

The Austrians

WHILE "The Austrians" are well known to readers of *Modern Age*, most historians of economic thought today treat the Austrian School of Economics as a passing episode that spanned the decades of the 1870's and 1880's in the evolution of economic ideas. Without fail, one is left with the impression that, at one time, the theories of the Austrians had been quite influential, but that the progress made in economic science in the twentieth century had either fully absorbed their contributions into the mainstream of economic analysis or rendered others obsolete.

But Austrian Economics we know only too well was much more than a temporary stepping stone that advanced economic understanding over a century ago. Rather, its rich tradition and voluminous scholarly literature, its principled stand on scientific methodology, and its perfect internal consistency has established it as a major school of economic thought. First and foremost, Austrian Economics offers a unique perspective of the socio-economic process that sets it clearly apart from the New Quantity Theory Monetarism of the Chicago School, as well as from the fiscal interventionism of the Keynesians. Although it may show a superficial similarity with Monetarism on issues of current public policy, it differs significantly on questions of methodology and world view. The Austrians' opposition to Keynesianism is, of course, complete. This orientation flows not only from disagreements concerning methodology, but even more from the differences on policy conclusions.

The founder of the Austrian School, Carl Menger (1840-1921), published his first and most important book in 1871. Intended as the first of a multi-volume treatise on economics that was never to be finished, *Grundsätze der Volkswirtschaftslehre* qualified Menger for the post of professor of economics at the University of Vienna, where he worked and taught for the next thirty-one years. This book is credited with a contributing role in the Marginalist Revolution of the 1870's against the Classical School of Adam Smith, David Ricardo, and John Stuart Mill. W. S. Jevons in England and Leon

Walras in Switzerland, who published their works on the principle of marginal utility in 1871 and 1874 respectively, are similarly recognized. Menger's pathbreaking work was not only different in language (he used verbal deductive reasoning, while Jevons and Walras produced mathematical formulations of their theory), it also represented an entirely different view of the market's dynamics and the nature of the valuation process.

The heterogeneous nature of the Marginalist Revolution is only now being recognized. However, it should have become apparent much earlier. Menger's second book, *Untersuchungen über die Methode der Sozialwissenschaften*, published in 1883, was intended as a broadside attack against the prevailing inductionism of the German Historical School, but it did much more than provide a systematic justification for his deductive method. It became the intellectual arsenal in the attack against empiricism in the social sciences and prepared the way for an analysis of the evolution of social institutions in the tradition of Bernard Mandeville, David Hume, and Adam Smith. This latter aspect of Menger's work not only clearly distinguished it from that of his "co-revolutionaries," but was to have a profound effect on the later development of the Austrian School which took it far beyond the boundaries of orthodox economics.

Unfortunately, Menger's two books were not published in English until 1950 and 1963, respectively, under the titles *Principles of Economics* and *Problems of Economics and Sociology*. The history of economic theory in the intervening eight decades might well have been very different had these monumental works been available earlier in the English-speaking world.

Menger firmly established the theoretical foundations upon which all writers in the Austrian tradition have since built their school's scientific structure. The common thread running through all the literature of the Austrians is a thoroughgoing and uncompromising methodological individualism. This is not the result of a biased world view, but is required by the very object of the social sciences: purposefully acting man. Observable social phenomena are always the out-

come of a complex process. To understand that process, Menger argued, it is necessary to trace these complex phenomena back to their simplest and irreducible elements, human choices, which in turn spring from the intrinsically subjective evaluations of the alternatives surrounding man at the time and in the place where the choice occurs.

Although Jevons and Walras used the concept of subjective utility to explain market prices, they and their followers failed to apply it consistently to all categories of human action. As a result, they built some of their theories and models in terms of complex phenomena and aggregates which are not, and never can be, objects of individual choice. Viewed in this way, today's neoclassical mainstream going back to Alfred Marshall's *Principles of Economics* (1890) can be considered a throwback to the pre-marginalist days of the diamond-water paradox which the Marginal Utility Revolution had finally resolved. It will be recalled that the famous paradox persisted because it was not realized that no man is ever in a position to choose between *all* the diamonds and *all* the water of the world, but always merely between a miniscule amount of *additional* diamonds and *additional* water. The methodological individualism in the theory of the Austrians is not only its most distinctive hallmark; it has also been credited by Hayek with "producing every important advance in economic theory during the last hundred years."

Eugen von Böhm-Bawerk (1851-1914) and Friedrich von Wieser (1851-1926), although never students of Carl Menger at the University of Vienna, became ardent and capable disciples at an early age. Böhm-Bawerk's monumental three-volume treatise, *Capital and Interest* (1884, 1889, and 1909-12) developed Menger's ideas in a direction that is crucial to the modern Austrian theory of the business cycle. A masterpiece of logical reasoning, it succeeded in refuting many of the older theories of interest rates, but it also represents a comprehensive analysis of the economic process. His own interest theory, however, was mercilessly attacked by his master. Menger believed that Böhm-Bawerk's theory was one of the greatest errors ever committed in economics. Böhm-Bawerk had

introduced the productivity of capital as an explanation for the rate of interest, a strictly non-subjective category. Today, most economists, working within the Austrian tradition, view interest strictly as a phenomenon of subjective valuation.

For nearly twenty years, Böhm-Bawerk was professor of economics at the universities of Innsbruck and Vienna. A man of immense intellectual accomplishment and a master of debate, he was also Finance Minister of Austria three times. His *Karl Marx and the Close of His System* is, in the words of one of his famous students, Joseph Schumpeter, "undoubtedly the best critique of Marx ever written."

Friedrich von Wieser, after twenty years as professor at the University of Prague, succeeded Carl Menger at the University of Vienna, following the latter's retirement in 1903. His most important works are *Natural Value* (1889) and *Social Economics* (1914), which include his theoretical contributions in cost and value theory. His elaboration of the subjective view of cost as sacrificed utility (today commonly known as opportunity cost) and his theory of imputation to determine the value of the factors of production, are very much in the Menger tradition. Some of his ideas, however, such as his belief in the measurability of utility and its interpersonal comparability, led in directions that did not become part of the Austrian analysis.

During its first five decades, the cultivation and growth of Austrian Economics was limited to the universities in the old empire. As a school, it experienced its greatest acceptance during the ten years preceding World War I. In the 1880's, when the most important works of Menger, Böhm-Bawerk and Wieser were first published and began to gain acceptance, the Austrian School gradually developed a following of a number of capable theoreticians and writers, including Emil Sax, Robert Zuckerkandl, Johann von Komorzynski, Robert Meyer, Gustav Gross, Richard Schüller and Hermann von Schullern. Eugen von Philippovich, a professor at Vienna for 25 years until 1917, published a textbook incorporating marginal utility theory in 1893, which proved to be most successful in Germany. It was also the only link to the

Austrian School there. Since the *Methodenstreit* of the 1880's, German universities were practically closed to anyone associated with the Austrian School.

Two very important propagators of the Austrian view outside Austria were the Swede Knut Wicksell (1851-1926), who (although a sympathizer of Leon Walras' mathematical general-equilibrium approach) was an enthusiastic admirer of Menger's and Frank A. Fetter (1863-1949) in the United States, whose brilliant work is today practically unknown.

Böhm-Bawerk's seminar in Vienna produced the third generation of theoreticians who worked within the Austrian tradition. They include Hans Mayer, Richard Strigl, Ewald Schams, and Leo Schönfeld-Ily. Joseph Schumpeter, certainly one of Böhm-Bawerk's most famous pupils, became an advocate of the Lausanne School; Alfred Amonn, on the other hand, later worked in the English classical tradition. Foremost among Böhm-Bawerk's students, however, was the great Ludwig von Mises. It is to his teaching, research, and writing career over a period of sixty years that we owe the existence of Austrian Economics today, as well as its recent flourishing again after a hiatus of nearly five decades.

Ludwig von Mises (1881-1973) firmly established his reputation as an eminent economist at the age of thirty-one with his book *The Theory of Money and Credit* (1912). Several pathbreaking ideas in this book make it one of the classics in Austrian Economics. His penetrating analysis of the monetary process launched the Austrian Malinvestment Theory of the Business Cycle. Following Menger, Mises succeeded in showing that money can have its origin only in a useful commodity and that it would develop without the conscious design of man through government. Mises also supported free banking and full gold backing of money and successfully criticized Irving Fisher's Quantity Theory of Money. In addition, he anticipated a number of developments in economic theory that would take several decades to be perfected by others.

During the turbulent years following World War I, Ludwig von Mises became interested in the problems of interventionism and

socialism, at the time a highly explosive and relevant topic. First in a 1920 article, and then in *Socialism: An Economic and Sociological Analysis* (1922), he produced the most brilliant critiques of socialist planning ever written. Mises showed that rational calculation without markets and their prices was impossible in a system of collective ownership in the means of production. Oskar Lange, one of the chief theoreticians of socialist economics, grateful to Mises for having pointed out the problem, suggested that a memorial to Mises be erected in the great halls of the Ministry of Socialization.

Although opposed and criticized by many, Mises continued his valiant crusade with a series of articles on interventionism and *Liberalismus* (1927), in which he stood up for true laissez-faire as the only humane and workable economic system.

For nearly thirty years, Mises was chief economist for the Vienna Chamber of Commerce, one of the most important posts an economist in Austria could have outside of a university. In addition, he was called upon for advice on financial and banking concerns, yet his practical influence was very small in the face of the totalitarian resurgence of the 1930's.

When, in 1934, he unexpectedly received an offer to teach at the Graduate Institute of International Studies in Geneva, Switzerland, Mises accepted with delight. In Vienna, he had fought a lonesome battle against the approaching waves of totalitarianism, and he foresaw the eventual outcome, just as he had anticipated the turbulent crises and runaway inflation following World War I.

In Geneva, Mises worked on his *magnum opus*, a comprehensive, 750-page treatise entitled *Nationalökonomie: Theorie des Handelns und Wirtschaftens*, published in Geneva in 1940. Later, after his emigration to the United States, the English-language version *Human Action* (1949) would, in the span of seventeen years, see three editions and a number of printings. *Nationalökonomie*, however, remained practically unknown until its republication in 1980.

As a teacher, Mises was one of the most successful in all of Vienna, despite the fact that he never held a full academic appointment at

the university (a fate similar to that of Sigmund Freud). In his famous private seminar, dozens of students learned about Austrian Economics and went on to great careers abroad. Among them were Gottfried Haberler, Fritz Machlup, Oskar Morgenstern, Paul N. Rosenstein-Rodan, and Richard Strigl. But the most prominent and successful among Mises' students in Vienna was Friedrich A. von Hayek, who carried on the work of the Austrian School in England, the United States and Germany.

F. A. Hayek's life work is the most encyclopedic of all that Austrian economists have produced. It ranges from books and articles on business cycle theory and economic policy to the philosophy of science and politics. But more than any other achievement, Hayek's view of the free market as a mechanism for social coordination and the efficient production and use of knowledge, has propelled the Austrian School into a new era of scientific respectability and intellectual growth.

While teaching at the University of Lon-

don, Hayek worked on his monetary and business cycle theory, which gained prominence and soon won influential adherents. His books *Prices and Production* (1931), *Monetary Theory and the Trade Cycle* (1933), and his articles established him as a figure rivaling John Maynard Keynes in the early 1930's. For a time, Hayek's new theory of the business cycle appeared to be successful in its challenge of Keynes' revolutionary ideas. But by the end of the decade, when he published the clearest statement yet of the Austrian trade cycle theory in *Profits, Interest and Investment* (1939), it was too late. Hayek had lost his audience to Keynes. The political and intellectual climate of the time called for interventionism, and the Keynesian Revolution delivered the rationale. The disastrous political and economic developments following the Keynesian wake would prompt Hayek only a few years later to write his first book on politics: *The Road to Serfdom* (1944).

—ALBERT H. ZLABINGER