

## THE MENGERIAN ROOTS OF HAYEK'S CONSERVATIVE LIBERALISM

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### 1. Menger on Methodology

In his tract on methodology, Carl Menger discussed the social phenomena which remind us of natural phenomena because “they, too, present themselves to us rather as ‘natural’ products (in a certain sense), as *unintended results of historical development*” (Menger 1883/1963, p. 130). This is an original (and somewhat crude) expression of the idea of evolution through spontaneous coordination. Menger’s examples of such phenomena are money, the law (by which he means the common law), language, markets, communities and the state.

On the social phenomena which present themselves to us as “unintended results of historical development”, Menger observed (1963, p. 146):

It is here that we meet a noteworthy, perhaps the most noteworthy, problem of the social sciences; 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?

This is of course a crucial problem in the social sciences as well as in the narrower field of political theory. How has beneficial development without design been possible? Long before Menger, Bernard de Mandeville tried to provide an answer with his famous fable of the bees (1714/1988). David Hume (1740/1972), Adam Ferguson (1767/1966), and Edmund Burke (1790/1968) all tried to express this thought, and above all Adam Smith (1776/1976) with his ‘invisible hand’. It is also the idea behind Savigny’s inquiries into the wisdom of traditional law, and in a different form, Frederic Bastiat’s ‘economic harmonies’ (Barry 1982).

This is the idea which Friedrich A. von Hayek and Karl Popper have tried to develop both into a research programme for the social sciences and, at least in Hayek’s case, into a particular political position. Hayek says (1979, p. 41) that the aim of social studies “is to explain the unintended or undesigned results of the actions of many men.” Popper (1960, p. 65) agrees and contrasts (1972, pp. 341–2) this scientific method with ‘conspiracy theories’, the temptation to look for a design or an intention behind all social phenomena, especially unwelcome ones. This contrast is, again, not too different from the one which Robert Nozick (1974, p. 19) draws between ‘hidden-hand explanations’ and ‘invisible-hand explanations.’

There is an apparent difference, however, between Menger on the one hand and Popper and Hayek on the other hand. Menger (1963, p. 172) speaks favourably about the “organic understanding of social phenomena.” But Popper (1966, p. 174) argues against it on the ground that individuals (and groups) in society have different and often conflicting aims, while this cannot be said to be the case about the different parts of an organism. Hayek (1973, p. 52) rejects it for the reason that in a real “organism most of the individual elements occupy fixed places” while this need not be so in a spontaneous order. But this is an apparent rather than a real difference. Menger recognised the limitations of the analogy. Using it as an expository device, he would have been the first to admit that perhaps the greatest problem of modern society arose from the need for accommodation of the often conflicting aims of different individuals.

Menger made a distinction between two schools, the ‘pragmatic liberalism’ of Adam Smith and his followers, as Menger called it, and the German Historical School of Law, of which Savigny was a prominent member. (It does not matter much that Menger seems somewhat to have misunderstood Smith; his critical comments on Smith apply rather to nineteenth century utilitarians; Smith, as other thinkers of the Scottish Enlightenment, had a much more sophisticated theory of man and society than did the utilitarians.) Pragmatic liberals, according to Menger (1963, p. 172), always looked at social phenomena as “the intended product of

the common will of society as such, results of expressed agreement by members of society or of positive legislation.” They were unable to understand that an orderly development could come about without design. Members of the German Historical School of Law, on the other hand, thought that “law, like language, is at least not originally the product in general of an activity of public authorities aimed at producing it, nor in particular is it the product of positive legislation. It is, instead, the unintended result of a higher wisdom, of the historical development of the nations” (Menger 1963, p. 174–5). They were, in other words, traditionalists.

Menger criticised both views as one-sided. The Pragmatic School (which, as already indicated, should be interpreted as the school of Bentham rather than Smith)

did not know how to value the significance of ‘organic’ social structures for society in general and economy in particular and therefore was nowhere concerned to *preserve* them. What characterizes the theories of A. Smith and his followers is the one-sided rationalistic liberalism, the not infrequently impetuous effort to get away with what exists, with what is not sufficiently understood, the just as impetuous urge to create something new in the realm of political institutions, often without sufficient knowledge and experience (Menger 1963, p. 177).

There is a striking similarity here to Hayek who complains (1960, p. 25) that “much of our occasional impetuous desire to smash the whole entangling machinery of civilization is due to this inability of man to understand what he is doing.”

## 2. Menger’s Approach: Both Conservative and Liberal

Menger contended that the conservative insights of the Historical School acted as a necessary corrective to the reformist urge of ‘pragmatic’ liberals:

The aim of the efforts under discussion here had to be ... the full understanding of existing social institutions in general and of organically created institutions in particular, the retention of what had proved its worth against the one-sidedly rationalistic mania for innovation in the field of economy. The object was to prevent the dissolution of the organically developed economy by means of a partially superficial pragmatism, a pragmatism that, contrary to the intention of its representatives, inexorably leads to socialism (Menger 1963, p. 177).

It should be noted how similar Menger’s strictures are to those of Edmund Burke. They both endorse the same ‘research programme’: to try and employ our “sagacity to discover the latent wisdom which prevails” in our inherited institutions, as Burke (1968, p. 183) put it, instead of trying to design new ones.

In the passage about “pragmatism that, contrary to the intention of its representatives, inexorably leads to socialism”, Menger was partly, it would seem, making the familiar liberal observation, common to Frederic Bastiat (1850/2016), A. V. Dicey (1914/1981, pp. 257–89), and Rose and Milton Friedman (1980, p. 297), that if we look upon matters ‘on their own merits’ rather than in the light of general principles, then we are almost bound to become interventionists. We see the hardship of visible victims of circumstances, for example, but ignore the plight of unseen victims. This is really the point that our moral vision is limited and will turn out to be selective, if unaided by general principles.

Partly, also, Menger was making the point that concepts applicable to ‘purposeful’ organisations—such as private firms run for profit or associations formed to further given goals—may not always be applicable to ‘purposeless’ orders such as the market order, the common law or language: that is, system of rules which enable individuals and purposeful organizations to further their given goals by coordinating their activities, but which do not have any goals of their own. To use his terminology, he was concerned with the illegitimate transfer of concepts pertaining to ‘pragmatic’ phenomena to ‘organic’ phenomena. But why did this “inexorably” lead to socialism? Because it consisted in the inability to understand, or at least to accept, unintended and unplanned social phenomena, and in a consequent demand for a rational reconstruction of society, through planning or legislation. It consisted, in other words, in the inability to understand the forces of spontaneous coordination.

On Menger's interpretation, socialism is seen, then, less as a utopian, Marxian vision of a future without contradictions than as a failure to grasp the 'invisible hand'. It is a demand for a society in which everything is rational in the sense that it has been thought out, planned or intended. This is an idea which can be recognised again in the political thought of Hayek (1976, p. 136) who argues that socialism should be interpreted as an intellectual error, mistaking a spontaneous order for an organization.

While Menger criticised the pragmatic liberals, he did not—any more than Hayek (1960)—fully endorse the conservative alternative. Respect for tradition was necessary, but hardly sufficient. Menger (1963, p. 233) pointed out, for example, that common law, although sometimes useful, had "also proved harmful to the common good often enough, and on the contrary, legislation has just as often changed common law in a way benefiting the common good." And he (1963, pp. 157–8) stressed that "institutions which came about organically find their continuation and reorganization by means of the purposeful activity of public powers applied to social aims." Menger objected to what he saw as the complete and unconditional conservative surrender of reason:

The mere allusion to the 'organic origin' of law, to its 'primeval nature' and to similar analogies, is completely worthless. The striving for the specifically historical solution of the above problem is hopeless. There can only be one way to reach the theoretical understanding of that 'organic' process to which law owes its first origin. That is to examine what tendencies of general human nature and what external conditions are apt to lead to the phenomenon common to all nations which we call law (Menger, 1963, p. 224).

Menger's point is that it is not enough to observe the 'latent wisdom' in inherited institutions, as conservatives do. We have to explain them in general terms and relate them to our knowledge of 'tendencies of human nature' and of 'external conditions', as he said.

### 3. Menger on Economics

In economics, Menger was a thoroughgoing subjectivist, trying to establish in painstaking detail that prices are formed in an evaluative, subjective process. The value of a consumption good does not depend on the value of the goods which are needed to produce it. The truth of the matter is, for Menger, the other way around. The value of a good depends on the utility it has for the consumer, directly if it is a consumption good—or, as Menger (1871/2007, p. 57) called it, a 'good of the first order'—and indirectly if it is a means of production—or, as Menger called it, a 'good of a higher order'. It is the anticipated future of the good which determines its value, not its past. It is the evaluative subjective process which takes place after the emergence of the object which is important, not the past history of the object itself. Cost is consequently interpreted or determined subjectively, not only the cost of consumption goods, but also the cost of means of production and natural resources. Hayek (1978b, p. 276) observes: "It was this extension of the derivation of the value of a good from its utility, from the case of given quantities of consumers' goods to the general case of all goods, including the factors, of production, that was Menger's main achievement."

Economic progress for Menger was not so much the extension of the division of labour—which is what Adam Smith (1981) had taught—as the extension of the chain which connects consumption goods to the means of production necessary to produce them in different stages. Savages go out hunting when they are hungry; they only know how to satisfy their immediate wants; they only produce consumption goods, in other words. In a modern complex society, however, people plan ahead; they employ resources to produce goods, which are not consumed, but used to produce another goods, and so on, until the final stage is reached where the goods are used to produce goods for direct consumption.

An important element of Menger's economic thought follows directly from these two ideas about value and economic progress: his emphasis on time and ignorance. For if progress means the extension of the chain of production, and if value is determined in an evaluative subjective process, these two categories of economic life are of paramount importance. Menger (2007, p. 69) stressed that time passes between the different stages of production. If oak trees have, say, been planted on a piece of land, almost one hundred years may pass before the timber is ready for the axe. Menger (2007, p. 68) wrote, therefore, that goods in the non-final stages of production (or, in his terminology, of an order higher than one) "acquire and maintain their goods-character ... not with respect to needs of the immediate present, but as a result of human foresight, only with respect to

needs that will be experienced when the process of production has been completed." The oak trees on the piece of land are only goods, can only carry a price, in so far as they are perceived as means to the satisfaction of human needs in the future.

Menger also stressed ignorance. The longer the chain is in time between the consumption goods and the goods which are required for their production, the more we become dependent on an uncertain future, and therefore on our foresight. Economic progress implies an increasing uncertainty, because it implies an increasing dependency on the future. First, there is uncertainty about future consumption. We are unable to foresee all future human needs and cannot therefore plan completely for their fulfilment. Secondly, there is uncertainty about future production: both uncertainty about productive factors, over which we may gradually gain some control, for example the effect of fertilisers on soil, and factors over which we have no control, such as the weather.

Neo-classical economists commonly conceive of economic life as somewhat similar to a real market, perhaps in a mediterranean town, where an auctioneer 'calls out' tentative prices, and where the individuals make gradual adjustments on the basis of these prices, which change in the process, until an equilibrium is reached where supply and demand are equated. An equilibrium, then, is a situation where no improvements can be made. On this basis, a mathematical model of a general equilibrium is constructed. But it is only too obvious that this is not the way the world works, or has ever worked. Neo-classical economists have to assume away delays, bottlenecks and other imperfections of daily life; they have to treat individual needs as given, but not gradually emerging by discoveries in the marketplace; and they have to expect somebody to perform the function of the auctioneer. First and foremost, they have to assume a situation where all the relevant facts are known to the participants; where they will all be at the same place at the same time (as people are when they are at an auction) and share the same set of data. They have to postulate a 'face-to-face' situation. It becomes a tempting and almost irresistible thought, Hayek points out, that government could and should act as the auctioneer or at least improve upon this imperfect mechanism. If the market order is judged in terms of an ideal situation or end state, such as a general equilibrium, it is almost bound to be rejected as unsatisfactory (Hayek, 1976, pp. 65–97).

For these reasons, economists in the Mengerian tradition criticise neo-classical economics, not necessarily as erroneous, but rather as impractical. They do not draw, however, the same conclusions as socialists. They accept that the outcomes of the market process are always imperfect, but they ascribe such imperfections to man's inevitable ignorance, rather than to the market itself. At any given point in time, there will be many imperfections. What is important is not that a situation is 'correct' according to some standard, because that may be more than we can hope for, but that the basic framework under which we work is such that an imperfect situation is corrigible.

#### **4. Political Implications of Mengerian Economics**

Mengerian economics certainly have some direct and obvious political implications. An awareness of the dimension of time tends to instil in people a certain kind of sceptical conservatism, or at least an aversion to some of the grander claims made on behalf of reason. The recognition of man's inevitable ignorance is closely connected to the conception of economic life as a process to be continued rather than as an end state to be attained.

The Mengerian conception of a process orientated towards the future may also discourage the quest for social justice. For example, Hayek's (1976) and Nozick's (1974) theories of justice in distribution are both Mengerian in the sense that they are presented not in terms of an end state, but in terms of a process in time in which people transfer holdings by consent, and in which prices are not rewards for the merits of producers, but signals about anticipated needs of consumers. On such a conception, prices have little or no moral significance; they are guidelines, or signposts, helping us to find our way about. Given some initial assumptions about people's rights to their assets, prices are outside the realm of approval and disapproval; they are as morally irrelevant as traffic signs. In a society of multiple orders of goods distribution is not really a task which can be set to or performed by anyone. Distribution of rewards or honours within an institution may be a matter of justice. But in a market order, 'distribution' is not the name of an activity, but a word used for the outcome, at any given point in time, of individual transactions in all their complexity: gifts, inheritance, trade, barter, favours, and so on.

It was probably Hayek's background in Mengerian economics which led him to see the problem of knowledge in society, and its solution, more clearly than many other economists have done. In his political works, Hayek poses a crucial question: It is what can bridge the gap between our inevitable individual ignorance and our observed collective achievement. What can bring about the spontaneous coordination which is so mutually beneficial? How did the Extended Order—which has enabled billions of people not only to survive, but to live better lives than most of their forefathers—arise and how can it be sustained? The answer which Hayek (1945) gives is the acquisition and transmission of knowledge which is, in turn, made possible by certain sets or systems of rules. In economics, it is the price mechanism which makes this acquisition and transmission of knowledge possible. It transmits information to us on changes on which we need not, consequently, inform ourselves. It enables us, also, to use knowledge which we do not have, for example the 'know how' which other people possess and from which we benefit by exchanging our goods and theirs. It makes possible the division of knowledge which may be even more important than the division of labour. Individual prices are coordinating conventions, which enable us to cope with our ignorance.

It is in the generalisation of this insight into the use of knowledge in society, and in its application, not only to economic, but also to social and even moral affairs, that Hayek's political position comes into being, a position which I would characterise as conservative liberalism in the tradition of Hume, Smith, Burke and Menger (Gissurarson, 2018). Conservative liberalism seeks to combine the recognition of our inevitable ignorance and the acceptance of the liberal order of the West into a coherent social theory, offering both an explanation for its emergence and setting out the preconditions for its maintenance.

Indeed, Hayek's argument about the use of knowledge in society is both conservative and liberal. It is conservative in that it emphasises the necessity of conventions. And it is liberal in that it requires people not to resist a further development of such conventions in the light of changing circumstances. Hayek's theory of the acquisition and transmission of knowledge may be his most lasting contribution to political theory. It represents a paradigm shift "from the criticism and evaluation of social institutions by reference to preferred principles of morality to an assessment of them in terms of their capacity to generate, transmit and use knowledge (including tacit knowledge)" (Gray 1984, p. 41). Thus, Hayek's support for liberal institutions like property does not rest in any requirements of abstract reason or morality (as Nozick's support for the same institutions seems to do), but in their ability to sustain the Extended Order, in all its richness and complexity.

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