

PREFACE: AUSTRIAN ECONOMICS FROM MENGER TO HAYEK

Barry Smith

The Austrian school of economics has its beginnings in the publication, in 1871, of Carl Menger's *Principles of Economics*, a brilliant demonstration of the possibility of an economics which would be at one and the same time truly theoretical ('exact') and also subjectivist. Thus the laws of the theory, laws of economic action and of economic value, are in every case related by Menger to individual utility, individual perception and individual decision in such a way as to embrace the recognition that all social phenomena are the result of human activity, all value the result of individual preference. An economy is not, from this subjectivist point of view, an autonomous formation with unintelligible properties of its own (it is not, for example, the circular flow that one finds represented in the standard textbooks). Rather, one can *understand* the workings of an economy. One can see, for example, how the value of goods at earlier stages in the productive process is in every case derived from the value to actual consumers of the products of the later stages.

The phrase 'Austrian school' was at first employed as a term of denigration by opponents of Menger's ideas, above all by the members of the German historical school. For in contrast to its more developed neighbours to the west, Austria at that time could look back on almost no important theoretical or scientific achievements of her own. Moreover, Austrian intellectual life was still permeated by an underlying philosophy of Aristotelianism and scholastic realism, a philosophy which must have seemed, from the perspective of a forward-looking and enlightened Germany, with its Kant and its Hegel, merely quaint and old-fashioned. Paradoxically, however, it was at least in part this Aristotelian background which enabled Menger to make theoretical advances of a sort which were ruled out by the narrow inductivism of his German contemporaries. For Aristotle had insisted that there are qualities, for example, of action or knowledge or of more complex social phenomena, which are knowable a

priori. Such phenomena thereby satisfy laws which do not stand in need of being inductively established. Menger was thus drawn to seek out such laws in the economic sphere, setting in train a tradition of research which can now be seen to have contributed much to our understanding both of the nature of the economic sphere and of the limits of economic theory.

The first-generation members of the Austrian school, Böhm-Bawerk and Wieser, were both, like Menger, professors of economics in Vienna, the latter in particular carrying forward Aristotelian ideas of the sort utilised earlier by Menger. Austrian economics then took part in that renaissance of intellectual and cultural life which is so characteristic of *fin-de-siècle* Austria. One can point, for example, to the names of Schumpeter, Mises, Mayer, Schönfeld-Illy, Rosenstein-Rodan, as well as to Austro-Marxists such as Hilferding and Otto Bauer who were also influenced by the thinking of Menger. It was above all, however, the circle of thinkers around Ludwig von Mises who did most to establish the characteristic methods and insights of the Austrian school—particularly in relation to the now increasingly influential Austrian theory of the trade circle—and to spread the Austrian ideas beyond the borders of Austria herself. Mises' circle included not only economists such as Hayek, Haberler, Machlup and Morgenstern, but also philosophers such as Felix Kaufmann and Alfred Schütz. Its influence is seen, for example, in the work of Lionel Robbins, but also—and more radically—in the philosophically challenging extreme subjectivism of G.L.S. Shackle.

Austrian economics in the present day is represented above all by Friedrich von Hayek, by Ludwig Lachmann, and by Israel Kirzner. Lachmann has perhaps done more than any other thinker within the Austrian tradition to push back the limits of subjectivism, particularly in relation to the role that is played by individual expectations in economic theory. Kirzner, who has developed and refined many of the ideas of Mises and Hayek on the role of knowledge and error in economic action, has shown how it is possible to utilise Misesian ideas on entrepreneurship in a way which has powerful consequences for economic theory in general and for our understanding of competition and the market in particular.

Competition, in the Austrian view, is never 'perfect'. The plans and expectations of distinct market participants are never even approximately in harmony with one another. Yet there are manifest benefits of market competition, benefits of a sort which, as the early Austrians did much to

demonstrate, would seem to be incapable of being simulated by, for example, a centrally planned economy. How, then, are such benefits to be understood? Classical economic theory has tackled this problem almost exclusively by examining the properties of the equilibrium state—a state which involves perfect harmony of all participants' plans—and by demonstrating mathematically why this state, for given—fixed—external conditions, is preferable to all others. Thus it has paid little attention to the problem of how the benefits of competition and of the market can be understood under the actually prevailing circumstances of endemic imperfection and of constantly changing external conditions. Austrian economists, in contrast, think not in terms of an ideal *state* of achieved equilibrium but rather in terms of a faltering *process* of always partial movement towards such an ideal state. Kirzner, in particular, has shown how it is the perception of disharmonies or of the mismatches of plans on the part of individual entrepreneurs that serves as the motor giving rise to a tendency towards relatively greater harmony, and thereby to the realisation of economic opportunities hitherto unexploited. But now the entrepreneur's task, in a view of this sort, is not, as in the classical (Robbinsian) view, one of *calculation*, as if the means and ends of economic activity were already identified and all that remained would be to fit the one to the other in the most rational possible way. The entrepreneur rather *discovers* these very means and ends themselves—or indeed he brings them into being by a process of serendipity.

We said that Menger's recognition of the possibility of an exact or a priori theory in economics has contributed to our understanding both of the economic sphere and of the limits of economic theory. In fact, the consequences of Menger's work extend much further, showing us the way to a more adequate understanding of large-scale social formations in general, both within and without the economic sphere. It is above all Hayek who has done most to show how we can refine and deepen Menger's insights to the point where we can understand—albeit at a level of generality and of theoretical abstractness which rules out prediction and quantification—even the ways in which such social formations may represent the *unintended* consequences of individual actions, that is, the consequences of actions directed towards other, quite disparate, ends. Building on the work of Menger, Hayek has provided a theory of spontaneous orders in society which has implications for our understanding

not only of economic formations but also of language, law, religion, politics, morals, and indeed for the subtle inner workings of scientific theory itself.

The present volume is a detailed treatment of the historical and philosophical background of the Menger tradition in nineteenth- and twentieth-century Austria. It puts forward an interrelated collection of ideas and theories, from both philosophy and economics, in a way which will, it is hoped, contribute to future research both on the Austrian background of the Austrian school and on the wider interplay between economic value theory on the one hand and general (philosophical) value theory on the other.

At the centre of the volume is the work on value and on philosophical method of the Brentano school, and the volume includes a unique study of the relations between the Austrian theory of values and the new economic approach to human behaviour propounded by Gary Becker and others in Chicago. It also includes considerable bibliographical material on general value theory which it is hoped will be of benefit both to philosophers and to economists with an interest in the field.

The seeds of the volume were planted at a symposium on 'Austrian Economics and Its Philosophical and Historical Background' which was held in Graz, Austria, from 27 to 31 July 1980. Of the participants in this symposium who are not represented here, the editors would like to thank in particular Professor Israel Kirzner, who is in many ways responsible for the fact that this volume exists at all, and, for his unfailing encouragement and guidance, Kenneth S. Templeton Jr. of the Liberty Fund, by which the Graz symposium was sponsored.