

Chapter 2

Methodological Principles

The object of investigation is man in a condition of activity. Hence our mind ratifies every accurate description of the processes of his consciousness by the affirmative declaration that such is the case, and by the compelling feeling that it must be so necessarily ... In these cases we, each of us, hear the law pronounced by an unmistakable inner voice. What unequalled advantage to the naturalist, could he, too, appeal to the voice of nature for their confirmation of the laws prevailing in the organic and inorganic world! Where the natural sciences can only offer proof, the theory of economics can persuade; it can enlist the unqualified inner consent of readers.

—Friedrich von Wieser (1927/2003), *Social Economics*: 8–9.

In recasting economics along the lines of marginal utility analysis, Carl Menger provided a unique set of methodological principles that are at the foundation of what makes Austrian economics distinct. These principles are grounded in the core purpose of economics, which is the intelligibility of the world in which we live. Further, since their goal is to understand the human world, economists must render the events under examination intelligible in terms of purposeful human action. This leads to the recognition that only individuals face decisions and make choices, though undoubtedly conditioned by their social surroundings. Therefore, social phenomena are only rendered intelligible if the economist traces those phenomena back to individual decisions. This is the concept of “methodological individualism,” which holds that people, with their unique purposes and plans, are the beginning of all economics analysis.

Groups and organizations, which consist of people, do not engage in choice and do not have purposes and plans absent the individuals that constitute the group. Charlotte can choose to be a member of a group, and

she may even cede subsequent decision-making power to another member of the group. However, in order to understand the group, and Charlotte's membership in that group, we must start with Charlotte's aims and how her decision to join the group fit with those goals. This involves starting with the individual choosers and tracing out the implications of their decisions in light of their desired ends.

These core principles—methodological individualism and purposive behaviour—have important implications for the way that we engage in economic analysis. We are interested in explaining a variety of complex phenomena—for example, exchange, price formation—and to do so we appreciate that these phenomena are composed of the actions of numerous individual actors. It is only by appreciating the purposes and plans of individuals that we can hope to make sense of the world. The theorems of economics—that is, the concepts of marginal utility and opportunity cost, and the principle of demand and supply—are all derived from reflection upon purposefulness in human action. Economic theory does not represent a set of testable hypotheses, but rather a set of conceptual tools that aid us in reading and understanding the complexities of the empirical world.

This is fundamentally different from the scientific method employed in the natural sciences. Following the methods of the natural sciences, for example, one could develop a “scientific” explanation of a man placing pieces of paper in raised boxes located at the curb. At 3:30 pm every afternoon, the scientist observes that a man in a uniform moves from house to house putting pieces of paper in the little boxes that sit in front of these houses. One could develop a testable hypothesis and make point predictions concerning this data, that is, “at 3:30 pm this man in a blue suit will place paper in the little boxes that are located on the street in front of the different homes.” The scientist can then “test” his hypothesis against the data derived from observation. The hypothesis is then either rejected or, for the moment, fails to be rejected.

What is unique about the human sciences, as opposed to the physical sciences, is that such an explanation would miss the essential point of the phenomenon under study. The human scientist can assign purpose to the phenomena under discussion. In fact, she must assign human purpose if she wishes to render those phenomena under investigation intelligible. We can understand that paper is not just being stuffed into boxes for no reason, but rather that

a postman is delivering mail to individuals who reside at specific addresses. This understanding is available because the human scientist can rely upon the knowledge of ideal types of other human beings.

We know some human beings because of our daily face-to-face relations with them—for example, friends, family, co-workers. Other humans we know through the functions they perform or beliefs they supposedly hold—for example, “postman,” “policeman,” “liberal.” The majority of other people, however, we simply know in anonymity as “human”—that is, beings who freely choose and strive to obtain their goals by arranging and rearranging the means available. We can understand the purposeful behaviour of “the other” because we, ourselves, are human. This knowledge, referred to as “knowledge from within,” is unique to the human sciences, and it creates fundamental issues of analysis when it is eliminated by importing the methods of the natural sciences to the social sciences to create “social physics.”

While it was desirable to eliminate anthropomorphism—that is, attributing human behaviour to animals or objects—from the study of nature, it would be completely undesirable to eliminate humanness—the purposes, plans, and imperfections of people—from the study of human phenomena. Such an exercise results in the mechanomorphism of the human sciences—that is, attributing mechanical behaviour to creative, choosing human subjects. In such a situation, economics is no longer a human science as we end up talking about the economic behaviour of robots and not of human beings.

For Austrian economists, the subjective nature of human beings permeates all aspects of economics. The “facts” of the human sciences are not objective, as in the natural sciences, but rather consist of how people perceive the world. All phenomena are filtered through the human mind. This understanding distinguished Menger from his co-revolutionaries (Jevons and Walras) in the marginal revolution. All three thinkers appreciated the idea of marginalism and the role of marginal utility. But Menger stressed that the evaluations of the desired ends, as well as the determination of the best means to achieve those ends, are uniquely subjective to the individual chooser. This has important implications that differentiate Austrian economists from many of their colleagues in economics.

In the wake of the marginal revolution, most economists agreed that value (the demand side of the market) is subjective. However, many held that

production (the supply side of the market) is determined by objective conditions. In this vein, the economist Alfred Marshall likened the market (supply and demand) to the two blades of a scissor. Just as both scissor blades cut a piece of paper, so too do subjective value and objective costs determine the market price. This view of the market, however, overlooks the subjective nature of costs, which can be understood as follows.

When engaging in choice over alternative courses of action, a person must necessarily choose one path of action over another. If Cordelia chooses to eat, she cannot pursue her next favoured alternative of taking a nap. The trade-offs associated with choosing among alternatives leads to one of the main concepts in economics—opportunity cost. The term “opportunity cost” refers to the value of the highest-valued foregone alternative associated with taking a specific action. At each moment of choice, the individual chooser weighs the expected benefits of one course of action against the expected benefits of other courses of action (the expected benefits of the next best alternative is the same as the cost foregone). These expected benefits are filtered through the human mind, meaning they are subjective to the individual chooser. Moreover, since the expected benefits of foregone alternatives are never experienced, the subjective opportunity cost is purely in the mind of the actor and is unknowable to the outside observer. It is indeed true, as Marshall noted, that both blades of a scissor cut the piece of paper. In economic matters involving human beings, however, the blades of both demand and supply are determined by people’s subjective valuations.

For Menger, and those who followed in his footsteps, subjectivism was central to the study of economic phenomena. Menger agreed with his corevolutionaries that individual choices are made on the margin by all economic actors. But he, in contrast to Jevons and Walras, emphasized the subjective nature of the entire decision-making process. Acts of choice—from ranking which ends to pursue, to choosing the means to achieve the desired ends—are grounded in the subjective assessments of individuals. Moreover, this series of choices is open-ended, which means that through time people are learning what ends to pursue and the most effective ways to achieve those ends. As a result, Austrian economists place an emphasis on understanding the process of discovery and learning that takes place through time.

Another foundational principle of Austrian economics is the adoption of the means-ends framework. This entails taking ends as given and focusing on whether the means proposed to achieve the desired ends are suitable. This

approach has a long history and revolves around the nature of economics as a science. In the nineteenth century, economists associated with the German Historical School embraced the connection between economic analysis and active advocacy for specific political outcomes. From the perspective of the German historicists, the value of economics was precisely that it enabled advocacy for desired outcomes. Max Weber, one of the founding fathers of sociology, offered an alternative position.

Weber argued that, for social science to be scientific, the practitioner had to draw a clear line between analysis and advocating for particular positions or advancing personal value judgments. The Weberian doctrine of *Wertfreiheit*—“value freedom”—was adopted by Mises as a foundational principle of what it meant to do economic science. This doctrine makes sense in light of the prior methodological principles. The adoption by Austrian economists of methodological individualism and purposive action places emphasis on the logic of choice regarding the use of scarce means to achieve desired ends. From the perspective of economics as a science, the ethical content of the ends is irrelevant as is the personal ethical or political positions of the economic analyst.

An economist may be tasked, for example, with studying whether a rent control policy is an effective means of increasing affordable housing for the least well-off in society. The analyst can use the tools of economics to show the perverse effects of such a policy: a housing shortage, a reduction in the supply of future housing compared to a situation without rent control, a reduction in the quality of existing houses, the reduction in the cost of landlords engaging in non-monetary discrimination. In this case, the economist has used the scientific tools of economics to show that the results of policy will be undesirable in terms of the ends desired by the policymakers. This is a bad policy, not because the ends of helping the least well-off is bad or because the economist has a personal dislike for rent control policies, but rather because the policy of rent control is an ineffective means to achieve the stated end of helping the most disadvantaged.

The adoption of the doctrine of *Wertfreiheit* allows for the operation of a distinct science of economics, separate from political advocacy or personal bias. While the science of economics is value free, it can be used to inform policy. For example, as we will discuss in a subsequent chapter, the process of exchange and competition under a regime of private property rights is what enables people to engage in the discovery that is at the foundation of improvements in human well-being. This insight can be used to inform policies related to economic development.

Economists can communicate their scientific findings to the public and policymakers, just as medical scientists might communicate the latest findings on research regarding the causes and known cures of cancer. In each case, the respective scientists are not involved in advocacy or in making personal value judgments, but instead are engaged in communicating the findings of their scientific explorations to those whom they believe will find the information of use. In this regard, economic science plays an important role in human well-being by providing crucial insight into the operation of the economic system and into the efficacy of various policies for achieving the desired ends of citizens. Appreciating the subtleties of the *Wertfreiheit* principle is important for avoiding the common mistake of confusing the scientific analysis of policy, and the communication of these findings, with biased advocacy grounded in the personal values of the analyst.