While classical economics had developed a theory that was based on *homo oeconomicus* — wealth maximizing individuals — and on the special institutions of a pure capitalistic society so that the propositions could not claim to be true for other historical epochs, Menger had the vision of a general economic theory whose validity is independent of space and time. The basic elements of this theory had to be: exact types and exact relations. These types and relations should capture the nature or essence of economic actors and of economic processes.

The description of economic phenomena and of empirical regularities, and the description of the development of social institutions — the main business of the historical school — are useful. But this empirical knowledge is unable to provide an understanding of the basic factors and mechanisms in the economy. As in the natural sciences one has to look for universal laws in order to explain the observable phenomena. Put in a modern language: Menger defended economic theory against the demand for realism in economics by pointing to the essential goal of science: the explanation of all important and interesting observations on the basis of universal laws which — as it stands — usually refer to unobservable (or badly observable) parts of reality. But, what is the relationship of Menger's exact types and exact relations to reality? Are these types and relations realistic descriptions of economic reality? And if not: How is it possible to explain the factual behavior of economic agents and economic systems with "unreal" economic models?

Menger's solution of this methodological problem is not quite satisfactory. However, the fact that he was neither a clear cut Aristotelian nor Kantian nor Humean nor Leibniz-rationalist but was influenced by all these philosophers in some way makes it difficult to give a unique interpretation of Menger's views. In my view he is correct in stating that not any deviation between theoretical propositions and empirical observation can establish the falsity of a theory. But if economics is to have explanatory power at all, then one cannot defend the methodological rule — as Menger seems to do — that empirical observations can never disprove a theoretical statement. In natural science any inconsistency of theory and observation poses a problem which has to be solved in one way or the other. If in economics one wants advance, one cannot simply pass over contradicting evidence.

Some of Menger's Aristotelian like arguments suggest the idea of a double reality: there is on the one hand the (logically characterized) essence of a thing — the "nature" (exact type) of money for example — and on the other hand the various empirical forms (real types) of money: shells, cowrie, cattle, grain, tea bricks, salt, fur, slaves, tin ingots, currency and so on. Some historical forms of money like salt, tobacco, slaves etc. can be used as a medium of exchange and also as a consumption or as a capital good. One can define as an exact type of money such and only such things or assets which were only used as an universally accepted medium of exchange. Further, one can develop a monetary theory in terms of this (exact type) concept of money. An element of this theory could be the statement that an increase in the supply of "money" would lead to an increase of the price level. Now, if there were never such a thing like this "pure" money, what about the cognitive status of this monetary theory?

There are various possibilities: (1) The theory could be interpreted as a description of a logically consistent but fictitious economic world with no claim to represent aspects of reality. In this interpretation the theory would be useless for explanatory purposes. I do not believe that Menger would have accepted such an interpretation. (2) The theory could be understood as an ideal type monetary theory in the sense of Max Weber. The ideal type could be used as a frame of reference in order to compare the factual money economy with the ideal type money economy. One can argue for such an interpretation on the basis of Menger's writings. But, as an ideal type does not entail any law one cannot see how the working of a real economy can be explained with the help of an ideal type model. (3) The theory could be a description of an ideal situation (in the sense of being not real).

In conjunction with an implicit law of human behavior as to the demand for goods applied to the ideal type "money", one can derive statements about the price level. Because in such an interpretation one makes use of a law one can say that this theory provides an explanation in principle. Applying this theory to a real economy one has to account, among
others, for the fact that “real” money usually provides other services too, besides being a medium of exchange. Therefore the demand for money — in contrast to the demand for “money” — has to depend on more than on money income as a variable which is indicative for money exchanges.

There is much in Menger’s writings which is in line with my third and favored interpretation of his exact theory. But there are statements of Menger which are incompatible with a strict natural-science interpretation of his method. In order to derive the laws of competitive prices or the result of bargaining in a bilateral monopoly situation, Menger assumes strict self-interested and economically efficient (rational) behavior on the side of the actors involved (exact type of economic action). This assumption is not a (natural) law of behavior as Menger correctly observed. Therefore the deductions of economic theory cannot claim the status of (factual) laws of the economy but are (normative) laws of economy (Gesetze der Wirtschaftlichkeit). As it is not possible to explain empirical events by normative laws (or rules of conduct) alone, i.e. without a law that explains why the actors follow those normative rules, Menger’s economic theory is useless (or incomplete) for the explanation of economic events. But as his main aim was the demonstration that one can build an economic theory that is able to give an explanation for the bewildering facts of economic life one has — at least today — two possible options: (1) to accept that Menger has failed to show that there can be an exact economic science that has the same cognitive status as the exact natural sciences. In this case there remains in fact only the interpretation of Max Weber: economic theory as the most advanced outcome of the method of ideal types in social science; (2) to acknowledge that economic theory is incomplete: we do need at least additional hypotheses that state under which conditions one has to expect a behavior of firms and of individuals in accordance with the “laws of economy”. The modern theory of rational choice and the modern theory of property rights are steps in this direction but are yet not sufficient for an adequate explanation of the bewildering facts of the economy. Anyway, anyone who follows Menger’s goal cannot but accept my interpretation. (3) of his exact theory and look for improvements the economic theory of human behavior.

In addition to his methodology of (exact) economic theory, Menger proposed the fundamentals of a non-functionalistic theory of social institutions. That theory tries to give a systematic answer to one of the most fundamental questions in social science: How can we explain the origin and development of social institutions being designed by nobody and yet fulfilling useful social purposes. Anybody thinks that in developing his social theory Menger should have learned from Hume or from Smith or from Ferguson. But Menger got his ideas probably from the historical law school (Savigny and Eichhorn) and not from classical economics. In fact he even accused Adam Smith for his alleged rationalistic social philosophy.

Depending on the interpretation of Menger’s methodology for exact economics, there remains the problem whether it is compatible with his social theory. Menger is consistent if one sees his philosophy of science as suggesting for economics as well as for social theory the idea to try to explain social facts on the basis of nomological hypotheses. The fact that due to the complexities of social life we can get, in practice, only explanations in principle does not reduce the fruitfulness of this program for social science because there is no acceptable alternative.