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**CARL MENGER AND FRIEDRICH VON WIESER ON THE ROLE OF  
KNOWLEDGE AND BELIEFS IN THE EMERGENCE AND EVOLUTION  
OF INSTITUTIONS**

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# **Carl Menger and Friedrich von Wieser on the role of knowledge and beliefs in the emergence and evolution of institutions\***

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*Abstract* – In this article we start from the well-known contribution of the Austrian school with respect to the problem of knowledge and its role in inter-individual coordination. Focusing on two authors of this school - his founding father Carl Menger and Friedrich von Wieser, we show that they both appreciate the role of knowledge in the emergence of economic and social institutions. However, their divergences regarding methodological individualism and subjectivism lead them to provide two different perspectives concerning the emergence and dynamics of institutions. This is exemplified by Menger and Wieser's way of dealing with the emergence of money: on one hand, Menger takes for granted the involuntary formation of shared knowledge about the validity of social institutions such as money; on the other hand, Wieser favours an explanation whereby collective beliefs are more than shared knowledge since they do have some autonomy vis-à-vis individuals.

## **Introduction**

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The revival of interest in the issue of knowledge in recent years<sup>1</sup> has rarely given way to systematic studies of the nature of knowledge within mainstream economics. Within this tradition, an entire generation of economists, following the seminal work of Arrow (1955, 1962), has confined scientific and technical knowledge to information, and argued that the knowledge generated by research activities possessed certain generic properties of public goods that implied that such activities could not be produced or distributed through the workings of competitive markets. By contrast, within the Austrian tradition<sup>2</sup>, but also in Polanyi (1967) and in the case of evolutionary economics, we find explicit recognition of the influential aspect of knowledge in human action.

The contribution of the Austrian tradition to this topic, culminating in the works of Hayek, is indeed undisputable<sup>3</sup>. Several reasons may explain this special focus on knowledge.

First and most importantly, it should be reminded that the Austrian economic tradition assumes that human action takes place in time and in a context of uncertainty<sup>4</sup>. Such an assertion implies, first, that in contrast to neo-classical economics, data such as individual preferences or production techniques are not given, but gradually take shape through individual action, experience and learning as well as under the influence of institutions and collective norms or beliefs.

Second, from a methodological perspective, the Austrian tradition is associated with the subjectivist viewpoint that it develops. This implies that, though often on a rather diverging basis according to the author considered, a fundamental heterogeneity in individuals is assumed.

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<sup>1</sup> This renewed interest has already swept many fields in economics such as decision theory, game theory, finance and organizational theory as well as neighbouring disciplines such as sociology, psychology or social philosophy. This increasing interest for analysing the role of knowledge and beliefs in economic phenomena is also characterized by increasing confusion regarding the use of the concepts of knowledge and beliefs in the various fields of social sciences. It is clear that a more systematic and general reflection on the role of knowledge and beliefs still needs to be carried out but this is beyond the scope of this paper (see Arena and Festré 2006).

<sup>2</sup> Apart from the most famous Austrian authors, one should mention, in particular, Fritz Machlup, who is less known as an Austrian economist but also contributed to this field of research. His contribution is summarized in the 3 of the 10 projected volume series: *Knowledge: its creation, distribution and economic significance* published respectively in 1980, 1982 and 1984.

<sup>3</sup> For a study of the place of knowledge and economic beliefs in the second generation of the Austrian School see Arena and Festré 2006a.

<sup>4</sup> Cf. the opposition between real time and Newtonian time made by O' Driscoll and Rizzo (1984).

From these two general arguments it follows that knowledge and beliefs play a fundamental role in connecting agents' decisions through time. Several questions then arise: how do individuals acquire knowledge? What is the nature of knowledge? How knowledge is created and diffused within the society? And finally how coordination arises?

The answers to those questions vary substantially among Austrian authors. To give only two polar cases, Mises, who endorses an apriorist approach, considers that knowledge consists of *a priori* logical categories such as causality and that human action is always intentional, rational and conscious, although he views history and law as playing some role in the determination of individual action (Mises [1949] 1996): p. 11). By contrast, for Hayek who favors a connectionist approach based on his 1952 book *Sensory Order*<sup>5</sup>, knowledge is conceived as an abstract process undergoing change in relation to new individual experiences<sup>6</sup>.

This oversimplified comparison gives a hint of the variety of the conceptions of the nature of knowledge within the Austrian tradition. It follows that conceptions regarding the role played by knowledge in economic and social activity will also vary by author.

For Hayek, since the process of classification into mental categories that underlies knowledge acquisition by individual agents is both abstract (in the sense of meta-conscious) and idiosyncratic, it is obvious that coordination of individual actions as well as communication between agents constitute crucial problems. As far as Mises' analysis is concerned, communication issues are less central although coordination of individual actions remains an important question since it involves time as well as uncertainty.

The importance attached to the problem of coordination of individual actions has also led the Austrian tradition to wonder about the role of institutions in economic and social life. The first who addressed this issue is the founding father of the Austrian School, Carl Menger. In his *Principles* (1871), he devoted an entire chapter to the question of the emergence of money to illustrate the distinction between organic and pragmatic institutions as regards their mode of emergence. For Menger, indeed, the case of the emergence of money is a striking example of how organic institutions – i.e., institutions that are not the result of individual's will, nor the fulfillment of a collective objective, in contrast with pragmatic institutions that are the result of an individual or group of individuals pursuing an intentional goal– emerge. This idea remained a key proposition of most Austrians economists - as the well-known statement by

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<sup>5</sup> In support of this interpretation, see, for instance Birner (1999) and Garrouste (1999).

<sup>6</sup> Hayek defines knowledge as a “system of rules of action supported and modified by rules indicating similarities and differences between combinations of stimuli” (Hayek 1978, p. 41).

Hayek 'human action but not human design' reminds us - even if, both the methodological background and the conception of knowledge of the author considered again reflect on the way he views institutions and their role in economic and social activity.

In this paper, we will focus on two authors: the founding father of the Austrian School, Carl Menger, and one of his direct successors, Friedrich von Wieser, who are emblematic of the way Austrian deals with the problems of knowledge and coordination. More particularly, we will contrast their respective conceptions of knowledge (and beliefs) in relation to the role of institutions. We will stress that, starting from a rather similar methodological background and being interested in solving questions such as how institutions emerge in an environment characterized by individuals' heterogeneity, time and spatial constraints, they however provide divergent perspectives of institutional dynamics.

Before entering into the details of their respective contributions to this field of analysis, let us make some general comments.

First, Menger and Wieser share the view that economic institutions are the product of individual action and not necessarily of human design. In other terms, they are interested in the self-regulating or spontaneous order properties of economic institutions or collective entities while, at the same time, they cannot conceive them as not resulting from the interactions between individual agents, in compliance with the principle of methodological individualism. The process of emergence of institutions must therefore be explained from the perspective of heterogeneous individual agents. It follows that assumptions concerning the nature of individual (or inter-individual) knowledge, the way it is transmitted from one individual to the other, and how it evolves through time, are determining to a large extent the role and the properties of institutions. In the following, we endeavour to contrast Menger and Wieser's respective conceptions of institutions from this angle.

Second, they both refer, even if implicitly, to two kinds of knowledge (or belief), namely, individual knowledge (or belief), on the one hand, and collective knowledge (or beliefs) on the other hand. As we will show, the articulation between these two kinds of knowledge appears to be essential in order to analyse such phenomena as the emergence or the maintenance of institutions as well as institutional change.

However, Menger and Wieser do not perceive institutions the same way, the former being more focused on the problem of emergence of institutions, the latter being more interested in the problem of institutional change in relation to the forces of power.

# 1.Menger: the role of knowledge in the emergence of institutions

For Menger, knowledge is central to economic phenomena in a very general and broad way. First, individual knowledge provides the foundations of a subjectivist conception of value. As reminded by Hayek in his introduction to the English edition of Menger's *Grundsätze* (translated into English as *Principles of Economics*), Menger defines value as “the importance which concrete goods, or quantities of goods receive for us from the fact that we are conscious of being dependent on our disposal over them for the satisfaction of our wants” (Menger quoted by Hayek, Introduction to *Principles of Economics* 1976, p. 18). On the basis of this definition, it appears that value can hardly be conceived as a static and objective concept, reducible to the concept of marginal utility, as sometimes alleged. Unlike classical and neo-classical economists, Menger is indeed not concerned about static resource allocation, but rather about resource use as a result of a better knowledge of production processes. Moreover, perceptions by individuals of their economic needs, conceived as the knowledge of the relationships between means and objectives is essential in the definition of economic value.

In another passage of his *Principles*, Menger explicitly endorses this vision by writing that “the quantities of consumption goods at human disposal are limited only by the extent of human knowledge of the causal connections between things, and by the extent of human, control over these things” (Menger [1871] 1979, p. 74). In this quotation, knowledge is conceived as general knowledge that is likely to expand with economic development. Menger indeed considers that any satisfaction of human needs begins from acquiring knowledge. For him, the driving force of economic life lies in gaining knowledge about relevant situations on a twofold basis. On the one hand, agents must know what their economic objectives are, i.e., their economic needs and how those ends can be achieved through time given the time-consuming nature of economic processes: “clarity about the objective of their endeavour is an essential factor in the success of every activity of men” and moreover, “it is also certain that knowledge of requirements for goods in future periods is the first prerequisite for the planning of all human activity directed to the satisfaction of need”. On the other hand, given any definite objective, people must know what are the means available to them in order to achieve their objectives: “the second factor that determines the success of human activity is the

knowledge gained by men of the means available to them for the attainment of the desired ends” (Menger [1871] 1979, p. 74).

Those two directions of knowledge growth permit to define the usefulness of things, i.e., individuals’ knowledge of the causal relationship between means and ends. This kind of knowledge can be illustrated by Menger’s reference, borrowed from Aristotle, to “imaginary goods” as a counterexample. Menger indeed defines those imaginary goods as things “that are incapable of being placed in any kind of causal connection with the satisfaction of human needs [but] are nevertheless treated by men as goods” (Menger [1871] 1979, p. 53). For Menger, this situation arises “when attributes, and therefore capacities, are erroneously ascribed to things that do not really possess them” or “when non-existent human needs are mistakenly assumed to exist” (ibid). The first case may be exemplified by cosmetics, love potions or medicines that were administered to the sick peoples of early civilizations, while examples of the second case may be medicines for diseases that do not actually exist, or statues, buildings etc. used by pagan people for the worship of idols (ibid). In sum, people may, owing to their ignorance or misperception of either their means or their ends, unduly consider some things as being useful, even though they are not. With the passing of time and thanks to economic progress, people are assumed to learn and have a better knowledge of their means and needs as well as of the relationships between means and ends in terms of usefulness. As mentioned by Menger in a footnote, the distinction between imaginary goods and (useful) goods can be connected to individuals’ rationality, as Aristotle suggests it when he distinguishes between true and imaginary goods according to whether the needs arise from rational deliberation (in the case of true goods) or are irrational (in the case of imaginary goods) (ibid. fn. p. 53). However, Menger does not elaborate on this line of argument even if he seems that he endorses such a distinction. One may however consider that this distinction is unfortunate since it is possible to conceive rationality in a more general perspective, as for instance in the line of Raymond Boudon, and therefore, to consider that individuals have ‘goods reasons’, even from the viewpoint of the criterion of usefulness, to connect some means with ends in cases that would be considered as falling into the category of imaginary goods for Menger.

A second question arises about individuals’ rationality: to which extent people can connect means and ends given the time constraints and the uncertainty that characterises economic activity? Clearly, for Menger, the correct foresight of the quantities available for the satisfaction of intended needs is unrealistic, so that “in practical life (...) men customary do not even attempt to obtain results as fully exact as is possible in the existing state of the arts of

measuring and taking inventory, but are satisfied with just the degree of exactness that is necessary for practical purposes” (ibid. p. 90).

More generally, knowledge of causalities between means and ends is a principle that guides economic activity as a whole and therefore, must not be understood as restricted to exchange analysis. First, Menger’s theoretical framework is based on the idea of the temporal antecedence of the production activity over that of exchange. Second, as well-known, he provided a microanalysis of the production structure defined as a temporal process characterized by vertical relations between different goods. The vertical hierarchy of goods or, in Menger’s terms, the order of the respective goods involved in the productive process is defined according to the degree of closeness of the good to the final stage of consumption. In terms of causal relations, this means that the basic direct causality between means and ends of one consumer does not differ in nature from the causality between productive goods of different orders within the production structure of one producer, but only in degree: the more remote in the production structure the good is the more indirect the causality is. Moreover, the value of remote goods is derived from the value of the final consumer goods they contribute to produce.

As Menger notes, this perspective challenges Adam Smith’s conception of economic progress based on the principle of increasing division of labor. For Menger, it is clear that the increase in the volume of consumption goods going with economic progress is not the exclusive effect of the division of labor but should also be imputed to an increased variety of kinds of economic goods, and as a corollary, to an increased knowledge of the causal relationships between means and ends, which requires an increased knowledge of the already mentioned dual-purpose knowledge (knowledge of the ends / knowledge of the means) but now extended due to time constraints: the knowledge of the “quantity of goods they will need to satisfy their needs during the time period over which their plans extend” and the knowledge of “the quantities of goods at their disposal for the purpose of meeting those requirements” (ibid p. 80)

This is only in this sense that it is possible to understand Menger’s sentence “the quantities of consumption goods at human disposal are limited only by the extent of human knowledge of the causal connections between things (...)” (Menger [1871] 1979, p. 74).

But as already noticed, this knowledge cannot, by nature, be complete: “error is inseparable from knowledge” (ibid, p. 148). With the extension of the production structure and the strengthening of time constraints, perfect foresight is an even less realistic assumption. Indeed, Menger saw the roots of uncertainty in the time-consuming nature of



economic processes. Assuming that all production takes time, producers have no way of knowing for certain that the market conditions prevailing when the production is ready for delivery. The result is that price of the finished product bears no resemblance to the costs of production, since the two represent market conditions at very different points on time. To a certain extent, one could say that the principle of increasing knowledge goes hand in hand with a principle of increasing uncertainty. Moreover, the increasing number of kinds of goods raises the problem of factor complementarity and substitutability.

Let us now envisage how Menger deals with these two issues.

As economic development proceeds, some individuals specialized in the acquisition of knowledge emerge. It is the case, for instance, of merchants, industrialists, who act as middlemen between “members of the society with whom they maintain trading connections” (ibid). With the passing of time, such middlemen constitute a class in its own right: they are “a special class of economizing individuals who take care of the intellectual and mechanical parts of exchange operations for society and who are reimbursed for this with a part of the gains for trade” (ibid. p. 239). These middlemen are referred to by Menger when he discusses the passage from the “isolated household” to the “organized economy” involving a transitory state of organization corresponding to the system of production on order (Menger [1871] 1976, see Arena and Gloria-Palermo 2001, p. 137-38). From this perspective, economic development can be seen as a process of division of knowledge – a principle that will be later systematized by Hayek, though from a different methodological perspective. This naturally leads Menger to elaborate further upon the role of organization and institutions with respect to the problem of knowledge. However, he is not very wordy concerning the conditions in terms of knowledge (explicit or tacit knowledge<sup>7</sup>, heterogeneity in agents’ cognitive capabilities) for those organization to emerge, to be maintained or to be efficient.

There is in Menger’s writing evidence that those middlemen, who arise with the development of the market, are more aware of the deficiencies of the previous organization of markets or have a better knowledge of their personal interest, which leads to improve the

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<sup>7</sup> Menger’s conception of knowledge is indeed difficult to specify precisely because it represents a very far-reaching form of knowledge. It includes general and explicit knowledge like scientific knowledge but also some more local forms of knowledge, that might be assimilated to the “knowledge of the circumstances of time and space”, to use Hayek’s terminology. Concerning this more local forms of knowledge, one can distinguish between explicit kinds of local knowledge that are articulable on one hand, and tacit, unconscious and non articulable local knowledge (see see Fleetwood 1997, pp. 164-166).

efficiency of exchanges. But this does not imply that those intermediaries do possess a distinctive kind of knowledge, such as practical knowledge that would be associated to their intermediation activity. More convincingly, what Menger puts forward is that they display a different kind of rationality, in the sense that they act as innovators or as leaders (see Arena and Gloria-Palermo 2001, p. 138). This assumption of a fragmented population made of leaders and followers is also implicit in Menger's description of the emergence of money as we shall show.

Concerning the problem of factor complementarity and substitutability, Menger emphasizes the principle of complementarity between goods of different orders, which he states as follows: "We can bring quantities of goods of higher order to the production of given quantities of goods of lower order, and thus finally to the meetings of our requirements, only if we are in the position of having the complementary quantities of other goods of higher order simultaneously at our disposal" (ibid, p. 85, italics in the original). Although this passage stresses the intertemporal complementarity constraint, it however does not prevent factor substitutability to occur provided this constraint is met.

This suggests that the specialization/ adaptability dilemma, borrowed from Richardson (1990)<sup>8</sup>, does not necessarily apply to Menger's analysis. As Lachmann puts it, the argument rests on the idea that factor complementarity and substitutability do not represent two mutually exclusive alternatives, but "are phenomena belonging to different provinces of the realm of action" (Lachmann 1977, p. 200). While the notion of factor complementarity applies to capital goods utilized in the prospect of a joint output, the idea of substitutability "is a phenomenon of change, the need for which arises whenever something has gone wrong with a prior plan" (ibid). Nevertheless, this argument does not preclude the lack of precision of Menger regarding organisational implications of both time constraints and uncertainty<sup>9</sup>.

This weakness also reflects on the problem of knowledge. As stressed before, Menger's explanation of successive stages of productive organization in terms of time and space constraints stands at a very general and abstract level of analysis. In retrospect, one can consider that Menger paved the way for a vast research field of research on capital theory,

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<sup>8</sup> This dilemma can be expressed as follows: if a firm always seeks specialization, this can be made only at the expense of adaptability in face of unexpected changes on the demand side. On this point, cf. Dulbecco and Garrouste (1999).

<sup>9</sup> In passing, this is an issue that Hicks will address seriously and that gives his contribution a strong Austrian complexion.

industrial organization and the role of knowledge in economic activity. Nevertheless, within the Austrian tradition, the road that will be followed focuses more on the prominent role of entrepreneurship than on the firm seen as an economic and social device for managing productive constraints. Kirzner's contribution, judging from his insistence on the awareness of the entrepreneur, provides a striking example of this tendency.

From a different perspective, Menger's emphasis on time constraints and limits to human knowledge also brings up the issue of learning and its place in economic life. Menger's analysis of the emergence of money provides a good illustration of the importance of learning in economic phenomena and, in particular, in the emergence of the specific institution of money. The case of the emergence of money is also typical of how Menger viewed the problem of emergence of organic – as opposed to pragmatic – institutions in his *Untersuchungen*<sup>10</sup>:

“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?” (Menger [1883] 1963: 146)

In his discussion of the origins of money (Menger 1892 ; Menger [1871] 1979, chapters 7 and 8, Menger [1883] 1963, Book 3, chapter 2), Menger points out that individuals do not always get what they want using the barter system. It is both costly and time-consuming to find the exact match, known as the ‘double-coincidence problem’ between individual needs. They tend to abandon direct exchange and exchange their goods with more marketable ones. The causes of saleableness in commodities is related, according to Menger, to different circumstances: to the organization of supply and demand (number of buyers, intensity of their needs, importance of their purchasing power, available quantity of the commodity), to the inner characteristics of goods (divisibility for instance) and to the organization of the market (degree of development of exchanges, of speculation and of free trade). Furthermore the saleableness of commodities is also conditioned by spatial limits (degree of transportability, degree of development of the means of transport, commerce and communication between markets) as well as time limits (permanence of needs, durability and cost of preservation of commodities, periodicity of the market, the rate of interest, the development of speculation,

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<sup>10</sup> From a methodological viewpoint, the case of the emergence of money or more generally of organic institutions comes under the case of the “exact orientation of economic research”, while pragmatic institutions refer to the “empirical realist approach” (Menger [1883] 1963: 55-61)

the weight of political restrictions to intertemporal transfers of the commodity) (Menger [1871] 1976, pp. 246-247). Agents thus progressively learn to select increasingly marketable goods and proceeds to indirect exchange, although it does not permit immediate satisfaction of their needs:

“The economic interest of the economic individuals, therefore, with increased knowledge of their *individual* interests, without agreement, without legislation compulsion, *even without any consideration of public interest*, leads them to turn over their wares for more marketable ones, even if they do not need the latter for their immediate consumer needs” (Menger [1883] 1963: 154)

This positive feedback<sup>11</sup> process eventually singles out one commodity, a commodity that becomes *money*. This selection process however is not the result of purposefully thinking about the advantages of commonly understood or used money. Market participants successfully experience smoother ways of trading for the sake of personal goals and, thus, are prone to carry on. In this case, the use of money by market participants is a spontaneous outcome of the market process. In other words, they do not invent money, nor are they able to know beforehand the superior properties of money in exchange, since it is an unintended result of their self-oriented activities. But it is also the use of prior or ex ante knowledge that helps people find better ways of carrying out transactions. As Menger explains in his 1892 paper on money , “the willing acceptance of the medium of exchange presupposes already a knowledge of these interests on the part of those economic subjects who are expected to accept in exchange for their wares a commodity which in and by itself is perhaps entirely useless to them” (Menger [1892], p. 261).

As such, Menger’s explanation is not satisfactory and involves some kind of circular reasoning: the question arises as to where this prior knowledge comes from since it is at the same time the result of a selection process. Menger’s answer to this question comes as follows: “this knowledge never arises in every part of a nation at the same time. It is only in the first instance a limited number of economic subjects who will recognize the advantage in such a procedure, an advantage which, in itself, is independent of the general recognition of a commodity as a medium of exchange (...)” (ibid p. 261).

To sum up, the process of selection consists in four mechanisms.

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<sup>11</sup> in the sense that a more marketable good is more exchangeable and then becomes more marketable.

First, it is based on an asymmetry of knowledge between two classes of agents: ‘leaders’ that are more able to see the advantages of indirect exchanges because they possess a better knowledge concerning the saleableness of specific commodities: they are referred to by Menger as “the most effective” and the “more intelligent bargainers” (Menger 1892, p. 254); and ‘followers’, who imitate them and who progressively become aware that through the use of these specific goods become, they can proceed “to [their] end much more quickly, more economically and with a greatly probability of success” (Menger [1871] 1976, p.258).

Second, it involves a process of learning by imitation: ‘followers’ indeed imitate leaders in their use of money. They want what their neighbours do possess because they observe that their neighbours perform better by using ‘money’ than they do themselves without it. As Menger explains, “ (...) it is admitted, that there is no better method of enlightening anyone about his economic interests than that he perceive the economic success of those who use the right means to secure their own” (Menger 1892, p. 247) The kind of imitation involved here is essentially of the informational type<sup>12</sup> since ‘follower’ imitates the ‘leaders’ because they are supposed to have a better knowledge of the properties of money in exchange and perform better.

Third, the selection process is depicted as a self-organizing procedure. As already emphasized, Menger only reluctantly admits the intrusion of external or legal compulsion in the process of emergence of money. In his 1892 article, he makes clear that “money has not been generated by law. In its origin it is a social, and not a state institution.” He only admits that “by state recognition and state regulation this social institution of money has been perfected and adjusted to the manifold and varying needs of evolving commerce (...)” (Menger 1892, p. 255). Clearly, in his analytical framework, legal or state compulsion is, at the most, of secondary importance since social and economic institutions such as money or the organization of markets are the unintended result of interacting agents.

Fourth, the emergence of money may be depicted as a self-enforcing learning process. Menger indeed emphasizes the existence of what economist today would call network externalities or network effects, i.e. the idea that the more the commodity is used as an intermediary of exchange, the more it becomes an efficient medium of exchange. In this way, a good which was initially used as an intermediate of exchange is converted, through “customs and practice” into a “commodity that [comes] to be accepted, not merely, but by all

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<sup>12</sup> Referring to Orlean’s typology of imitation (informational , self-reference and normative imitation).

economizing individuals in exchange for their own commodities” (Menger [1871] 1976, p. 261).

With respect to the problem of knowledge, Menger appreciates the role of non articulable, unconscious knowledge when the use of money becomes ever more widespread, though never using the term of tacit knowledge. Rather, he implicitly refers to some social or collective knowledge that is embodied in social organic institutions<sup>13</sup>. In other words, under civilization, the individual benefits from more knowledge than he is aware of. This is at least one way to explain the fact that useful organic institutions cannot be conceived only as a result of deliberate actions<sup>14</sup>. In other terms, actors frequently do better than they know merely because they know better than they are aware of knowing. It is then likely that with the passing of time the use of money becomes so anchored within habits and customs of market participants that using it does not require any longer the knowledge of its inner qualities in exchange. At this moment, using money becomes completely collective tacit knowledge. Although this argument anticipates Hayek’s analysis of the process of abstraction of rules, the following passage from Menger gives some support to this line of interpretation:

“With economic progress, therefore, we can everywhere observe the phenomenon of a certain number of goods, especially those that are more easily saleable at a given time and place, becoming, under the powerful influence of *custom*, acceptable to everyone in trade, and thus capable of being given in exchange for any other commodity” (ibid, p. 260)

In sum, Menger’s conception of knowledge is very general and far-reaching. It includes the two kinds of categories of knowledge that are usually distinguished within the literature (explicit vs. tacit knowledge) but also involves the articulation between individual and collective knowledge. Although Menger does not elaborate fully on the mechanisms at works in the articulation between individual and collective knowledge, the existence of shared knowledge is however essential for understanding the process of emergence of institutions.

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<sup>13</sup> One may refer here to some kind of knowledge creation following Nonaka and Takeuchi (1995).

<sup>14</sup> The process of emergence of money can also depicted as a “stochastically stable strategy” (Young, 1988; see Garrouste 2003 110-111). In other terms, the institution of money emerges partly as the result of chance, and partly as the consequence of the better knowing of some agents of the intrinsic properties of the commodity that is likely to be commonly accepted.

Moreover, this shared knowledge cannot be built through mere conscious imitation of leaders by followers. It is indeed the superposition of a collective / tacit knowledge that may explain the self-organizing and self-enforcing dimensions of the process of diffusion of money. Finally, it explains why organic institutions are the unintended result of interacting individual agents.

## 2. Wieser : the role of beliefs in the evolution of institutions

Friedrich von Wieser is the least known author within the triumvirate of the founders of the Austrian School. On the one hand, he is often viewed as a faithful follower of Menger paling into insignificance beside Böhm-Bawerk. On the other hand, his inclination in favour of authoritarian political regimes did not contribute to make him very well-liked. These circumstances certainly contributed to the underestimation of his work. However, as it has been said, Wieser's contribution to capital and imputation theory had a great influence on the development of the intellectual achievements of the second generation of the Austrian School even if it is mostly still unappreciated in the literature<sup>15</sup> (Streissler 1987; Endres 1991). Moreover, from a methodological viewpoint, he offers a very interesting mixture of economic analysis and economic sociology that shares some common features with Schumpeter's theoretical construction (see Streissler 1988, p. 195 and Arena and Gloria-Palermo 2001).

More peculiarly, Wieser developed a very interesting analysis of the role of knowledge and beliefs in economic and social phenomena in relation to the issues of the emergence and evolution of institutions. The remainder of the article will be focused on this aspect of Wieser's contribution. The accomplished version of this analysis is to be found in his late book *Das Gesetz der Macht* (translated as *The Law of Power*), which he published only a few months before his death, even if the overall scheme of thought of this last piece of writing is already sketched out in one of his previous works: *Theorie der Gesellschaftlichen Wirtschaft* (translated as *Social Economics*). More precisely, in *Social Economics*, Wieser is concerned about the deficiencies of a theory of marginal utility independent of the distribution of wealth or economic and social inequalities for those factors, according to him, do affect

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<sup>15</sup>As Stigler (1941) puts it, Wieser's contribution on capital theory "occupies a position of indisputable importance in the history of economics" and he "presented one of the best theories of capital which had emerged" in his time (Stigler 1941, pp. 158, 177; quoted by Endres 1991, p. 68).

subjective individual valuations<sup>16</sup>. In particular, in contrast to Menger, Wieser maintains that political compulsion and power do play a decisive role in the formation of individual preferences<sup>17</sup>. In this same book, Wieser contrasts the *Theory of the Simple Economy* with *Social Economics*, stating that in the latter, social stratification between classes exerts substantial effects on the economic activity, and in particular, on individual preferences valuations (see Arena 2003, p. 303). The existence of three classes implies that the group of ‘mass-commodities’ has to be evaluated by the marginal utility of the poor, the set of ‘intermediate goods’ by the preferences of the middle classes and the group of ‘luxury goods’, by the valuations of rich people (Wieser [1927] 1967, pp. 157-58).

But it is in his last contribution, the *Law of Power*, that Wieser provides an overall analysis of society that emphasizes power – power play, the psychology of power – and the role of beliefs in the emergence and evolution of institutions. We will therefore concentrate on this piece of work of Wieser.

First, let us focus on some important methodological features and terminology of Wieser’s overall theoretical approach that might be helpful for understanding his perspective on the problems of emergence and evolution of institutions.

From a methodological standpoint, it is important to note that Wieser departs from Menger’s strict methodological individualism and promotes an original view that mixes methodological individualism and holism<sup>18</sup>. This perspective is, for Wieser, a necessary one if one wants to deal with social phenomena such as the emergence of institutions. He indeed is not satisfied with individualistic explanations that provide no other explanation “(...)than the one which suggests itself in the personal sphere for the relations between individuals (...)” In particular, such explanations afford no room for “the element of constraint or command without which the [S]tate could neither originate nor endure and which can be clearly

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<sup>16</sup> For Wieser, there is not one but two theories of distribution: the first one measures the efficiency of productive services; the second determines the allocation of wealth. This distinction is made by a French sociologist economist, Roche Agussol, in “Friedrich von Wieser”, *Revue d’Economie Politique*, 1930, nos 4 and 5, p. 53, quoted by F. Perroux in his Introduction to the French Translation of Schumpeter’s Theory of Economic Development, Paris: Dalloz, p. 31.

<sup>17</sup> As indicated by Warren J. Samuels in his introduction to the 1983 English translation of *Das Gesetz der Macht*, even in *Social Economics*, power is seriously taken into account since it constitutes, together with the principle of utility, the “twin organizing principles” of Wieser’s theoretical economic framework. This feature had not been unnoticed by Oskar Morgenstern, who wrote in his obituary to Wieser that *Social Economics* had been the “greatest systematic treatise that has been written by an Austrian in which the principle of marginal utility is analyzed in all its ramifications” (Morgenstern 1927, p. 671, quoted by Samuels in the introduction of the *Law of Power*, Wieser [1926] 1983, p. xv).

<sup>18</sup> This is a feature that he shares with Schumpeter. See Festré and Garrouste (2006)



established for money as well” (Wieser [1926] 1983, p. 146).” In this passage, Wieser implicitly refers to Menger’s explanation of the emergence of money, which he considers unsatisfactory for reasons that are not only related to the absence of legal or State compulsion but also on other grounds that will be explained in the following. Wieser is no more satisfied with the polar case of collectivist explanations, stating that “in a roundabout way, [they] lead back to the individualistic explanation[s] by taking the people and the masses as a magnified individual” (ibid, p. 146). For Wieser, there is no hope in those two kinds of monist explanations. He also criticizes “dualist explanations”, arguing that they also confront us with problems and do not, therefore, constitute a satisfactory alternative. Wieser takes as an example of the dualist explanations the classical distinction between the subjective (use) and the objective (exchange) value of goods, supposedly able to reconcile respectively the “personal or individual influences” and “those influences which transcend the personal or individual”. But without a suitable way for connecting those two elements, this approach cannot be accepted either. For Wieser, the manner classical economics connect the two dimensions is misleading because the “so-called objective exchange value does not by any means apply objectively to everybody”. More precisely, on the demand side of the market of a particular good, the principle of the objective exchange value holds true “only for those who can pay the current price, i.e., for those for whom the acquisition of the good brings an increase in utility which at least offsets the decrease in utility brought about by the payment of the price”. Symmetrically, on the supply side, the principle holds good “only for those to whom the attainable price brings an increase in utility sufficient to compensate for the sacrifice which giving up possession of the goods involves” (ibid, p. 147). Wieser therefore concludes that “the objectively determined price gives only the proximate base and not the ultimate standard for valuation, for one and the same quantity if money means a quite *different utility experience* for the poor and for the rich person (...)” (ibid, p. 147, *italics in the original*). In other terms, it amounts to saying that the so-called objective exchange value is the subjective exchange value for market participants since those who participate in exchange are oriented towards the same objective base, i.e., the market price. But for those excluded from the market, the objective exchange value has no meaning since “its outcome is as subjectively determined as is the personal use value in each individual case” (ibid, p. 148). *In fine*, the contrast between objective exchange value and subjective use value is nothing more than a “contrast between a multitude of *parallel subjective cases* and the *isolated case*” (ibid, *italics in the original*).

From a terminological viewpoint, Wieser refers to “social institutions” as distinguished from “historical formations” with respect to their mode of emergence. Social institutions are characterized by the fact that they “are *created* by governments or by other order powers for a deliberate purpose and following a deliberate plan” or “in the awareness of a task to be done”, while ‘historical formations’ “grow up without the possibility of one’s becoming aware of a specific creator” but rather as a “searching force” Wieser ([1926] 1983, p. 141-45).

At first sight, Wieser’s distinction is reminiscent of Menger’s distinction between organic and pragmatic institutions. By analogy, historical formations could be conceived as organic institutions since they are the result of unintended action while social institutions should be considered as pragmatic ones since they are the result of “intentions, opinions, and available instrumentalities of human social unions or their ruler” (Menger [1883] 1963: 145).

Nevertheless, this analogy does not hold any longer if one reminds that for Menger, the distinction between pragmatic and organic institutions follows directly from another distinction of a methodological nature: the distinction between two orientations of theoretical research, namely the “realistic-empirical” approach and the “exact science” one<sup>19</sup>. Even though Menger admits that these two orientations can supplement each other, they nevertheless constitute two logically distinct perspectives. For Wieser, by contrast, explanation of social institutions and historical formations cannot be the subject of independent analyses. On the one hand, Wieser explains that social institutions are always embedded in “historical formations” (Wieser, [1926] 1983: 146) in the sense that an emerging social institutions must necessary fit or be consistent with the contemporary existing historical formation. Wieser takes as examples the market institution and monetary institutions, indicating that, “the market system presupposes the market as created by the coincidence of supply and demand”, or monetary institutions and that “the special monetary arrangements of a country are based on the general characteristics of money, which has come about as a result of the tortuous paths of commerce (...)” (ibid. p. 143). Generalizing this argument, Wieser maintains that:

“[with] all institutional arrangements it can be clearly seen how in their effect they always depend on being properly adjusted to the nature of historical formations which serve as their foundations” (Wieser [1926] 1983: 143)

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<sup>19</sup> In passing, it is interesting to note that Menger’s distinction between pragmatic and organic institutions is purely formal since he neither elaborates on, nor give examples of pragmatic institutions.

For Wieser indeed, a market system which is not consistent with the law of supply and demand cannot succeed. The same is true for “a monetary system attempting to maintain a value of money which has become untenable by an excess of monetary media issued by the state” (ibid. p. 143).

On the other hand, historical formations are defined in relation to power, which as already mentioned, plays an important role in Wieser’s analysis of institutions. This characteristic stands in sharp contrast with Menger’s framework, in which power (or even state power) is virtually absent<sup>20</sup>. On the contrary, when referring to historical formations, Wieser notes that they constitute particular states of the evolution of the society, characterized by a certain social stratification of powers, and which result from “the *accord of many personal units of consciousness* which to a certain degree give up their independence, but without a *higher encompassing unit of consciousness* taking their place” (Wieser [1926] 1983, 146, *italics in the original*).

Wieser’s analysis of power is based on two distinctions: on one hand, the distinction between masses and leaders; on the other hand, the distinction between internal and external power.

If Wieser distinguishes between leaders and masses, it is more to put forward that their respective behaviours or rationality obey different laws or display a distinct psychology of power than to suggest an idea of intellectual superiority of leaders with respect to masses or to convey a pejorative meaning to the term ‘mass’. In Wieser’s own terms, being a leader “(...) means nothing but to be the first in matters of common concern [and] [t]he social function of a leader is to walk in front (...)” (Wieser [1926] 1983, p. 38). However, the phenomenon of leadership is based on the existence of inequalities within a given population: it is governed by the “law of small numbers” based “on the *social success of small groups*” (ibid. p.1). Moreover, it is possible to distinguish between two types of leadership according to the mode of their emergence. On the one hand, there is the *authoritarian* kind of leadership, including despotic as well as lordly leadership, who emerges from historical selection by success. On the other hand, there is the *cooperative* kind of leadership, including leadership in a free

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<sup>20</sup> To be more exact, Menger emphasizes the role of power but only in the sense of the power of command over economic resources. In other terms, he deals with power as a necessary condition for being (or not) in position to use economic goods but does not elaborate further on how power is distributed among individuals and how this distribution evolves through time and on the interaction of agents or groups of agents.

society as well as *anonymous* leadership, which results from an election process by the masses.”(Wieser [1926] 1983, p. 39)<sup>21</sup>.

As far as masses are concerned, Wieser describes them as “following the leader” (ibid. p. 38), although he distinguishes between two forms of following: *dead masses* or *blind following*; *true following*. Blind following refers to a passive form of following that is reducible to sheep-like behaviour or to normative imitation<sup>22</sup>: “the model of the anonymous leader is being emulated by his environment and subsequently by a wider circle as well” (ibid. p. 44). True following, on the contrary, refers to reflective searching type of following or active following “which demands of the masses a certain independence of conduct and the capacity to adapt to the given circumstances” (ibid. p. 45). Moreover, in the case of true following, the psychology of masses also displays a process of internalization (or even true identification) of power:

“Internal power arouses in the masses the urge for ready emulation. In this connection the individual obeys not only his own instinct, but his behavior is also determined by the contact he has with the attitude of his environment and that of the masses in their entirety. The experience of power is intensified by the fact that the individual submitting to power thereby enhances the effective weight of internal power in society: he joins the ranks of the social rulers, albeit with a minimal share of power” (Wieser [1926] 1983: 57)

This passage suggests a dynamics between masses and leaders that is more complex than the term ‘following’ suggests. In fact, as we shall develop, this dynamics cannot be described in terms of imitation only. In particular, it involves the interplay of ‘internal power’, which constitutes a critical factor of the dynamics between masses and leaders. Let us now consider how Wieser defines internal power as distinguished from external power.

Wieser conceives “internal power” as being “impersonal and anonymous” (Wieser [1926] 1983, p. 3) while “external power” corresponds to the power that some persons or some groups exert on people with the help of “external” means such as “numerical superiority, arms or wealth” (ibid. p. 3). Internal power may be channelled by several means: science and knowledge for instance, through “historical education”, contribute to the creation of the social

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<sup>21</sup> Here again, one may be tempted to apply Menger’s typology of pragmatic vs. organic to leadership. The analogy is however quite superficial. What is arguable, however, is that Wieser is more focused on historical formations and cooperative leadership and that he privileges causal-genetic explanations, which places him squarely in Menger’s tradition from this viewpoint.

<sup>22</sup> If we stick to Orléan’s definition (op. cit.), normative imitation occurs in situations where people, for reputation motives, are inclined to imitate the behaviour of others, by fear of sanctions or social disapproval. In the case of authoritarian leadership, this type of behaviour is very common.

interactions which support social internal power (ibid. p. 107), while arts rather falls in the category of external power and leaders, even if it is rooted in the populace (ibid. p. 113). But the power of knowledge, contrary to faith power, is not a direct power but needs many intermediaries within the ruling classes in order to reach masses. It is therefore associated with Wieser's first law of social growth: the tendency toward increasing stratification (ibid. p. 26).

To a certain extent, the distinction between internal and external power again echoes the one between historical formations and social institutions. Internal power indeed refers to historical formations conceived as the result of unintended actions while external power can be associated with social institutions viewed as human devices designed with a specific task or purpose in mind. Similarly as in the case of the distinction between historical formations and social institutions, internal and external power can hardly be dealt with independently from each other<sup>23</sup>. As Wieser emphasizes, there must be some complementarity and consistency between internal and external power. Related to this issue, he criticizes Nietzsche and Spencer's too emphatic conception of the leader or the "great man" which is, according to him, out of touch with the reality of masses (ibid. p. 46):

“[i]ndispensable as is the performance of the leader in front for the achievements of society, no less so is the following by the masses. If the leader is viewed as the sower casting out the seed, the masses may be viewed as the ground which absorbs it” (Wiser [1926] 1983: 47)

This quotation brings us back to the issue of methodological individualism and holism. As we have emphasized, Wieser is neither satisfied with monist approaches nor with dualist ones, as he understands them. So what is the suitable method to be applied? Wieser's answer is not always clear and his argument easy to follow. As we have also stressed, when he describes the dynamics between masses and leaders, Wieser clearly has in mind something more than passive imitation or 'blind borrowing'. We could argue that the kind of following that he labels 'true following' has some common features with self-reference imitation, defined by Orléan as a kind of imitation that takes place when agents imitate but, by so doing, create a social value or a convention that gather some momentum and gain some autonomy vis-à-vis individuals that initiated the dynamics. By the same token, the idea of "anonymous leadership" could also be interpreted as a sophisticated mechanism that involves more than

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<sup>23</sup> In contrast to Menger's treatment of organic vs. pragmatic institutions, as we already pointed out above in this article.

mutual interaction between masses and leaders. For, as Wieser indicates, this kind of leadership is characterized by the fact that “the social success of small groups can be magnified to *full-fledged social success* if the new strength, which first was formed by the small group in its own interest, is removed from its control and placed at the disposal of the society as a whole” (ibid. p. 33)<sup>24</sup>.

The following arguments may indeed support this view.

First, Wieser refers to the notion of ‘objective spirit’ which he borrowed from Dilthey and Freyer, whose teaching was widespread in Germany. He argues that the existence of an ‘objective spirit’ plays an essential role in the articulation between individuals or masses and leaders and strengthens the coherence of social systems. More precisely, this ‘objective spirit’ relates to the commonly observed psychology of social human beings to infer from others and share some significations or values:

“Because we ourselves are moved by emotions, follow impulses, act purpose-oriented, connect mental images, forge concepts, and because this structural coherence of minds, characteristic of our very nature, falls within the realm of our experience, we can imagine ourselves as partaking in the consequences of the acts of foreign human beings and can re-create what spiritual values they contain (...) What is foreign becomes a signpost which we are able to follow even when it does not guide us simply in a certain direction but leads us to a plenitude of heterogeneous realities: languages, literatures, states, architectural styles, churches, customs, arts, and systems of sciences” (Freyer, *Theory of the objective Spirit*, quoted by Wieser [1926] 1983: 147)

This idea of ‘objective spirit’ can be interpreted as a means to articulate individual beliefs or values with collective ones in a manner that is more sophisticated than the one implied by mere imitation. More precisely, for Wieser, the objective spirit of a community is more than a signpost: it is “like a current to which we are glad to yield because we feel its supporting power and whose superior strength we possibly may not be able to escape at all even when we are terrified to discover that it will carry us toward the abyss” (ibid, p. 148). In other terms, the ‘objective spirit’ becomes an entity which has its own developmental mechanisms, such as inertia, self-preservation (ibid. p. 124) and destructive power. However, its autonomy vis-à-

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<sup>24</sup> In passing, this quotation could be put in perspective with the notion of heteronomy, borrowed from political philosophy, and defined as the subordination or subjection of individuals to the law of another or to something else that individuals fail to see. This notion is in sharp contrast with the widespread idea among Austrian authors of the autonomy of the individual vis-à-vis the State. As rightly put forward by J-P Dupuy, this boils down to the theoretical problem of the articulation between two kinds of autonomy: 1) the autonomy of the individual freed from any relation of subordination towards the sacred, the State or the social whole; 2) the social autonomy, which does not mean that men do control the society, quite the opposite: the society escape them, it seems to be endowed with a life on its own, foreign to the individuals that form it (see J-P. Dupuy 1992, p. 247)

vis individuals “must not undermine our recognition that it is borne out of the spirit of the united individuals” (ibid, p. 149).

The idea of ‘objective spirit’ can also be related to Wieser’s notion of social egoism, which he already developed in *Social Economics*. For Wieser, social egoism is conceived as an intrinsic component of the psychology of human beings implying that “by reason of the social egoism a man is ready to fit into the social order which includes both submission and domination” (Wieser [1927] 1967, p. 161).

Second, Wieser refers to the notion of success, a concept that he shares with Menger by the way. But, in contrast to Menger, for Wieser, the notion of success encompasses more than the idea of the replication by followers of supposedly efficient behaviours displayed by leaders. As pointed out by Samuels (op. cit.), Wieser’s concept of ‘success’ is not defined *in abstracto* as the achievement of the fittest economic state. In particular, depending on the fact that it is *actual* or *perceived*, success can also lead to negative outcomes, such as dictatorships:

“Success constitutes a mechanism, as it were, of historical selection. The course of history is marked by a path of success vis-à-vis other paths which might have been. Success in this context signifies survival (...). Success, in Wieser’s analysis, has no independent positive or normative, ex ante, test. It is circumstantial, episodic, and without external or internal value basis independent of the fact of survival. It is the consequence of successes, however, which marks the course of history” (Samuels, introduction of the *Law of Power*, Wieser [1926] 1983, p. xxxi)

Third, Wieser refers to “the law of upward mobility of classes<sup>25</sup>”, which implies the existence of a tendency towards the congruence of beliefs between masses and leaders. Indeed, at first, masses have no share in public power, but through social interaction – through labor and art essentially, they may have an opportunity to further their personal achievements and therefore, to resist the pressure from the leaders and not completely succumbing to it. As far as the ruling leaders are concerned, they are themselves aware of their own interest in augmenting the vigor of the people to utilize it better, so that the more enlightened rulers have a strong affinity for the populace and begin sharing public power with it. As Wieser summarizes it:

“In the present epoch, the face of the earth is being technically transformed by the alertness of (...) both those in command and those in subordination positions. All

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<sup>25</sup> This law defines the second law of social growth, the first one, being, as already mentioned, the “law of increasing social stratification”.

these quietly evolving and ascending collective forces have in due time been transformed into social power or they will do so, acting as a resistance first but eventually also sharing leadership roles” (Wieser [1926] 1983: 26)

All these arguments give strong support to an interpretation of Wieser’s approach of the emergence of institutions in terms of a more sophisticated dynamics of social interaction than the one put forward by Menger. This interpretation is reinforced by thorough investigation of Wieser’s remarks regarding Menger’s explanation of the emergence of money. In *Social Economics*, Wieser dedicates several pages to Menger’s approach of the emergence of money. If he clearly regards, as Menger, money as one of the founding institutions of social economy, he has reservations about the way Menger deals with the issue of its emergence. On the one hand, he appreciates Menger’s novel ‘penetrating investigation” into the problem of money which – by taking “the phenomenon of money as a paradigm” allowing to show that “all social institutions of the economy are nothing more than ‘unintended social results of individual teleological factor’ (*Untersuchungen*, pp. 171-87)” – put an end to the “long series of writers who sought to explain money as an individualistic institutions.” (Wieser [1927] 1967: 163). On the other hand, a few pages later, he point out that:

“Menger’s explanation would be entirely satisfactory if he had appreciated as fully the part that the masses play in the development of money as he did that taken by leaders. The function of the masses consists in that their imitation establishes the universal practice which gives to a rule its binding force and social power. (...) It is in keeping with (...) [his] individualistic point of view that he (...) [did] not fully appreciate the part played by the masses in the creation of money. (...) Therefore it is not possible for him (...) to concede that money represents *something more and stronger than the will of participating individuals*. A money for which a mass habit of acceptance has once been established is no longer the mere result of the individual aims of leaders whom the masses follow. Neither in the beginning nor later did the leaders have in mind a social institution. (...) The final form of money is not a mere resultant; because of the universal social resonance that it awoke it represents a tremendous strengthening of their endeavors” (Wieser [1927] 1967: 165, *underlined by us*)

From this passage, it follows that the intervention of masses cannot be interpreted as an act of pure recognition of the social utility of leaders’ decisions. For reasons that still need to be elaborated upon, masses tend to create a final rule “far beyond [leaders]’ expectations” (Wieser [1927] 1967: 165). This suggests again an interpretation of Wieser’s approach



conception of the emergence of institutions in terms of conventions (or social norms) or in terms of the supervenience approach, as we already sketched out.

Such an interpretation is also consistent with Wieser's description of some of the characteristics of the social dynamics between leaders and masses. As we have shown, for Wieser, this dynamics is not only governed by purely economic interests but also includes some extra-economic sociological laws such as the law of power, the law of increasing social stratification, the law of upward mobility of classes or the role of success. The resulting effect of these mechanisms is all but determinist, even neither can it be considered as welfare improving. From this viewpoint, Wieser differentiates himself from Menger who implicitly assumes that organic institutions serve the common welfare. Additional arguments taken from Wieser's writings may be put forward in order to support this view.

First, Wieser makes reference to "inner rules" such as inertia effects or self-destruction mechanisms that underlie the law of power, as the following quotation exemplifies:

"A social group, once it has been formed into a unit by the *sacrificium voluntatis* of its members, cannot easily be jolted by the sacrifices which it demands of them. Once success has induced leaders and masses to go together, failure will not automatically induce separation in spite of the losses caused by it" (Wieser [1926] 1983: 26)

Those mechanisms belong to the psychology of power and constitute what Wieser refers as the 'supra-social' or 'anti-individual' or even 'anti-social' character of power, which stands "in complete reversal to the law of success" (Wieser [1926] 1983: 71). They also contribute to explain the emergence of collective wholes or social entities that have acquired some autonomy vis-à-vis individuals. This 'holistic' feature does not however lead to neglect the role of individuals within social dynamics. Wieser indeed explains that personal strength is at the origin of the growing of power but, "by aligning itself with the strength of a like-minded individuals, [it] is being enhanced way beyond its inherent potential[;] [a]longside it, there is a strengthening of the feeling of power, though at the same time strength *in no small degree is being deprived of its personal roots*" (ibid. p. 70).

Moreover, by emphasizing the relation of individuals towards their neighbourhood but also towards the society considered as a whole entity, Wieser is able, in contrast to Menger, to deal with the issue of the evolution (and not only of the emergence) of institutions. For instance, Wieser points out the possibility of conflicts between a new historical task and existing

historical powers (ibid. p. 203), or the existence of tensions regarding the sharing of power between the leadership strata and the strata representing the masses (ibid. p. 52). In mathematical terms, leaving aside the well-know reservations of Austrian economics about the use of mathematical relationships, these conflicts or tensions could be assimilated to path-dependency or hysteresis effects.

To conclude, Wieser is far from being a faithful following of Menger. His overall scheme of thought displays original thinking on several issues. First, on the methodological ground, Wieser's combination of individualism and holism and of economic analysis and economic sociology is very insightful and demonstrates quite convincingly, by using the method of successive approximations, the limits of pure economics, in particular regarding power considerations. From this perspective, his contribution is comparable to the one of Pareto (see Ragni in this volume) or Schumpeter (concerning Schumpeter, see the introduction of Arena and Dangel-Hagnauer, 2002). Second, by facing the problem of the influence of individual and social knowledge as well as systems of beliefs on economic and social phenomena, he offers a broader conception of rationality, where beliefs and action cannot be dealt with separately but determine each other. This concern, which is to-day very lively among social philosophers and sociologists, makes Wieser's contribution very topical. Third, Wieser's contribution is also very enlightening regarding institutional matters. In particular, it provides some foundations for an analysis of the dynamics of institutions based on interlocking groups of agents and conflicting interests rooted in power and social strata.

### **Concluding remarks**

Menger and Wieser approaches to the problem of the emergence of institutions share some common features. On the one hand, they both see it as the “unintended social results of individual tendencies” (Menger [1927] 1967). On the other hand, both authors introduce a distinction between leaders and followers or masses, which underlies a further distinction between innovative and imitative behaviours. However, for Wieser, those two kinds of behaviour may overlap, because they also are rooted and subject to the law of power. This original feature of Wieser also permits to provide an analysis not only of the emergence but also on the evolution of institutions. Furthermore, they both appreciate the role of knowledge in economic and social phenomena in general, and in the more particular case of the

emergence of institutions. As we have shown, both explanations of the emergence of institutions involve the interplay of individual and collective knowledge (or beliefs). If they both attempt to analyse the phenomenon of economic or social institutions from the perspective of interactions between individuals, they however differentiate from one another as regards the dynamic process underlying those interactions. On one hand, Menger takes for granted the involuntary formation of shared knowledge about the validity of social institutions such as money. On the other hand, Wieser favours an explanation whereby collective beliefs are more than shared knowledge since they do have some autonomy vis-à-vis individuals.

As we have stressed, Wieser's emphasis on the psychology of masses and leaders lead him to consider the influence of compulsion forces, besides the forces of freedom or "natural controls", on the historical formations underpinning institutions, while they are discarded by Menger. This also explains why Wieser views historical development and social institutions as radically non deterministic, and possibly welfare damaging, while Menger implicitly assumes, judging from his analysis of the emergence of money, that they are always welfare enhancing. To this extent, Menger's analysis is limited to the emergence of institutions, viewed as a 'discovery' process, while Wieser's is more focused on the dynamics of institutions, seen as a creative-destructive process.

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