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History of Economic Thought to 1870

### From Say to Menger: The Evolution from French Liberalism to Austrian Tradition

Even the most cursory glance at the work of famous French liberal economists like Jean-Baptiste Say, Anne Robert Jacques Turgot, or Frédéric Bastiat would reveal striking similarities in both method and conclusions to the work of members of the Austrian school, like Carl Menger or Ludwig von Mises. The praxeological approach and theories about money, government intervention, and human behavior line up so closely and frequently that it is difficult to simply dismiss it as coincidence despite no clear connection. However, there is a connection and the relationship is no mere coincidence. French liberalism owes its evolution into Austrian economics to the work of two Germans, Heinrich von Storch and Karl Heinrich Rau.

Jean-Baptiste Say is frequently considered the face of French liberal economics, simply based on the fame of his Smithian work, *A Treatise on Political Economy*. Although the *Treatise* was commonly considered a simpler, easier to read version of Smith's *Wealth of Nations*, readers that pay attention will notice his departures and sharp criticisms of the British classical economics Smith founded. This important divergence is one of the reasons the French liberal school exists. Even more important is Say's reputation as the proto-Austrian economist. Say is certainly not a full Austrian, although some would like to claim him as such. His work as the "precursor of the

Austrian School”, as Larry Sechrest refers to him in *15 Great Austrian Economists*<sup>1</sup>, makes him an excellent representation of French liberalism in this discussion.

Say was possibly the first person to use praxeology as a method in the field of economics. This is important simply because it is the praxeological method that the Austrian school prides itself on. Murray Rothbard said that “Praxeology rests on the fundamental axiom that individual human beings act, that is, on the primordial fact that individuals engage in conscious actions toward chosen goals.”<sup>2</sup> In other words, economics based on the logical, self-evident implications of actions.

Say considered economics a genuine science, one alongside chemistry or biology, one that could provide absolute truths, but not from the inductive studies that his contemporaries would have used. He thought that “[n]othing can be more idle than the opposition of theory to practice!”<sup>3</sup> This is something for which he would have criticized the British classical economists.

This is the reason that the *Treatise* was seen as a simpler *Wealth of Nations*. Smith was not popular in France, and while Say may have diverged from him at times, Smith was the biggest advocate of free markets at the time. Say brought this Smithian tradition to France with his books, and even credits Smith as the founder of political economy at large. However, Say was a man of practicality who wanted theory to match practice. To this end, he criticized Smith, and Sechrest sums up his criticisms with “‘destitute of method,’ obscure, vague, and disjointed as well as for containing too many long and distracting digressions.”<sup>4</sup>

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<sup>1</sup> Sechrest, Larry. *15 Great Austrian Economists*. Ludwig von Mises Institute, 1999.

<sup>2</sup> Rothbard, Murray. *Economic Controversies*. Ludwig von Mises Institute, 2011.

<sup>3</sup> Say, Jean-Baptiste. *A Treatise on Political Economy*.

<sup>4</sup> Sechrest, Larry. *15 Great Austrian Economists*. Ludwig von Mises Institute, 1999.

In line with his preference for the simple and precise, Say did not consider economics based on statistics useful or even trustworthy. This combination of simplicity, precision, and perspicuity resulted in considerable fame for the *Treatise* everywhere except where he was trampling on what came before. The British classical economists who Say ran afoul of saw his work as trivial, or a simple popularization of Smith, and they “confused smoothness of surface with superficiality.”<sup>5</sup> Say’s method and style, however, would go on to have much importance to the Austrians.

Say’s discussion of value was significantly better than his British contemporaries, who firmly believed in the labor theory of value. David Ricardo, prominent British classical, said that “The value of a commodity, or the quantity of any other commodity for which it will exchange, depends on the relative quantity of labour which is necessary for its production[...]”<sup>6</sup> Say believed in subjective valuations of goods, and that the utility of these goods is what provided the goods with value. However, Say still lacked the key that would later would arguably become Menger’s most important contribution to economics.

Despite saying that the wants of individuals were both unlimited and constantly changing depending “upon the moral and physical nature of man, the climate he lives in [...] He has wants of the body, wants of the mind, and of the soul; wants for himself, others for family, others still as a member of society,”<sup>7</sup> therefore making subjective value constantly in flux and immeasurable, Say held the belief that all exchange was for goods of equal value. In *Treatise*, Say writes “When Spanish wine is bought at Paris, equal value is really given for equal value: the silver paid, and the wine received, are worth one the other.”<sup>8</sup>

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<sup>5</sup> Rothbard, Murray. *Classical Economics*. Ludwig von Mises Institute, 1995.

<sup>6</sup> Ricardo, David. *The Principles of Political Economy and Taxation*.

<sup>7</sup> Say, Jean-Baptiste. *Letters to Malthus*.

<sup>8</sup> Say, Jean-Baptiste. *A Treatise on Political Economy*.

Say also gave the entrepreneur and capitalist a fair treatment, unlike Smith. The entrepreneur is of vital importance to the economy, because he is the person who supplies and satisfies consumer wants. Rothbard credits Say for this service, saying “If Adam Smith purged economic thought of the very existence of the entrepreneur, J.B. Say, to his everlasting credit, brought him back.”<sup>9</sup> Say points out that the capitalist assumes plenty of risk when starting a venture, and his role as the connection between buyers and sellers is not an easy one. In fact, Say’s successful entrepreneur is an extremely talented person. He manages his business, knows the relevant facts about business and the world, and he uses that knowledge to satisfy consumer preferences. He oversees all steps of production from the procurement of the basic materials up until a final product is ready, and tracks means of production as well as buyer demand.

If an entrepreneur cannot do this, Say believes he cannot be successful, in which case society owes a lot to the people who can and do perform this role. Say finalizes his assessment by saying “The producers themselves are the only competent judges of the transformation, export, and import of these various matters and commodities; and every government which interferes, every system calculated to influence production, can only do mischief.”<sup>10</sup>

In fact, Say’s general hostility to state intervention shines through in much of his work, not just that of the entrepreneur. He despised taxes and explicitly called them derived from coercion. Say states that taxation “Is virtually a burthen imposed upon individuals, either in a separate or corporate character, by the ruling power [...] for the purpose of supplying the consumption it may think proper to make at their expense; in short, an impost, in the literal sense.”<sup>11</sup> Of course, Say

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<sup>9</sup> Rothbard, Murray. *Classical Economics*. Ludwig von Mises Institute, 1995.

<sup>10</sup> Say, Jean-Baptiste. *A Treatise on Political Economy*.

<sup>11</sup> *Ibid.*

does not think much of the things government supplies because it thinks it proper. Say states that in every case, a man would have been much better off simply spending the money he had stolen from him for the things he knows he needs, rather than what the government thinks he needs.

Say's most lasting contribution to mainstream economics would be his law of markets. "It is worthwhile to remark that a product is no sooner created than it, from that instant, affords a market for other products to the full extent of its own value."<sup>12</sup> A common argument between Say and Malthus was over the possibility of a "general glut" of goods, and what would come to be known simply as "Say's law" was J.B. Say's principle and most convincing argument against the possibility of a general glut.

Although it is often summarized simply as "supply creates its own demand" thanks to John Maynard Keynes, this is practically a strawman summarization. The law closer states that production of commodities in general allows for the demand of the commodity and other goods. If demand for a product is not high enough, and if prices can adjust, prices will fall until quantity demanded matches supply. Therefore, any overabundance of a good is, at best, temporary. Say illustrates this by saying,

"Let us go back only two hundred years, and suppose that a merchant had taken a rich cargo to the sites on which the present cities of New York and Philadelphia stand – Would he have sold it? [...] Would he have sold there any of his articles? Most certainly not. [...] Why do we see it so differently in our days? Why, as soon as goods arrive, or are manufactured at Philadelphia or New York, are we sure to sell them at the course of exchange? It appears evident to that it is because the farmers, the merchants, and at present the manufacturers, even of New York and

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<sup>12</sup> Ibid.

Philadelphia, and of the surrounding provinces, produce, and import produce, by the means of which they acquire that which is offered to them by others.”<sup>13</sup>

A merchant arriving on the shores of America in the early 1600’s would not have been able to sell his wares because the people there did not produce anything by which they could trade to satisfy wants. People cannot demand something they cannot pay or trade to receive. The lack of production in 1600’s America meant that the people there could not have demand for products. Therefore, both now and in Say’s time, the production that takes place in both Philadelphia and New York allows a demand for other products to form.

Finally, Say’s theory on money should be familiar to any Austrian economists because it is his theories that Carl Menger would develop into a better version used by the Austrian school. It begins with the now-familiar “double coincidence of wants problem,” one of the barter systems most problematic flaws. The problem is that a person who wants an item in a barter economy may not have the goods he needs to trade for said good, which is where money, a common medium of exchange arises. With money, whatever it may be, people do not have to worry about lacking something the other party will want, because money is always useful for them.

He concludes that the ideal medium of exchange should be durable so that it can last as a medium for as long as possible, portable so that you are able to take it everywhere, divisible so it retains proportional value when divided, have high purchasing power, and be uniform so there is not uncertainty in exchange. He also mentions that the money should be decided by the custom of the people and not the government.

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<sup>13</sup> Say, Jean-Baptiste. *Letters to Malthus*.

Say falls on the usual examples of gold and silver as currency, because they rather neatly fit the above requirements. Although gold and silver are the best options in his eyes, he stringently opposes government intervention into the value of the metals, citing Gresham's law, that currency undervalued by the government would on net flow out of the country. He does not necessarily oppose paper currency as long as it can always be redeemed for an appropriate amount of its worth in precious metal, pointing to the French assignats, paper currency that was essentially irredeemable for anything of worth, which resulted in large amounts of inflation.

J.B. Say may not have gotten everything right, but he laid the foundations for later economists to come and opposed the misinformation of the British classical school and of labor theorists of value. One of the subsequent economists for whom he laid the path was named Heinrich von Storch, the next important influence on Carl Menger.

Heinrich von Storch was a German-Russian economist who wrote most of his main works in French. Von Storch admits freely in the foreword of his book, the *Cours d'économie politique ou exposition des principes qui déterminent la prospérité des nations*, that he was influenced by and used the words of J.B. Say, and Say even accused him of plagiarism. That is how close the two of their views were.

Von Storch, like Say, was not able to piece together the problem of marginal utility in relation to value, but he was a believer in subjective utility. In *Cours*, he says (translated from French<sup>14</sup>) that “The impact on our judgment of the utility of things constitutes their value and, in fact, makes them goods.”<sup>15</sup>

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<sup>14</sup> Schumann, Jochen. “Heinrich von Storch's Innovative Contributions to Economics.” *European Journal of the History of Economic Thought* 25, no. 2 (April 2018): 388–400.

<sup>15</sup> von Storch, Heinrich. *Cours d'économie politique ou exposition des principes qui déterminent la prospérité des nations*.

He also argues against fiat money, saying that it is a sure way to achieve rapid inflation, and mentions that when the government gets involved with bimetal systems, “the exchange rate may rise to what may be called a silver-export point where it pays to ship silver abroad.”<sup>16</sup> Von Storch was an advocate of free trade, contra the mercantilist tradition. More interestingly, he discussed comparative advantage by means of technological innovation, which he calls (translated from French<sup>17</sup>) “the secret of more advantageous proceeds” by which he means a more efficient way of producing goods. This discussion of comparative advantage makes von Storch “a very early predecessor of foreign trade theories of innovation leaderships and of technological gaps.”<sup>18</sup>

Another of von Storch’s disagreement with Adam Smith was Smith’s distinction between productive and “unproductive” labor, which von Storch thought was unconvincing because “unproductive” labor also contributes to wealth. This disagreement would lead him to develop the theory of inner and outer goods, the latter of which is its “material stock of wealth”<sup>19</sup> and the former of which is its “civilization” made up of “non-physical commercial stock.”<sup>20</sup> This notion is important because it recognizes the importance of the things he calls “inner goods” to a country’s welfare, but the concept would not make any real impact from him.

However, as previously mentioned, von Storch’s more important works were written in French, and therefore essentially unavailable to Carl Menger. This is where a second German economist, Karl Heinrich Rau, becomes relevant to the discussion. Rau was another liberal economist from Germany, who, like von Storch, was fluent in both German and French. Although

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<sup>16</sup> Schumann, Jochen. “Heinrich von Storch’s Innovative Contributions to Economics.” *European Journal of the History of Economic Thought* 25, no. 2 (April 2018): 388–400.

<sup>17</sup> Ibid.

<sup>18</sup> Ibid.

<sup>19</sup> Ibid.

<sup>20</sup> Ibid.

not much of his work is available today, it is easy to presume his liberal economic views based on his appreciation of Say and von Storch and his explanations of Say's points from *Letters to Malthus*.

Rau's bilingual talent would prove to be of enormous benefit to his undertaking of translating all of von Storch's *Cours d'économie politique*, including its annotations by Jean-Baptiste Say himself, from French into his native German. The resulting German economics book was called *Rau Handbuch der National-Wirtschaftslehre* and included both annotations from Say, and Rau's own commentary. Rau's commentary is overwhelmingly positive, another piece of evidence that points towards Rau's own liberal economic views.

Rau's goal was a unified theory of price, and he gave one for all commodities from the perspective of the consumer. The price theory he put forth was one that was based on subjective valuations by the consumer, and so despite Rau's love of Adam Smith, he changes things where Smith got them wrong. Rau's theory text has five books, the fourth of which, *Consumption of Wealth*, sounds much like J. B. Say.<sup>21</sup>

In fact, the third book of Rau's five, *Distribution of Wealth*, does not resemble the British classical economists at all. Erich Streissler says "book III already foreshadows neoclassical thought: it is not, as in Mill, first distribution, and then exchange – the logical sequence if you have a cost of production theory of price. With Rau, the theory of exchange *is* the theory of distribution, *nothing but price theory* announced as a common theory both for commodities *and* factors in the first paragraphs of that book."<sup>22</sup>

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<sup>21</sup> Streissler, Erich W. "Rau, Hermann and Roscher: Contributions of German Economics around the Middle of the Nineteenth Century." *European Journal of the History of Economic Thought* 8, no. 3 (September 2001): 311–31.

<sup>22</sup> Ibid.

Rau clearly sees market exchange as the proper vehicle for distribution despite his classical roots, and this leads to a much more individual focused economic method. It appears it did lead there, as Rau would later state that the economic principle was “the desire to satisfy wants with the least effort.”<sup>23</sup>

This *Handbuch*, translated by and commented on by a liberal economist, written by a liberal economist who was inspired by the French liberal economist who was the face of the French liberal tradition, would become one of the biggest influences on Carl Menger, founder of the Austrian school. Indeed, it was the book “with which Menger started his systematic studies in the autumn of 1867.”<sup>24</sup> Rau also wrote a three-volume textbook called *Lehrbuch der politischen Oekonomie* that was published between 1822 and 1837. This textbook was the gold standard in Economics from 1826 until 1869, with a final revised edition published in 1876, solidly within the time when Menger would have been a student. Further, “A student as late as Wieser thought Rau would be the first textbook a German scholar would turn to;”<sup>25</sup> Finally and most convincing, it turns out that Menger wrote the first draft of his first book, *Principles of Economics*, in the margins of his own 1863 edition of Rau’s textbook.<sup>26</sup>

If any other evidence was needed to see where Menger’s influences came from, one need not look further than the references in Menger’s *Principles of Economics*. Jean-Baptiste Say is quoted ten times, Rau seven times, and A. R. J Turgot, another famous French liberal, is quoted seven times as well. Karl G. A. Knies, the teacher of soon-to-be Austrian Eugen Böhm von Bawerk, is quoted nine times.

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<sup>23</sup> Rau, Karl. *Lehrbuch der politischen Ökonomie*.

<sup>24</sup> Streissler, Erich. *The influence of German economics*. Duke University Press, 1990.

<sup>25</sup> Ibid.

<sup>26</sup> Menger, C. 1963. *Carl Mengers erster Entwurf zu seinem Hauptwerk ‘Grundsätze’*. Tokyo: Library of Hitotsubashi University.

It seems clear that Carl Menger was, in fact influenced by the French liberal school and the people who espoused it. However, that does not necessarily imply that the Austrian tradition *evolved* out of the French tradition. It is one thing to be influenced by a thing, and another thing entirely for your ideas to come from a different tradition with an evolution stemming from your own thought. Was the French tradition changed into the Austrian school because of an addition by Menger?

As a reference for comparison between the schools, let us summarize the positions taken by Menger, and the Austrians after him. First, and most importantly, Menger was the person to discover and spread the idea of marginal utility, the idea necessary for analysis of value that had eluded economists for centuries. Alongside that, he believed in subjective valuations of utility and goods. He says in *Principles* that the “perception of the same relationship [between supply and demand] makes us aware of the significance that command of each concrete unit of the available quantities of these goods has for our lives and well-being, thus causing it to attain value for us.”<sup>27</sup> In fact, Menger saw that subjective valuations affected the supply of goods as well, meaning that marginal utility truly was necessary for understanding supply, demand, and value.

It was because of marginal utility and subjective valuations that Menger saw that exchange was mutually beneficial to the parties involved, not a process where equally valuable goods were arbitrarily exchanged. Again, in *Principles* he says “If, in addition, the two economizing individuals (a) recognize the situation, and (b) have the power actually to perform the transfer of the goods, a relationship exists that makes it possible for them, by a mere agreement, to provide

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<sup>27</sup> Menger, Carl. *Principles of Economics*. Ludwig von Mises Institute, 2007.

better, or more completely, for the satisfaction of their needs than would be the case if the relationship were not exploited.”<sup>28</sup>

Menger thinks highly of the entrepreneur and the work they are responsible, especially as the firm grows larger, and the time they must invest grows with it. Menger’s entrepreneur must obtain information about the “economic situation,” which includes relevant demand as well as market structure and health, perform all the necessary economic calculations, supervise production through each of its stages, and assign production processes to goods.

Concerning money, Menger too works through the double coincidence of wants problem, citing civilizations who used cattle as a primitive form of currency but eventually ran into the problem. Menger diverges from Say by saying that based on his observations, the idea of money as a “measure of exchange value” is “untenable.” Despite this, he mentions Say’s properties of money as fact, and shares Say’s distaste for the government setting what qualifies as money, saying “Thus money presents itself to us, in its special locally and temporally different forms, not as the result of an agreement, legislative compulsion, or mere chance, but as the natural product of differences in the economic situation of different peoples at the same time, or of the same people in different periods of their history.”<sup>29</sup>

Finally, although he never outright states it, the language he uses and the fact that Menger never made any “formal models of hypothetical economic relationships”<sup>30</sup> indicates that Menger, too, did not think statistics and mathematics were valid tools for economic analysis. This is further

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<sup>28</sup> Ibid.

<sup>29</sup> Ibid.

<sup>30</sup> Ibid.

validated by the positions taken up by later Austrians, who would argue this very point against economists like Keynes.

What is striking after comparing the relevant positions of both J.B. Say and Carl Menger are the many similarities between them, save for a few divergences of Menger from Say. What is more striking is that these divergences are always consequences of Menger's analysis on marginal utility. Menger's ideas about the value of goods, his thoughts about exchange, and some of the other, finer, points of his theory resemble Say, if Say had access to marginal utility theory. What was just described, of course, is the definition of the evolution of a way of thought. Newly discovered ideas permeate what is already known and change the relevant knowledge until everything connects again. For the Austrians, what was needed were Menger's brilliant ideas, and the hard work of two Germans trying to advance economic thought.