

CARL MENGER: THE LEADER OF THE AUSTRIAN SCHOOL

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From the end of the 19th century until after the end of the First World War there were great economic fluctuations, when the economists tried to achieve social justice with the transfer of income from the rich to the poor. Thus the idea for the study of economic equilibrium and income arose while the idea of the freedom of trade and competition came back into the policy of most countries. In that climate the ideas of Jevons, Menger and Walras were formulated (around 1870).

Toward the end of the 19th century and beginning of our century appeared the Austrian or Psychological School or the Subjective School, or the Vienna School¹ headed by Carl Menger and his adherents Böhm-Bawerk and Friedrich von Wieser, who with the founder of the Mathematical School² or the School of Economic Equilibrium or the Lausanne School Léon Walras, and his successor Pareto who both

1. N. Smart: *An Introduction to the Theory of Value of the Lines of Carl Menger, Böhm-Bawerk Friedrich Wieser*, London, 1920. P.N. Rosenstein Rodan: *The Theory of Marginal Utility*, 1938. F. Perroux: *La Valeur*, Paris, 1943. G. Pirou: *L' utilité marginale* (de Carl Menger à John Bates Clark), Paris, 1945. Ch. Cornelissen: *La Valeur*, Paris, 1927. L. Th. Houmanidis: *E Epokeimeniki peri axias theira apo tis epohis ton physiocraton mechri simera*, (in greek) Athens, 1954. G.J. Stigler: *Utility Theory* in "The Journal of Political Economy", Vol LVIII, No. 1, 1950. N. Anagnos: *The Economic Theory of the Austrian School*, in "Archeion Ekonomikon kai Koinonikon Epistimon" (reprint), Athens, 1965.

2. G. Pirou: *Les Théories de l'Equilibre Economique*, Paris 1944 – L. Houmanidis: op. cit.

taught in Lausanne, were called hedonists from the nature of the hedonistic principle of the greatest benefit from the least sacrifice, which they maintained.

The originator of the first School was H.H. von Gossen (1810-1858) who in his work *Entwicklung des Menschlichen Verkehrs* (1854) formulated the law of satiety in which the needs are divided up and are satisfied by section until satiety appears. According to Gossen man achieves the acquisition of direct goods through the proper combination of indirect goods, having in view the hedonistic principle, which is combined with the law of satiety. The production of direct goods relates to this so that the last unit of each produced good has the same value for the producer. The pioneer of the second School was A. Cournot (1801-1877) who in his work *Recherches sur les principes mathématiques de la théorie des richesses* (1838) and through the demand curve depicted the demanded amount as a function of prices. He also wrote the works: *Exposition de la théorie des chances et des probabilités* (1843). *Traité de l'enchaînement des idées fondamentales dans les Sciences et l'Histoire* (1862, Vol. I, II), *Materialisme, Vitalisme, Nationalisme*, (1875). Schumpeter mentions as a precursor Achille Nicolas Insard an engineer who wrote, *Théorie des Recherches* (1781) (J. Schumpeter: *History of Economic Analysis*, p. 217). In 1904 in Moscow was published *Economieskie Oerki* by V.K. Dimitriev following the path opened by the School of Lausanne of Warlas, but of not of the same calibre. The above work of Dimitriev was translated into French by B. Joly under the supervision of A. Zaubermann and H. Denis in the editions of the "Centre National de la Recherches Scientifique", Paris (1968).

Menger and his followers, argued their theories on abstract hypotheses but attempted to succeed in the construction of an ideal world in which everyone is moved according to his own interest³.

According to the hedonists the economist does not need to concern himself with all the manifestations of social life, but only with the economic phenomena, as these belong to a separate world, believing that this manner of confronting economic problems simplifies the field of investigation of the economist. The application of their system to reality they leave to men of action and politics. The hedonists did not examine how the market is moved but how it will move if each person seeking his own interest achieves this, leaving it to be understood that the person of reality is obliged to follow this road for his own good and for the general good. In addition, for the hedonists, the principle of the greatest amount of satisfaction for the greatest amount of people must regulate the conduct of state leaders, who must distinguish

3. The naturalism of these schools Professor Amintore Fanfani called the "naturalism of convenience" (naturalismo della convenienza). (A. Fanfani: *Economica*, Brescia, 1953, p. 64).

for this the greatest utility for a community and the greatest utility of community⁴, viewing this as subjective (Pareto) of a reserve good is measured by the utility which is offered by the last unit of the reserve of this good.

The leader of the Psychological School, Carl Menger (1840-1921) acquired great fame as an economist during his academic life as well as after his death. The fame of Menger is due to the marginal analysis of the utility theory⁵ and his systematic investigation and classification of the elaborated subjects. Professor of the University of Vienna till 1903 and an academician, Menger wrote several works and studies among which is *Grundsätze der Volks wirtschaftslehre* (1871) only one volume of which was published, because at the time he was involved in a battle with the Historical School and then with Schmoller (the famous Methodenstreit) about which he published his study, *Untersuchungen über die method der Socialwissenschaften und der politischen Oeconomie insbesondere* (1883).

Carl Menger divided goods into two basic categories: a category of goods of a *higher order* (Höererer Ordnung), the indirect goods or productive goods and into goods of a *lower order* (Erster Ordnung), or consumption goods.⁶ The value of indirect goods, is determined by the value of the goods produced by them.⁷ The indirect goods, in the procedure by which these produce direct goods, are combined with the elements of *time* and *risk*.⁸ And this is because for a good to be produced time is required, which depends on the nature of the good under production as well as the possibility of its production. The element of time has significance in relationship to the short or long period of time needed to satisfy needs into which

4. "The hedonists" Pietre says, "tried to set up Political Economy as Pure Political Economy giving it a completely abstract meaning". (A. Pietre: *Pensée Économique et Théories Contemporaines*, Paris 1965 p. 80). This does not mean though that they did not aim at wedding theory to action or were against the acceptance of applied rationalism (Gilles - Gaston - Granger: p. 4). Already, Cournot considered mathematics as being of secondary importance in relation to reality which is why on the one hand he accepted the State concern for the social group and on the other private initiative in a way that the natural laws of private initiative would not be abandoned, because they are the regulators of things. Thus, economics was for him a synthesis of logic and history and instances of that thought are found not only in Walras but also in Pareto. (Gilles - Gaston - Granger: *Méthodologie Économique*, Paris 1955 ib.).

5. Among these writers is Galiani. See L. Houmanidis: The paradox of value is Ferdinando Galiani in «Wirtschaftskräfte und Wirtschaftswege» Band IV Übersee und allgemeine Wirtschaftsgeschichte (Festschrift für Herman Kellenbenz), 1978 p. 599 ff.

6. C. Menger: *Grundsätze*, Italian trans: *Principii Fondamentali di Economica Politica* (Preface Maffeo Pantaleoni), Bari, 1927, p. 27ff.

7. C. Menger: p. 36

8. C. Menger: p. 37

slips the element of risk. The immediate possibility to satisfy our need of consumption goods, which we already have at our disposal, excludes the element of risk, but such is not the case with the uncertain quantity and quality of goods which we expect them to have in the future.

And on the basis of this assumption Menger observes: "In every day life, the buyers of goods of a higher order, necessary for the production of a direct good, never pay the foreseen price for it, but much less".⁹

The value of direct consumption goods, according to Carl Menger, is determined by the intensity of the need for these and the change of this relationship changes their value. In consequence the measure of value is in its entirety subjective and hence for every good's value utility by itself is not enough but its scarcity is also taken into account. A person, Menger says, always endeavors to satisfy his most urgent needs, each need puts pressure on him with particular emphasis and from this is determined the value of the goods by which the needs are treated. So that the value of goods depends on subjective evaluation of the kind and of the intensity of this to the satisfaction of need in relationship to the reserve of the good through which this is to be satisfied. And Menger added his famous Table¹⁰ on which each horizontal arrangement of Roman numerals shows the needs according to the degree of importance and the vertical arrangement of arabic numbers the intensity of each of these needs.

In the beginning are placed the most urgent needs (food, clothing, shelter, etc) followed by the less urgent needs (alcohol, tobacco) followed by the least urgent needs which relate to travel, entertainment, etc.

Menger's Table verifies that the diminishing intensity of need parallels the diminishing utility; the result is that the endeavor to satisfy these various needs according to this intensity is observed in the physiological man¹¹.

9. C. Menger: p. 195

10. C. Menger: p. 158ff.

11. Menger added to the table the aims of economic development according to utilitarian preference, as well as, by extension, concepts on the development of the economy. (A. Graziani: *Teoria delle scelte negli investimenti pubblici*, Napoli, 1960). Besides marginalism constitutes a general theory of the strategy of the production and the consumption of human goods (Gilles - Gaston - Granger: p. 4).

I	II	III	IV	V	VI	VII	VIII	IX	X
10	9	8	7	6	5	4	3	2	1
9	8	7	6	5	4	3	2	1	0
8	7	6	5	4	3	2	1	0	
7	6	5	4	3	2	1	0		
6	5	4	3	2	1	0			
5	4	3	2	1	0				
4	3	2	1	0					
3	2	1	0						
2	1	0							
1	0								
0									

On the basis of his ideas concerning value Menger distinguishes three instances in the formulation of prices:¹²

1. **The formulation of price between two individuals.** In this case each of the exchanges enters into the exchange of his good with the good of the other, since he believes that the exchange will be of benefit to him.

This evaluation occurs through the comparison by calculation of what amount of units of the good possessed by him it is in his interest to exchange for units of the good which he desires. If it is a question of money coming into the exchange then the highest price will be determined at the evaluation of the buyer and the lowest at the evaluation of the seller. The price that will be realised falls between these two limits.

2. **The formulation of price in the instance of one seller and many buyers.** In this instance the following is observed:

a) If the seller has a singular and indivisible good, then its price is formulated to its marginal utility which it gives to each of the buyers; he who has the greatest need will pay the highest price and displace the rest of the buyers. b) If, however, the seller has more units of the good, then many prices are formulated, the first unit having the highest value because it will be purchased by the strongest of the buyers. However, this happens only when the units of the good are offered in succession. In the contrary case, when the units are offered in succession. In the contrary case, when the units are presented simultaneously, then the price that will be formulated will, be singular, fluctuating between the price offered by the weakest of the satisfied buyers and the price offered by the strongest of the exclusive buyers.

As for a monopoly, Menger maintains that the interest of the monopolist is to increase the production of his product and bring down prices through various methods

12. C. Menger: Italian trans p. 237ff and also G. Pirou: *L' utilité marginale*, Paris, 1945, p. 50ff.

of improving the conditions of the production of the product. Thus the circle of consumers will be widened because weaker buyers which were excluded by the stronger will be attracted.

3. The formulation of price in the instance of competition of many buyers and many sellers. In this instance the formulation of price will be on the one hand lower than the lowest price offered by the satisfied buyers and the lowest price offered by the exclusive sellers and on the other it will be higher than the price offered by the strongest of the exclusive buyers and higher than the price asked by the most expensive seller who has affected the sale. In this way a singular price is formed after competition, the motive of which consists in the sellers selling with the most profit possible and the buyers buying at the price suited to their interest.

In accordance with his theory concerning value, Carl Menger based his view of the formulation of prices on the marginal utility of those supplied and demanded goods through their individual evaluations, that is, the intensity of the final satisfaction of the needs of the exchangers. In addition, Menger via his theory of marginal utility managed to avoid the tautology in which the theory of objective value terminates. Because the value of the factors of production is explained through cost or labor, which includes labor, i.e., through cost or labor which was expended for these factors. Menger, however, who was followed by Bawerk and Wieser avoided this tautology in his theory in which the value of the indirect goods is determined by the value of the direct goods produced by them.

Examining the rest of the economic phenomena, Carl Menger observed about the labor wage that the future value of a produced good (direct good) is that which determines the demand for labor and since the buyers of indirect goods necessary for the production of a direct good never pay the price expected for it but much less, the wages received by the worker is paid to him as a kind of advance payment for his contribution.¹³

Also we have the capital used to produce the direct goods on which, according to the theory of Carl Menger, the value of the indirect goods is dependent. However, until the direct goods are produced a period of time is required in which, so to speak, the value produced by capital is pre-paid as interest. With the interest it is also necessary to take into account the danger in the case of the withdrawal of capital for use by another person as a loan¹⁴, while the businessman is rewarded from the total of the produced product through his business activity.

As for land rent in relation to the Ricardian theory, Menger observed that this only explains certain changes, entirely overlooking the significance which land has through demand. The viewpoint of Ricardo concerning the varying fertility of various

13. C. Menger: p. 197.

14. 15. C. Menger: p. 195.

lands is certainly correct but he did not take into consideration the evaluative judgment of man of goods, overlooking the significance of the marginal utility of the production factors, the price of which is determined by the marginal utility of the goods produced from them. The characteristic of land, Menger said, is that it is immovable, limited, not easily increased, of varying quality and therefore rare, so that when there is a large demand for products of the land their price will be higher.¹⁵ Hence land rent.

Menger expanded his psychological theory also to relate to the value of money.¹⁶

Money, according to him, is considered a good, having the property of use as a good — means of exchange, differing from the other commodities in that they cease being commodities during their consumption while money become a commodity the moment it comes into circulation.¹⁷ The demand for money depends on its utility and its scarcity. When we speak about scarcity we mean the relationship between the need for money and the amount of it there is.

Menger, distinguishing between the factors which have an influence on the value of money, maintained that these are due either to this money itself or to the commodities. He distinguishes a *quantitative internal factor* of the increase of the amount of money in the case where this increase is automatic and arises from the demand for money as a consequence of the increase of prices of the volume of exchange, and a *quantitative external factor* when the increase of the prices and the volume of the exchange give rise to an increase in the amount of money.

Carl Menger then proceeded to two basic observations:¹⁸ If, he says, the increase of the value of money is due to hoarding, then the factor involved here is *internally subjective*. If again this hoarding is the result not of a tendency toward the preservation of liquid assets, but of the fall of prices which is due to a decrease in the value of commodities, then the factor is *externally subjective*.

In conclusion, Menger maintained that the value of money depends on the sum of the amount which the individuals need to dispose of in exchange for the success of their works and their personal expenditures.¹⁹

16. H.B. Bilis: *German monetary theory 1905-1933*, Harvard University Press, 1934. E. Bongras: *Les théories monétaires allemandes contemporaines*, Paris, 1930 and G. Pirou: *L'Utilité Marginale*, p. 221 and Tj. Griedanus: *The Value of money* (English tr.), London p. 55.

17. C. Menger: pp. 326-328 ff. Also concerning money according to Menger see his work *Das Geld* in "Handwörterbuch der Staatswissenschaften" Vol. IV, 1905. English trans C.A. Foley in "Economic Journal", Vol. II (1892).

18. C. Menger: p. 386ff.

19. C. Menger: pp. 606-608 Tj. Griedanus: p. 55.

Carl Menger is one of the Great Economists. He formulated his theory, his own theory belonging entirely to his — as also to Jevons and Walras.²⁰ Menger was nobody pupil and if has not conceived a sociology or any explanation of History undoubtedly he contributed to the theory of value and price as also of distribution.²¹ So Schumpeter was right to carecterize Menger with the following words: “With the autonomy of scientific greatness, the lifemark of Menger stands out in sharp relief against this background — Schumpeter means the old theories — without external stimulation, and certainly without external help, he attacked the half-ruined edifice of economic theory”.²²

20. 21. J. Schumpeter: Ten Great Economists, London 1966, p. 87.

22. J. Schumpeter: p. 82.