monetary policy has often become centralized and top down, an area in which governments have "so greatly misused their power" (Menger [1871] 2007, p. 283). Money is mere paper money instead of an actual good or at least a backed currency, such as that under a gold standard. Because of excessive inflation, it is not stable. And it is anything but decentralized, in contrast to, for instance, cryptocurrencies. Without a doubt, almost all currencies today would fail Menger's test of good money. He would have argued for greater decentralization, more technological innovation, policies that ensure stability, and potentially even the denationalization of money. His criticism of government's handling of money in his time certainly rings true for ours as well: "The fact that governments treated money as if it actually had been merely the product of the convenience of men in general and of their legislative whims in particular contributed therefore in no small degree to furthering errors about the nature of money" (p. 283).

VII. Conclusion

Carl Menger's work changed the economic discipline in a long-lasting way; and his contributions have become so mainstream that we don't even see his influence fully anymore. He founded the Austrian School of economics, and "the core concepts of contemporary Austrian economics—human action, means and ends, subjective value, marginal analysis, methodological individualism, the time structure of production, and so on—along with the Austrian theory of value and price, which forms the heart of Austrian analysis, all flow from Menger's pathbreaking work" (Klein 2007, p. 10).

But even now, 150 years after his *Principles of Economics* was first published and a century after he left the Earth in 1921 at the age of eighty-one, his contributions can teach us many things. As we have seen, many of Menger's main points imply a humility in policymaking that is deeply lacking among our governments today. Objective value judgments about economic results are made that are wholly arbitrary. At the same time, the reality of economic laws is fully denied, and policies are introduced looking simply at the direct results, not the unintended consequences and other potential side effects. Policymaking continues to be made top down, far away from those affected. The belief that through market and societal processes institutions and beneficial results can come about is deemed as a naive belief in neoliberalism. Equally, money is something that we can simply use in whatever way we think is best—even if a collapse is likely.

Obviously, we don't know what Menger would have thought of all this. Looking at his theory, however, we may say that as intellectual descendants of Menger, we should embrace his ideas and call for a more decentralized, hands-off, and limited policymaking that expands freedom, human agency, and the opportunities for individuals to work together and collaborate—and brings forth new organic results that benefit our world.

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