

THE NEXT GENERATION OF AUSTRIAN ECONOMICS

ESSAYS IN HONOR OF JOSEPH T. SALERNO

EDITED BY
PER BYLUND AND DAVID HOWDEN

MISESINSTITUTE

Published 2015 by the Mises Institute. This work is licensed under a Creative Commons Attribution-NonCommercial-NoDerivs 4.0 International License.
<http://creativecommons.org/licenses/by-nc-nd/4.0/>

Mises Institute
518 West Magnolia Avenue
Auburn, Alabama 36832
mises.org

ISBN: 978-1-61016-593-8
eISBN: 978-1-61016-636-2

UNSUSPECTED ORIGINS OF MODERN AUSTRIAN ECONOMICS: THE HISTORICAL SCHOOL OF ECONOMICS ON CAPITAL AND ECONOMIC CALCULATION

EDUARD BRAUN*

The Historical school of economics does not enjoy the best reputation among present-day economists, but especially the Austrian school appears to be out of sorts with its former adversary in the *Methodenstreit*. It seems fair to say that David Gordon's (1996, p. 7ff.) account, according to which the members of the Historical school bluntly rejected economic laws like the principle of supply and demand, is generally accepted among Austrian scholars today. In the English-speaking world, Friedrich von Hayek, Joseph Schumpeter, and Ludwig von Mises are mainly responsible for this state of affairs (Hodgson 2010, p. 296; Grimmer-Solem and Romani 1998, p. 268).

*Eduard Braun holds a postdoctoral position to the chair of economics at Clausthal University of Technology, Clausthal-Zellerfeld, Germany.

I attended the Mises University in 2007 and was a summer research fellow in 2008. The present chapter is an outflow of my introduction to and study of German economic thought between 1800 and 1950, which I became interested in while a summer fellow at the Mises Institute under the direction of Professor Salerno.

I do not try, in this chapter, to overturn this negative judgment. However, I would like to point out that there are some elements in the body of Austrian Economics that definitely stem from the Historical school. Surprisingly, the Historical school acts as the model for Mises's capital concept and, by implication, for his economic calculation argument against socialism. Mises's discussion of the fundamental difference between capitalism and socialism does not, or not only, rest upon praxeological reasoning. In fact, the same praxeological laws apply in both capitalism and socialism. In order to make his case, Mises has to presuppose several *historical* institutions that only exist in developed and monetized market economies. In this context, he draws on concepts developed by the Historical school. It was not necessary for him to acknowledge his debt to this school — and possibly he was not even aware of it — because he could act on the authority of Carl Menger, at least regarding the capital concept they both employed. Carl Menger himself, however, derived the capital concept on which Mises would later rely directly from Richard Hildebrand, a member of the Historical school. Like in monetary theory (see Gabriel 2012, p. 41), the influence of the Historical school on Mises concerning capital theory was an indirect one — via Menger.

The present chapter starts, in section 2, with a short presentation of how Menger, in 1888, changed his point of view on capital, and continues, in section 3, with the demonstration that Menger, in adopting the new and different view, made a step toward the Historical school. Section 4 traces this historical point of view on capital in Ludwig von Mises's writings. It cannot be said that section 5 demonstrates, once and for all, that Mises implicitly admitted that economics is, in some sense, a historical science. But it tries to indicate the difference he made between praxeology and economics. The former he calls the *general* theory of human action, but the latter he does not consider to be entirely free from historical preconditions. Finally, section 6 contains a short discussion of Albert Schäffle's analysis of economic calculation as a central institution of capitalism. Apparently, Mises argument against the feasibility of socialism was at least foreshadowed by a member of the often ridiculed Historical school.

CARL MENGER ON CAPITAL

Carl Menger changed his point of view on capital theory considerably between 1871 and 1888 (Schumpeter 1997, p. 187; Braun 2014). He did not discuss capital very deeply in his *Principles* (Stigler 1937, p. 248), but to the extent he did, he advocated a capital theory that is concerned with

production. His capital theory was connected to his vision of the production process as divided into several successive stages, where consumer goods result from the successive processing of combinations of higher-order goods to lower-order goods. Menger (1871, p. 155) says that one possesses *capital* if one “already has command of quantities of economic goods of higher order ... in the present for future periods of time.” By adding this aspect to production theory and associating it with capital theory, he laid the groundwork for Austrian capital theory as developed by Böhm-Bawerk (1930), Friedrich von Hayek (1941), and Ludwig Lachmann (1978).

It is seldom recognized that by 1888 Menger had changed his view. In a long article on the subject — *Zur Theorie des Kapitals* (A Contribution to the theory of capital) — Menger proposed a radically different vision of the scope of capital theory. Streissler (2008, p. 371) is of the opinion that, by writing his article, Menger only made a prepublication attempt to refute the theory of Böhm-Bawerk. However, it seems more probable that Menger turned against *all* capital theories — including his own one — which have been developed by economists in disregard of everyday language use and established business practices. At the very outset, he declares that it is

a mistake that cannot be disapproved of enough when a science ... denotes completely new concepts by words that, in common parlance, already describe a fundamentally different category of phenomena — a category that is also important for the respective discipline — correctly and properly (Menger 1888, 2).

It could be suggested that he was referring mainly to Böhm-Bawerk’s theory in this quote. However, there is every indication that Menger also implicitly revoked his earlier point of view. For the common parlance concept of capital is not identical with his own one from the *Principles* at all. In Menger’s (1888, p. 37; emphasis added) words, the common parlance view has nothing to do with the production process or the different orders of goods:

When businessmen and lawyers speak about capital, they do mean neither raw materials, nor auxiliary materials, nor articles of commerce, machines, buildings and other goods like this. Wherever the terminology of the Smithian school has not already penetrated common parlance, *only sums of money are denoted by the above word.*

He hastens to add that capital only embraces sums of money that are *dedicated to the acquisition of income*, and that “sums of money” not only refers to plain money, but to the *monetary value* of all kinds of business assets in economic calculation.

Menger thus switched sides in a debate that seems to be as old as economics itself. Does the term “capital” refer to a *production factor* or does it refer to the organization of the market economy by calculating entrepreneurs who maximize the monetary yield on their *financial capital*? At a first glance, the distinction between these two viewpoints does not seem to create a great problem. To give an example, even Mises (1949, p. 260 ff.) contains traces of *both* concepts of capital. He reserved the plain term “capital” for the economic calculation of entrepreneurs but, for lack of a better term, he referred to the produced goods of higher orders as “capital goods.” The next section will demonstrate, however, that the two sides of the term capital do not fit together harmoniously; rather they roughly correspond to the two sides of the *Methodenstreit* between the Austrian and the Historical school of economics. Menger’s earlier concept was elaborated to Austrian capital theory, whereas his concept of 1888 turns out to be the one endorsed by the Historical school.

THE HISTORICAL SCHOOL AS THE SOURCE OF MENGER’S LATER VIEWPOINT ON CAPITAL

The first thing that must be mentioned is that Gustav Schmoller, Menger’s principal opponent in the *Methodenstreit*, was quite happy with Menger’s later standpoint on capital theory. In his *Grundriß der allgemeinen Volkswirtschaftslehre*, Schmoller (1904, p. 180; emphasis added) appreciated Menger’s step toward the common parlance concept of capital:

Where one has provisions of goods in mind that technically serve further production, one *may* also use the term capital; often it will be better to say acquisitional wealth. *All in all it seems to me to be the right thing to return, with C. Menger, to the capital notion as established in business life.*

In fact, it can hardly surprise that Schmoller welcomed Menger’s shift of opinion. In his 1888 article, Menger clearly adopted the viewpoint of the Historical school of economics.

It is easy to demonstrate this point. When Karl Rodbertus (1843, p. 23ff.) made, probably for the first time in the history of economic thought (Jacoby

1908, p. 27), the distinction between social and private capital — between capital as a production factor and capital as a means of acquisition and calculation denominated in money — he ascribed each term to a distinctive problem area. For him, social (or real) capital is a universal, absolute, and pure concept that can be defined independently of time and place. It is the capital concept that *he* thought is apt for economic science. Private capital, on the other hand, only has relative importance. It results “from the arbitrary ingredients of a *historical* state of affairs. It would disappear if profit-yielding property disappeared” (Rodbertus 1843, p. 24, n.; emphasis added).

In other words, the capital concept which Menger used in his *Principles* and which later Austrians like Böhm-Bawerk, Hayek, and Lachmann adopted (and which relates to Mises’s “capital goods”) can be found in any economic system and in any time period. Individuals in isolation, like Robinson Crusoe, employ higher order goods in the same way as a socialistic and a capitalistic society does. It is a general theoretical concept and independent of historical factors. Monetary calculation, on the other hand, which is the background of Menger’s later (1888) capital concept, is only a *historical* phenomenon. It is neither part of Robinson’s island nor of a socialist society. It only appears in a developed and monetized market economy where property rights to the means of production are enforced. Later on, German economists like Adolph Wagner generally referred to this concept of capital as the *historical-legal* one (Jacoby 1908, p. 28).

That Carl Menger adopted the viewpoint of the Historical school becomes even more obvious when one compares his 1888 article with what Richard Hildebrand had written five years earlier. Hildebrand, a member of the Historical school teaching in Graz, Austria (Schulak and Unterköfler 2011, p. 25), had written a book on monetary theory that contained one chapter on capital. There, he clearly foreshadowed Menger’s later position. First of all, like Menger (1888), he rejected the efforts of economists to create capital concepts that deviate from common parlance. Hildebrand (1883, p. 72, n. 35) counters the

idea that the capital concept is open to arbitrary terminology at all, or that science, in a way, has to create or invent the concept in the first place. To the contrary, the concept of capital ... is a fact that is already given by economic life.

Second, Hildebrand’s positive view of the common parlance concept unsurprisingly coincides with Menger’s. He (1883, p. 74, n. 35) states that

“capital indeed can only be thought of or imagined as a certain sum of money,” and, like Menger, he immediately adds that capital also comprises real assets in so far as they have or represent monetary value.

LUDWIG VON MISES ON CAPITAL

As opposed to nearly all other Austrian economists to the present day, Ludwig von Mises did not follow Menger’s discussion of capital as contained in the latter’s *Principles*, but was oriented toward the 1888 article on capital theory. This shines through, for the first time, in his treatise on *Socialism* where he explicitly refers to Menger (1888) and states:

[W]e must first ask what significance is attached to the term [capital] in business practice. ... The concept of capital is derived from economic calculation. Its true home is accountancy — the chief instrument of commercial rationality. Calculation in terms of money is an essential element of the concept of capital. (Mises 1951, p. 123)

In his *Human Action*, Mises went a step further and not only stuck to the monetary notion of capital, but explicitly rejected the social (or real) capital concept. He (1949, p. 262) called it a confusion to argue, as some economists do,

that “capital” is a category of all human production, that it is present in every thinkable system of the conduct of production processes — i.e., no less in Robinson Crusoe’s involuntary hermitage than in a socialist society — and that it does not depend upon the practice of monetary calculation.

So in fact, without admitting it though, Mises adhered to the capital concept developed and called for by the Historical school of economics. He did not follow the early Menger or Böhm-Bawerk, who had assigned capital theory to the analysis of the production process; he rather built upon Menger’s later article which was, as shown above, a concession to the Historical school.

THE HISTORICAL CHARACTER OF ECONOMICS — ACCORDING TO LUDWIG VON MISES

Why did Mises rely on the *historical-legal* capital concept? After all, Mises argued that economics is a part of the more universal science praxeology, and that praxeology is the science of *every* kind of human action (Mises 1949, p. 3). According to this classification, no historical relativity is

involved in economics, and therefore the real capital concept, which can easily be reconciled with every individual human action like it is done in Crusoe economics, seems to suggest itself. However, it is often overlooked that economics is not identical with praxeology, even in Mises's own thinking.

Whereas praxeology, the general theory of human action, "can be precisely defined and circumscribed" (Mises 1949, p. 235), the scope of economics can not so easily be demarcated. Its relationship to praxeology is not a simple one, and especially its area of application is not easy to determine.

The specifically economic problems, the problems of economic action in the narrower sense, can *only by and large be disengaged* from the comprehensive body of praxeological theory. (Mises 1949, p. 235; emphasis added)

And here comes the main point. Other than praxeology, which is general and absolute, economics is bound to special preconditions and, consequently, is not a general theory in the same way as praxeology. This claim is emphasized by Mises himself when he adds that "*in this disengagement [of economics from praxeology], historical and conventional aspects cannot be ignored*" (1940, p. 226; emphasis added).¹ The historical relativity of economics, which Mises admits in these few words, manifests itself a few lines further where he says that economics and catallactics are "the analysis of those actions which are conducted on the basis of monetary calculation," and that the analysis of socialism, where monetary calculation does not exist, "is possible only through the study of catallactics, the elucidation of a system in which there are money prices and economic calculation" (Mises 1949, p. 235).

In short, economics itself does not deal with *all* human actions in *all* kind of societies, but only with human actions that are directly or indirectly connected to money prices and economic calculation. It is true: in order

¹I quote from Mises's *Nationalökonomie* because the same passage in *Human Action* does not seem to make sense: "Accidental facts of the history of science and conventions play a role in all attempts to provide a definition of the scope of 'genuine' economics" (Mises 1949, p. 235). The same is true for the third edition.

to do this adequately, economics presupposes a *general* theory of human action — praxeology — but it is not identical with it.²

It should be remembered that Mises's (1951) famous argument according to which a collectively planned society is not feasible is also based on *historical* institutions. Without exchange between money and producers' goods, he argued, prices of these goods cannot be determined and consequently economic calculation becomes impossible in socialism. This argument is not based on praxeology alone, but it presupposes, for the market economy which serves as benchmark, the existence of money, monetary calculation, and property rights to the means of production. It was this aspect of capitalism that Mises focused on, and from this perspective it becomes clear why he adhered to the *historical-legal* capital concept. This kind of capital does not exist in socialism, and therefore it could help to distinguish *capitalism* from any other economic system.

THE ECONOMIC CALCULATION ARGUMENT AS FOUND IN ALBERT SCHÄFFLE'S WORK

That Mises's use of the capital concept endorsed by the Historical school is no coincidence is apparent when reading the approach of earlier members of this school to the question of economic calculation. In this regard, especially Menger's predecessor on the chair of economics in Vienna, Albert Schäffle (1823 — 1903), must be mentioned. It has been noted before that Schäffle at least hinted at the difficulties a socialist society would face when allocating the available resources to the myriads of different uses. Schäffle is cited for having argued, in Hodgson's (2010, p. 300) words,

that a system based on calculations concerning labour time faced intractable problems, including the heterogeneity of labour and the inaccessibility of relevant data, and would undermine individual incentives.

Apparently, Schäffle had at least a sense of the calculation problem of socialism, although, according to Hodgson at least, he primarily seems to

²Joseph Salerno comes to a similar conclusion concerning another important economic concept: The *entrepreneur-promoter* does not exist under all circumstances, either. The entrepreneur-promoter "cannot be defined with praxeological rigor; it can only be identified by a historical judgment" (Salerno 2008, p. 195).

have aimed at the well-known incentive problem. Huerta de Soto (2010, p. 100) goes a step further and imputes to Schäßle the demonstration

that, without imitating the system of price determination found in market processes, it would be inconceivable that a central planning agency could efficiently, in terms of both quantity and quality, allocate society's resources.

However, neither Hodgson nor Huerta de Soto argues that Schäßle has anticipated Mises's argument in the proper sense. They merely concede him to have sensed the difficulties of organizing production without the help of economic calculation.

It does not become clear, in their short remarks, how close Schäßle actually came to deal with questions that later became central for the Austrian school. In his *Kapitalismus and Socialismus*, a book which Hodgson and Huerta de Soto do not analyze and which has not been translated into English, Schäßle demonstrates that he was well aware of the problem that has to be solved by any economic order. In this, he partly anticipated Leonard Read's famous story *I, pencil* where it is shown that even in the production of such a simple thing as a pencil more or less the whole world participates.

The social character of the human economy shows that everyone, from morning to night, depends on the work of the whole humanity. I wake up in the morning and put on a dressing gown: the wool it consists of has been grown, years ago, in Australia; it has been shipped to Trieste by Dalmatians, freighted to Moravia by Italian workers and the staff of the Austrian railways, spun and woven there with the help of English machines, and dyed with African colors. (Schäßle 1870, p. 103)

Confronting the complicated relationships of the modern production process, Schäßle (1870, p. 105; emphasis added) uttered the question: "*The economic miracle of the much discussed division of labor — by which means is it accomplished?*"

So he clearly posed the question that Mises would answer in his discussion of the possibility of economic calculation under socialism. Furthermore, he was well aware of the fact that the socialist authors had either not realized that socialism has to solve this problem or had provided merely superficial solutions. This becomes clear in the second edition of

Kapitalismus und Socialismus which was part of a larger work on the social sciences. First, Schäffle pointed out that socialism must think of something that could substitute private entrepreneurship:

With the abolition of private capital as the profit-oriented director of the economy, the difficulty occurs to achieve productivity, which was aspired by private capital in its own interest, in the same or even a larger and progressing measure, so that the fairer distribution of the created wealth does not end up with less to distribute than the present-day market. (Schäffle 1881, p. 317; emphasis removed)

Therefore, he continued, socialism must find a means of minimizing costs. But “[h]ow are the [socialist] managers of the production process supposed to determine the ‘socially required’ amount of costs?” (Schäffle 1881, p. 317). This would be a very difficult task, he noted, as the ‘socially required’ amount of costs depends on numerous and variable factors. Socialist theorists deceive themselves as long as they ignore this problem:

In my opinion, socialism exposes itself to a fateful and economically cardinal calculation error as long as it does not try to contrive ways and means which guarantee, in a better way than the current competition among capitalists does, that no arbitrary measure of “socially required” amount of labor is found and asserted for the determination of exchange value, but the one that is as low as possible from a social and evolutionary point of view. (Schäffle 1881, p. 318)

How deep Schäffle actually analyzed the whole question of economic calculation in socialism is difficult to tell. He wrote several books, like *The Quintessence of Socialism* and *The Impossibility of Social Democracy*, touching on this topic. Hodgson (2010), who analyzed them, has not found a systematic treatment of the issue. *Kapitalismus und Socialismus*, from which I have quoted above, is a treatise of more than 700 pages and consists of public lectures Schäffle had given in Vienna. Therefore, it does not contain a systematic line of argument. Schäffle neither comes up with a proposal for the organization of the production process under socialism nor does he outrightly deny its possibility. He rather seems to advocate a mixed economy as he does in his other books (Hodgson 2010, p. 311). However, a profound judgment can only be made after a thorough study of all of his works which include, next to his lengthy monographs on socialism, several multi-volume textbooks on economics and sociology.

At this place it suffices to register that Albert Schäffle, a member of the Historical school, came close to seeing the problem of economic calculation under socialism. Whether he analyzed it satisfactorily is not top priority. One must not forget that, unlike Mises and Hayek, Schäffle wrote decades before the Bolshevik Revolution and had no real-world example of socialism to consider. Furthermore, he mainly wrote before the neoclassical revolution, thus lacking the apparatus necessary for the dismantling of Marxist theory (Hodgson 2010, p. 306). At any rate, Schäffle and the Historical school can be shown to have points of contact with Austrian Economics, whatever the methodological differences may be. Whether these links are worth a closer inspection and whether modern Austrians can profit from it cannot be foretold. For my part, I believe that the comprehensive rejection of a whole school of thought will rarely be justified.

CONCLUSION

Streissler (1990, p. 31) has called it a myth that the early members of the Austrian school elaborated their novel insights independently of and in contrast to German economics of their day. I would not go so far as to maintain that the fundamental opposition between the Austrian and the Historical school is also a myth. At any rate, I tried to show in this chapter that at least some caveats must be made. Although he did not stress this point, even Ludwig von Mises, the father of the *general* theory of human action, in some of his theoretical arguments presupposes the existence of *historical* conditions and institutions. The connection to the Historical school can best be seen in the fact that both Menger and Mises employed its capital concept. Mises's argument on the impossibility of economic calculation under socialism is based on it, and it even seems that the argument naturally flows from it. At least one member of the Historical school, Albert Schäffle, was led to similar, though less elaborated and precise views concerning the role of economic calculation in capitalism and socialism.

REFERENCES

- Böhm-Bawerk, Eugen von. 1930. *The Positive Theory of Capital*, translated with a preface and analysis by W. Smart. New York: G. E. Stechert.
- Braun, Eduard. 2014. "The Menger-Lachmann Trajectory on Capital: A Comment on Endres and Harper." *Journal of the History of Economic Thought* 36 (1): 97–102.

- Gabriel, Amadeus. 2012. "Why was the Reception of the First Edition of Mises's *Theory of Money and Credit* so Lukewarm?" In Jörg Guido Hülsmann, ed., *Theory of Money and Fiduciary Media: Essays in Celebration of the Centennial*, pp. 37–61. Auburn, Ala.: Mises Institute.
- Gordon, David. 1996. *The Philosophical Origins of Austrian Economics*. Auburn, Ala.: Mises Institute.
- Grimmer-Solem, E., and R. Romani. 1998. "The Historical School, 1870–1900: A Cross-National Reassessment." *History of European Ideas* 24 (4/5): 267–99.
- Hayek, F. A. 1941. *The Pure Theory of Capital*. London: Macmillan.
- Hodgson, G.M. 2010. "Albert Schäffle's critique of socialism." In J. Vint et al., ed., *Economic Theory and Economic Thought*, pp. 296–315. Florence, Ky.: Routledge.
- Huerta de Soto, Jesús. 2010. *Socialism, Economic Calculation and Entrepreneurship*. Cheltenham, UK and Northampton, Mass.: Edward Elgar.
- Jacoby, W. 1908. *Der Streit um den Kapitalbegriff: Seine geschichtliche Entwicklung und Versuche zu seiner Lösung*. Jena: G. Fischer.
- Lachmann, Ludwig M. 1978. *Capital and Its Structure*, 2nd ed. Kansas City, Mo.: Sheed Andrews and McNeel.
- Menger, Carl. 2007 [1871]. *Principles of Economics*. J. Dingwall and B. F. Hoselitz, trans. Auburn, Ala.: Mises Institute.
- Menger, C. 1888. "Zur Theorie des Kapitals." *Jahrbücher für Nationalökonomie und Statistik* 17: 1–49.
- Mises, Ludwig v. 1940. *Nationalökonomie: Theorie des Handelns und Wirtschaftens*. Genf: ed. Union.
- . 1949: *Human Action: A Treatise on Economics*. New Haven, Conn.: Yale University Press.
- . 1951: *Socialism. An Economic and Sociological Analysis*. J. Kahane, trans. New Haven, Conn.: Yale University Press.
- Robertus, K. 1842. *Zur Erkenntniss unsrer staatswirthschaftlichen Zustände*. Neubrandenburg and Friedland: Barnewitz.
- Salerno, Joseph T. 2008. "The Entrepreneur: Real and Imagined." *Quarterly Journal of Austrian Economics* 11: 188–207.
- Schäffle, Albert E. F. 1870. *Kapitalismus und Socialismus mit besonderer Rücksicht auf Geschäfts- und Vermögensformen*. Tübingen: Laupp.
- . 1881. *Bau und Leben des socialen Körpers. Dritter Band*, new edition. Tübingen: Laupp.

- Schmoller, Gustav. 1904. *Grundriß der allgemeinen Volkswirtschaftslehre. Zweiter Teil*. 1–6. Auflage. Leipzig: Duncker & Humblot.
- Schulak, Eugen Maria, and Herbert Unterköfler. 2012. *The Austrian School of Economics. A History of Its Ideas, Ambassadors, and Institutions*. A. Oost-Zinner., trans. Auburn, Ala.: Mises Institute.
- Schumpeter, Joseph A. 1997. *Theorie der wirtschaftlichen Entwicklung*. 9th ed. Berlin: Duncker & Humblot.
- Stigler, George J. 1937. “The Economics of Carl Menger.” *Journal of Political Economy* 45(2): 229–250.
- Streissler, Erich. W. 1990. “The influence of German economics on the work of Menger and Marshall.” *History of Political Economy* 22 (Annual Supplement): 107–30.
- . 2008. “Capital and Time.” In R. Scazzieri et al., ed., *Markets, Money and Capital: Hicksian Economics for the Twenty-first Century*, pp. 367–81. Cambridge: Cambridge University Press.