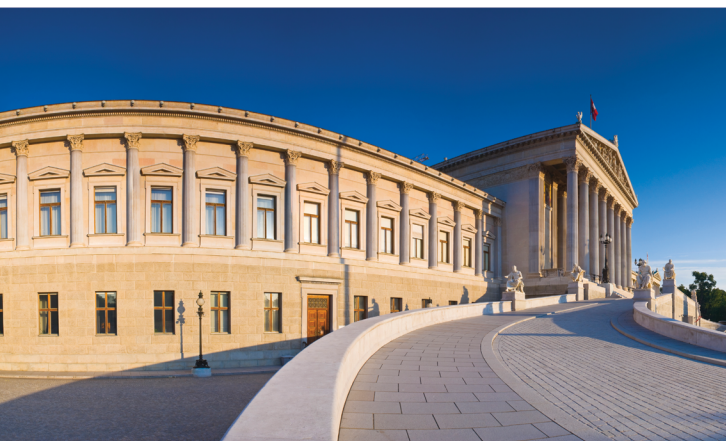


The Viennese School of Economics



A HISTORY
OF ITS IDEAS,
INSTITUTIONS &
REPRESENTATIVES

Eugen Maria Schulak
& Herbert Unterköfler

The Viennese School of Economics

This draft is not the final edition

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The Viennese School in brief

The Viennese School of Economics, also called the Austrian School of Economics, was founded by Carl Menger in Vienna during the last third of the 19th century, and enjoys to this day a vibrant teaching tradition. Since the early 1900s this teaching tradition has been a significant influence on the education and further development of modern social sciences and economics in Europe and the US.

In the 1930s a general change of economic paradigm increasingly pushed the Viennese School on to the academic sidelines. This development intensified when many of its exponents left Vienna and the last remaining representatives were finally driven out after the National Socialists seized power. After the Second World War, in the political climate of consensus of the grand coalition in Austria, it was no longer possible to re-form the Viennese School, which was considered by many to be the intellectual legacy of the French and English Enlightenment and of political and economic liberalism. However, by means of their scholarly publications and their teaching, Ludwig von Mises and Friedrich von Hayek were, to a greater or lesser extent, able to maintain the tradition in the US, so that from the 1970s onwards it experienced a revival as the Modern Austrian School of Economics.

Until 1938, the research program of the Viennese School was characterized by an astonishing multitude of differing, in some cases even contradictory, conclusions. What the 40 or so economists had in common was their education in law, their almost exclusively elite or aristocratic public service background, and their employment by state-funded universities, in public service or in institutions close to the state, such as banks or chambers of commerce. Socially and professionally in any case, the exponents of the Viennese School were highly successful: five were honored with the post of government minister, many filled senior positions in officialdom or in banks with close ties to the state, and quite a few were bestowed with aristocratic titles.

All branches of the School shared the common conviction that the decisive actor behind economic activity was the subjectively feeling and acting individ-

ual. The subsequent explanations, derived from this conviction, for economic phenomena such as value, exchange, price, entrepreneurial profit or interest, were gradually assembled into a comprehensive theory of money and business cycles. This subjective-individualistic outlook and approach made any kind of collective appear as an unscientific “construct”, which led to fierce arguments—incidentally bringing the members of the School closer together—with the Marxists, with the German Historical School and later with the exponents of a planned economy and state interventionism.

In the Modern Austrian School of Economics more emphasis was then placed on questions regarding knowledge, monetary theory, entrepreneurship, the market process and spontaneous order, subjects which the older Viennese School, with remarkable foresight, had already taken up or dealt with in detail. This book endeavors to trace the multifaceted tradition of the Viennese School, with all its ideas, people and institutions.

Preface

It seems an odd coincidence that after several years of preparatory work and numerous interruptions, the authors finalized their manuscript just when signs of a global crisis in the financial sector suddenly became visible to all. Since then, economic developments appear simply to confirm many fundamental insights of the Viennese School of Economics, especially those in monetary and business cycle theory. A low interest rate policy over many years in the US, and a steady increase of the supply of money and money substitutes in the industrial nations seem to have led to a staggering volume of misallocations and generated countless unsustainable business models.

The attempts of industrial nations to impede, by means of government intervention, the suppressed need for correction, will at best lead to a deceptive gain in time, but hardly to a real solution. However, the astonishingly purposeful government interventions are certainly no accident, for in recent decades the so-called welfare states have entered into a very close symbiosis with the financial sector. In no other sector of the economy—apart from maybe the armaments industry in certain countries—are the institutions, people and economy so closely interwoven with the state as in the finance industry. Consequently, in recent decades it has been possible on several occasions to get the impression that welfare states were almost competing with the banking industry in their efforts to circumvent, in the most imaginative and opportunistic ways, the basic laws that rule economics, money and markets. While for many years the welfare states, with their ever increasing national budget deficits, nourished the illusion of growing prosperity, banks and financial institutes functioned, on the one hand as financiers of these deficits, and on the other hand as strong advertising messengers of an everything-is-affordable philosophy for the wider public. The crisis, which at the present time has nowhere near reached its full extent, will therefore profoundly affect both the global financial sector and the individual countries much more deeply than all previous crises.

The Viennese School, working on the assumption of the individual as

the essential economic agent, and subsequently centering its research on individual preferences and on the intersubjective balancing of these preferences in the context of markets, consistently pointed out that institutions such as money, states and markets had emerged without any planning, central purpose or force, but simply on the basis of human interactions, in a way that befitted both humans and human logic and was therefore natural, as it were. Of course, this basic insight got in the way of all those political and economic ideologies, which viewed such institutions as operational areas for establishing or developing authoritarian activities and which aimed specifically at influencing or even controlling the emergence of individual preferences or the balancing out of these preferences between individuals.

In practice this meant that in Austria during the interwar period the Viennese School was attacked, sometimes ferociously, by political parties both of the right and the left, because it not only denied the legitimacy, but also the efficacy, of many economic policies. Furthermore, the School always considered itself a universal science in which there was no room for national, religious or class-oriented constrictions. In a way it even represented a sort of alternate world to many of this country's idiosyncrasies: it focused exclusively on the individual and declared that individual action on the basis of subjective preferences was the starting point of research; it proceeded from a realistic image of humanity, which could not possibly lend itself to flights of idealistic fantasy and which for this reason alone did not lend itself to cheap political exploitation; it was free of magniloquent utopias, upheld the principles of self-determination and non-violence and was fundamentally critical of any state intervention occurring under a monopoly of the use of force. In addition, it emanated a highly scholarly ethos, which made possible the emergence of an uncommonly cosmopolitan and tolerant discourse.

Accordingly, among the many intellectual legacies of the Austrian monarchy, the Viennese School of economics was one of the few traditions which in the political upheavals of the 20th century did not become entangled in vice and guilt. In fact, it was those very ideologues, of both left and right, who in the 20th century so often caused bloodshed and large scale destitution and misery, who, with the greatest impudence, accused the Viennese School of blindness to the urgent economic questions of the period. Not only from this perspective, the history and philosophy of the Viennese School refuse to be absorbed into the foundation and reconciliation myth of the Second Republic's grand coalition.

Against this backdrop it is commendable when Prof. Dr. Hubert Christian Ehalt, the publisher of the series "Enzyklopädie des Wiener Wissens" ("Encyclopedia of Viennese Learning"), makes space for this almost forgotten piece of Viennese intellectual and scholarly history. Despite some delays on the part of the authors, he has always remained a patient and loyal supporter of our

project, to whom we are particularly indebted.

Altogether it seems to be in the nature of every longer project that, in the course of its development, a considerable debt of gratitude is accumulated which can hardly be paid off in a few lines. We remember with gratitude the many suggestions which led to the gradual coming to maturity of the idea for this book: Firstly the extensive discussions of economic theory in the “Haldenhof-Runde” in Kitzbühel with the considerate host and profound expert of the Viennese School, Karl-Heinz Muhr; then the in-depth engagement with ordoliberalism, repeatedly prompted by Dr. Rüdiger Stix, who like scarcely any other discussion partner combines Viennese charm with erudition and intellectual honesty; and finally the providential encounter with Prof. Dr. Hans-Hermann Hoppe, then still at the University of Nevada, who introduced us to the current world of the *Austrian School of Economics* in the US and crucially aroused our interest in the already almost forgotten history of the Viennese School. Prof. Hoppe, whose friendship and hospitality led to a series of fruitful conversations, has continued to be well-disposed to our project, giving it impetus and contributing a number of important suggestions.

In the course of our quite considerable archive and literary researches we were lucky enough to encounter a number of exceptionally helpful employees in several Viennese libraries: Dr. Roland Zwanziger, of the University of Vienna library, set off in person more than once to search for some rare volume or other in the depths of the archive basement. Frau Daniela Atanasovski sometimes adjusted her lunch break to suit the authors’ time constraints, and Gabriela Freisehner of the economic faculty library, along with her expert help, created a particularly hospitable atmosphere by now and again providing us with Viennese coffee. In the University of Vienna archive, in the history faculty library, in the Austrian Nationalbibliothek and in the parliamentary library we were also received kindly. We would like to thank them all sincerely, including Veronika Weiser, who provided valuable support by sourcing literature, thus saving us time.

While drafting the manuscript, we received help and support on many occasions from Rahim Taghizadegan and Gregor Hochreiter from the Institut für Wertwirtschaft in Vienna, for which we are very grateful. Apart from many expert suggestions and some help in researching literature they have commented on our drafts and critically looked over the final draft. After having completed this book project we not only have the feeling that we have greatly profited from their tremendous subject knowledge but also certitude of having received a selfless and sincere friendship. Heartfelt thanks also extend to Beate Huber for the many valuable and extensive conversations which definitely accelerated the acquisition of knowledge.

Of particular help was the proof reading by Dr. Barbara Fink of the publishers Bibliothek der Provinz. Dr. Fink’s sharp eye and mind brought to light

a considerable number of incorrect source citations which were subsequently corrected by the authors.

The authors are also much obliged to those discussion and conversation partners who contributed a great deal to their understanding of the dramatic ruptures in recent Austrian history. In particular Prof. Dr. Norbert Leser focused our sight on genuine Austro-Marxism in the course of many friendly conversations, and Prof. Dr. Oliver Rathkolb offered a number of new perspectives on the great intellectual exodus of 1938 and on Schumpeter's work in the US.

Finally, our special thanks go to Prof. Dr. Jörg-Guido Hülsmann of the University of Angers, France, who, having expert knowledge of the original Viennese School literature and being a biographer of Mises, was very often able to give valuable advice and make suggestions regarding the history of dogmas. In the end, he also very kindly took upon himself the task of looking through the final manuscript. Of course, all remaining deficiencies, inaccuracies or even errors in content or form are the sole responsibility of the authors.

Last but not least it is our wish to extend our thanks to our nearest and dearest: to Elvira, for whom this book offered the opportunity to exercise the virtue of spousal tolerance and to Veit-Georg, who had to do without a number of games of soccer with his father; and to Kerstin, who, faced with the radical reduction of free time always remained a loving soul and an affectionate partner.

Eugen Maria Schulak / Herbert Unterköfler
Vienna, November 2008

CHAPTER 1

Vienna in the Mid-19th Century

Sometime during the late summer months of 1859—we do not know precisely when—an eighteen year old youth from Biala/Bielitz on the Galician-Silesian border set off for Vienna, a leaving-certificate from Krakow High School and perhaps also a letter of recommendation or two from a teacher or relative in his luggage. He was one of many from the so-called Crown lands pouring into the incessantly growing “Imperial-Royal Capital and Residential City” of Vienna.

From 1820 to 1830 the share of inhabitants not born in Vienna had already grown from 9.5 to 30.5 percent; in 1856 the figure was 44 percent. One fifth of the immigrants originated from Bohemia and Moravia, another fifth from Lower Austria, 11.5 percent from the Alp countries. Whereas up to the middle of the century immigrants had been mainly German speakers, the wave of immigration now increasingly consisted of Czech speakers (cf. Buchmann/Buchmann 2006, 22f.). In 1857, in one of the first censuses in Europe, 476,222 people were registered in Vienna and its suburbs; in 1869 there were 607,507 and in 1888 as many as 1.3 Million (cf. Meyers Konversations-Lexikon 1888-1891). During the 19th century the population grew sevenfold. Vienna became a metropolis, the fourth largest city after London, Paris and New York. Not until 1871 did Berlin edge ahead, after which Vienna occupied fifth place for a long time.

To our traveler, Carl Menger von Wolfensgrün (1840-1921), the subsequent founder of the Viennese School of Economics,¹ the city skyline would still have looked like “old Vienna”: enclosed on three sides by a city wall and moat, while being naturally confined by an arm of the Danube on its eastern side. For military reasons, the city outskirts, the “Glacis”, had never been

¹ also Austrian School of Economics.

built upon and, partly lined with avenues of trees, served the inhabitants as an esplanade, with plots for market stalls, coffee tents, playgrounds and junk dealers, and offered artisans and traders open storage and work areas. Within the city walls the number of houses (1,200), households (10,600) and inhabitants (about 50,000) had remained virtually constant for decades. Immigrants settled in the outer boroughs and suburbs (cf. Buchmann 2006, 47f. and 65).

“What struck young people from the provinces as particularly pleasant” a fellow student of Carl Menger remembered, “was most of all the hospitality of the local people” (Przibram 1910, Vol.1, 64). Something that was later even registered in a well-known encyclopedia: “The main characteristics of the Viennese are mirth and bonhomie. The archetypal Viennese has a heart which is responsive to his fellows and he feels most content when he can be gentle and good. Public amusements, no matter how uproarious they are, are always harmless and jovial. In no large city will one feel at home so soon as in Vienna, and a stranger receives easy access to society” (Meyers Konversations-Lexikon 1888-1891).

At the time of Menger’s arrival, the razing of the city walls, commissioned in 1857 by the emperor Franz Josef I., was already under way. Following this, the soon apparent changes and the plans still due for realization gave rise to animated discussions, even heated arguments, all over the town: “Every week brought new surprises; first here, then there, some favorite spot of the old Viennese disappeared. The columns of the daily newspapers were filled with ‘cries of anguish’” (Przibram 1910, Vol.1, 64). The younger generation of citizens, however, inspired by the belief in progress and filled with confidence, saw in the demolition of the stronghold ring a new beginning (cf. Leisching/Kann 1978, 38f.). With a rhythmically jolly/gay “Demolierpolka” and his martial “Explosionspolka”, Johann Strauss the Younger (1825-1899) expressed these current events in a lively manner. In any case, it seemed “that love of watching others and enjoyment of theatre filled public life completely. The goings-on in front of, and behind, the scenes provided the topics of conversation in all circles of society. The few daily papers published in Vienna fed the reader with theatre gossip” (Przibram 1910, Vol.1, 9). On May 1st, 1865, as a culmination of this constructional redevelopment, the “Ringstrasse”, a magnificent boulevard more than three miles long, could finally be ceremoniously opened.

However, the theatre-merry façade could hardly cover up the fact that the general economic situation was difficult, because of the ruined state of government finances. The 163 million guilders necessary for constructing public buildings and grounds were financed by selling parts of the newly available building area to private companies, entrepreneurs and investors (cf. Buchmann 2006, 67). A positive economic climate was created only after two exceptionally good harvests, and received an additional stimulation, albeit only an illusory and superficial one, when in 1866 the war against Prussia was fi-

nanced by increasing the money supply. The size of the railway network—a reliable economic indicator of the time—almost doubled between 1866 and 1873 (cf. Sandgruber 2005 [1995], 245) and between 1867 and 1873 in Vienna alone no less than 104 construction companies were newly licensed (cf. Matis 1972, 195). The city quickly turned into a gigantic construction site. Instead of many two-storey houses about 500 private and public buildings as well as 90 new roads and squares were constructed (Maderthaner 2006, 198). In addition, there was the Viennese mountain spring water main, the Danube flood control, three railway stations and a considerable number of buildings in the surrounding towns and suburbs in order to at least partly accommodate the enormous influx of immigrants (*ibid.*, 189).

The monumental architecture of the “Ringstrasse” (ring road) was a strong expression of the citizens’ new self-confidence. Among the eligible voters of Vienna, hardly more than four percent of the inhabitants (in 1870 it was 26,069 people, cf. Czeike 1962, 17), a liberal attitude became the predominant political trend. This mindset came to expression in the December Constitution of 1867, in which the relationship of citizen and state was codified and a catalogue of basic individual and freedom rights, still valid to this day, was laid down. Freedom of expression, freedom of the press, freedom of religion and faith, freedom of assembly and academic freedom were followed in 1868 by an extension of compulsory school attendance for children and a very controversial secularization of the school system.

When Emperor Franz Josef, lobbied by the business and society elites, authorized the holding of a world exhibition in 1873, economic expectations, which were already excessive, were stoked up even more. The Viennese were hoping for a “jingle of golden rain” (Felder 1964, 337): “Everyone is counting on, everyone is speculating on the world exhibition,” wrote economist August Oncken (1844–1911), who was then appointed at the Universität für Bodenkultur, and another contemporary also clearly echoed the euphoric atmosphere: “Around the year 1870 we were living rather in dulce jubilee [...] To be sure, one shook one’s head regarding the audaciousness of the project, [...] but one thought the boom would last and one plunged right into it” (cited in Premsel 1985, 65). On an area larger than 16 hectares, 200 exhibition halls were built for more than 50,000 exhibits, three new bridges were built across the Danube Canal and the first luxury hotels of Vienna constructed for the expected 20 million visitors (*ibid.*, 64–67). In expectation of brisk business, the prices for rent and food increased considerably. Between 1867 and 1873, a total of 1005 companies with a combined capital worth 4 billion guilders, were founded (cf. Sandgruber 2005 [1995], 247). The number of banks grew from twelve to 141, 69 of which were in Vienna alone (cf. Matis 1972, 219 a. 221). The number of share titles on the Viennese stock exchange multiplied from 169 to 605 (*ibid.*, 207).

The overheated economy, stoking the already rife speculation, blossomed wondrously: “Individuals, who had only shortly before had to content themselves with some modest job, suddenly, on account of some successful venture, came into a fortune and also took pains to make this change in their position as conspicuous as possible. [...] The whole of social life of the old imperial city was turned upside down. The previous humble coziness was replaced by occasionally very declamatory and obtrusive luxury” (Przibram 1910, Vol. I, 361). The fact that seasoned bankers had long since recognized the dangers and had gradually withdrawn from activities on the stock exchange didn’t make much difference. Experts and economists warned emphatically in public speeches against the “stock market swindle” and the “corruption of the press”. But it was virtually impossible to put a stop to the unchecked gambling and speculating around the asset stripping (cf. Schäffle 1905, Vol. I, 158-160). Johann Strauss the Younger aptly reflected this precarious mood in his operetta *Die Fledermaus* (1874): “Illusion makes us happy”.

In the end the opening of the World Exhibition on May 1st, 1873 became the overture to the inevitable admission of complete failure: the exhibition halls were not completed, the weather changeable, the numbers of visitors remained below expectations and many business aspirations shattered abruptly against reality. A little over a week later the Viennese stock exchange recorded 110 insolvencies and on the next day, “Black Friday”, the “Great Crash” ensued with 120 additional companies collapsing (cf. Sandgruber 1985, 70; Matis 1972, 260-265). By the end of the year 48 banks, eight insurance and two railroad companies, together with 59 industrial firms had gone into liquidation or had even gone bankrupt. On the stock exchange, 1.5 billion guilders were wiped out, four times the complete government revenue of the Austro-Hungarian monarchy in 1872 (Matis 1972, 277 u. 55). Many families fell on hard times. 152 people committed suicide in Vienna (cf. Premsel 1985, 67).

The “Great Crash”, the devastating effects of which would live on in the memory of the Viennese citizens for a very long time, resulted in a kind of watershed in the general mentality (cf. Plener 1911, 386). In the following years, liberalism increasingly lost political support: “Pursuing security became the new guiding value. Risk aversion, ‘pensioner mentality’ and a guilds and small trades way of thinking became long lamented basic components” (Sandgruber 2005 [1995], 250). The immediate effects were the re-nationalization of the railroad industries, protectionism and restrictions of economic freedom. The Austrian tendency to bureaucratic paternalism and the desire on the part of economic interest groups to be shielded and protected acted in concert and close agreement. The “Great Crash” was thus the birth of the public “welfare apparatus”, in which the old Josefinian spirit of the authoritarian state raised its head again: from 1870 to 1914, the number of public servants in Cisleithania (the western and northern regions of the Austro-Hungarian Empire [Transl.])

grew from 80,000 to 400,000 (cf. Schimetschek 1984, 213). In Vienna, the number of municipal servants increased between 1873 and 1900 from 2,000 to 30,000 (cf. Maderthaner 2006, 229).

The political and intellectual climate in 20th century Austria—ranging from a conservative-Catholic tradition to an Austro-revolutionary attitude, be it socialist, communist or national-socialist—would have preferred to leave forgotten that the short phase of liberalism created lasting material and spiritual values: an economic catching-up process and modernizing boost, urbanity with cultural openness as well as the principles of a constitutional state with modern basic and individual rights. The development of individuality in the liberal era ultimately created precisely that tension-filled polarity of tradition and avant-garde, faith in progress and pessimism, love of life and yearning for death that was to be the fertile soil of Viennese art, literature, music and science in the late 19th century.

CHAPTER 2

Economics as an academic discipline

Economic disciplines at Austrian universities developed from the 18th century science of “cameralistics”, which were intended to endow future civil servants with the necessary economic and administrative skills to manage the domains and estates of the sovereign. In 1751, the first relevant chair was instituted at the Theresianische Akademie, which at the time was an educational center for young Viennese aristocrats. Later, the universities of Vienna and Prague followed suit. This development was driven mainly by Joseph von Sonnenfels (1732-1817), who in 1763 established the “Polizey- und Cameralwissenschaften” (“Science of policing and cameralistics”) at the Faculty of Philosophy in Vienna. In 1784 he relocated the chair to the Faculty of Law. From then on until 1919, economics remained, under a variety of labels, part of the law curriculum (cf. Schrutka 1898, 170-173).

With his *Grundsätze der Polizey-, Handlungs- und Finanzwissenschaft* (1765–1772, three volumes), Sonnenfels presented a text book which was a mixture of well meaning concern and constraining paternalism typical of the enlightened Josefian authoritarian state. Up until the middle of the 19th century it served to educate prospective civil servants and was only replaced by *Die Grundlehren der Volkswirtschaft* (1846), written by Joseph von Kudler (1786-1853), one of von Sonnenfels’ successors. Thus, until far into the 19th century, Austrian students were attuned to a way of thinking that took paternalism by the state and comprehensive administrative monitoring of citizens and business for granted.

With Kudler’s death this traditional Austrian approach soon dwindled away. What followed was increasing orientation towards German and Prussian universities, where cameralistic studies were mostly assigned to the philosophy faculties. Only in Strassbourg, Würzburg and Freiburg were they integrated into the respective law faculties. Independent faculties of political

science existed in Munich and Tübingen (cf. Grimmer-Solem 2003, 41). In the middle of the 19th century, in a phase of identity-seeking reorientation, the term “*Cameralwissenschaft*” (“cameralistics”) was replaced by a confusing multitude of denotations, for example “*Finanzwissenschaft*” (“public finance”), “*Politische Ökonomie*” (“political economy”), “*Nationalökonomie*” (“national economics”), “*Volkswirtschaftslehre*” (“social economics”) or “*Staatswissenschaften*” (“political science”) (ibid., 39–42). For the graduates, the term “*Kameralist*” or “*Nationalökonom*” came out on top (cf. Conrad 1884, 135). The term “*Volkswirth*” (“social economist”) tended to be rejected because of its linguistic closeness to “*Bierwirth*” or “*Schenkwirth*” (both meaning “publican” [Transl.]) (cf. Wagner 1892, 264f.)

Since the role of the German economists, in the course of the growing nation state and the developing industrial society, was changing rapidly, the inadequacy of their education, usually lasting only two years, soon became apparent. It had a detrimental effect on career prospects in the civil service and began to unsettle all its members. Concerns were voiced that educated lawyers could possibly replace the cameralists. (cf. Lindenfeld 1997, 212; Bruch 1985, 135; Kleinwächter 1876, 2, 6 a. 12f.). By contrast, these sorts of problems were unknown to economists in Austria. Their foundation studies in law ensured they had sufficient career opportunities. In fact, there was actually a great increase in demand, on the part of the Austrian state administration.

The Verein für Socialpolitik, which was founded with the substantial involvement of the German economist Gustav Schmoller (1838–1917), succeeded in calling a halt to this uncertainty. From the beginning, tangible corporate interests played a major role (cf. Lindenfeld 1997, 224) and for a short while members even considered setting up the society as an official trade association (cf. Brentano 1888, 141). The generally held view was that economics should principally be concerned with the possibilities of state influence on economic processes. On the basis of this policy, members expected to receive jobs, resources, reputation and influence. Comprehending economics as a science for analyzing and explaining the nature of the economy was comparatively neglected (cf. Hennings 1988, 48). After this confident reorientation, those voices, which had been in favor of a combined legal and economic education in Germany, gradually disappeared too (cf. Kleinwächter 1876, 2 a. 14; Conrad 1884, 119).

The establishment of economics at various faculties also resulted in the typical Austrian and German graduate having remarkably different social profiles. Evidence exists showing that law students at the University of Vienna, comprising about 40 percent of the empire’s total law students, originated largely from the middle and upper classes (high level civil servants, officers, lawyers, factory owners, businessmen; cf. Cohen 1987, 301 a. 307f.). The same can be said of law students (as a whole) in Germany. The Faculty of Philosophy, how-

ever, where the German 'cameralists' studied, primarily attracted members of the "lower class" (Conrad 1884, 110 u. 54).

Even more perhaps than social background, it was the way in which institutions and curricula were established that determined a different intellectual character and a significantly different scholarly socialization. In order to graduate as an economist in Austria, one had to complete a course in law, which included a substantial part about the history of law. While working on abstract law terms, terminology analyses, methods of interpretation and their practical applications, above all students were being coached in analytical thinking, linguistic precision and logic. The major subjects of jurisprudence were oriented towards hermeneutics. In contrast, at the German universities, cameralistics was based on a predominantly descriptive-empirical approach, which was evident from the encyclopedic breadth of the course alone. Areas of study ranged from farming, agriculture, mining, trade and industry to finance, political science and government accounting, and the course was closely associated, both institutionally and methodically, with the natural sciences. As far as their intellectual self-conception, career goals, career options, scientific culture and methodological repertoire were concerned, economists trained in Austria and Germany basically came from two different worlds.

Looking at university statistics, it is easy to understand German economists' fears of falling behind in their careers. The total number of students at the 20 German and Prussian universities had increased steeply from 13,247 (1861/62) to 24,207 (1882/83, including the newly founded University of Strasbourg) (Conrad 1884, 24f.). It is true that the cameralists were only registered, for statistics purposes, together with the agriculturalists and the pharmacists, but even so together they totaled only 1,455 students, to which about 100 students of the Munich and Tübingen faculties of political science should be added (*ibid.*, 137 a. 150). In any case, their proportion in the student body decreased from 10 percent in 1841 to less than 6 percent in 1881 (*ibid.*, 135). Despite a general boom in education the number of authors in the discipline of cameralistics remained, almost unchanged, at about 100 throughout the 19th century, about half of whom held a professorship (cf. Hennings 1988, 53). In comparison, the total number of students at the seven German language universities of the Austrian monarchy (Vienna, Prague, Innsbruck, Lemberg, Krakow and Cernowitz) had increased from 6,034 (1863/64) to 13,069 (1883/84), even though the University of Krakow was "Polonized" in 1870 and the University of Cernowitz had only been founded in 1875 (cf. Pliwa 1908, No. 106). The law faculties had 2,527 (1863/64) and 5,407 (1883/84) students respectively, thus constantly more than 40 percent of all students (*ibid.*, No. 45.). In terms of student numbers, the Faculty of Law in Vienna was the largest law teaching institution in the world.

Because of growing student numbers, the larger law faculties were given a

second chair of economics in the 1860s. The two Viennese professorships were deemed to be particularly lucrative, especially as enrolment charges and exam fees flowed in plentifully: “With a considerable 3,000 to 4,000 students attending, I had the most attractive outlook for my accounts,” recollected Albert Eberhard Friedrich Schäffle (1831-1903), Carl Menger’s predecessor (Schäffle 1905, Vol. 1, 150). Nevertheless, because of a great shortage of professors, some chairs remained vacant for years. Of the 71 professorships at all law faculties in the Austrian monarchy, only 50 were occupied in 1874. In Vienna alone, six of the 17 chairs were vacant. The circle of possible candidates from Germany was limited from the start, because Austrian professors had to be qualified in law as well. Furthermore, many ideal candidates rejected the summons to Vienna, because the faculty was considered to be too “school-like”, the research there neglected and the climate among the teaching staff less than harmonious (cf. Grimmer-Solem 2003, 268). The shortage of local junior lecturers was the result of the boom of the “Gründerjahre” (the economic expansion in Germany in the second half of the 19th century [Transl.]). This boom “absorbed a not insignificant number of the most talented younger lawyers, who received rewarding, often illustrious positions as directors, secretaries and the like” (Kleinwächter 1876, 72). Only a significant increase in public officials’ salaries in the 1870s resulted in a greater influx of lawyers entering public service.

When Carl Menger began his law studies in Vienna, Lorenz von Stein (1815-1890) was teaching political economy. The second professorship was occupied by Leopold Hasner von Artha (1818-1891), who, however, after serving for only two years, was promoted to Minister for Education, later to Prime Minister and did not return to the university. His successor, Albert E. F. Schäffle, from Württemberg, took over the office of Minister for Trade in 1871 and shortly after that went to Stuttgart. Almost at the same time, the Viennese Braumüller publishing house published a book by Carl Menger, aged 30 and at that time unknown. It was almost three hundred pages long and would yet make history: *The Grundsätze der Volkswirtschaftslehre* (1871) (*Principles of Economics* (2004 [1950])).

CHAPTER 3

The discovery of the self: The theory of subjective value

Tradition has it that as a journalist of the *Wiener Zeitung*, Carl Menger, while “studying the market reports”, noticed contradictions between traditional price theories and the explanations of the “most experienced and sophisticated market participants” (cf. Wieser 1923, 89 a. Menger 1923, Vf.). Some have viewed this story skeptically (cf. Hayek 1968, XII), others in turn have dismissed it as “myth” (Ikeda 1997, 59), nevertheless there would seem to be some truth in it. Stock market reports were regularly published in the *Wiener Zeitung*, when Menger worked for a few months in its business editorial team, from March 1866. In his *Principles* too, Menger goes into remarkable detail about stock exchanges and markets, as though he were able to draw on direct observation (cf. Menger 2004 [1950], 92; 194; 218f.; 238; 249).

The particular atmosphere of the Vienna stock exchange, then one of the most important in Europe, has been handed down to us vividly in his *Handbuch für Börse-Speculation* (cf. Rubrom 1861 a. 1871), which was reprinted several times. The only thing that counted in the day to day dealings were future expectations. Past events were irrelevant (cf. Rubrom 1861, 119). The market price was apparently determined solely by subjective preferences, by “multiple emotions, conjectures and opinions, hopes and fears” (ibid., 115). Knowledge and information were critical (ibid., 210-212). Menger, who in his *Principles* stressed the importance of observation of real business life as a rich source of insight, must have gained important inspiration from this environment (cf. Menger 2004 [1950], 47).

At the beginning of September 1867, in Schleifmühlgasse 3, his new home near Karlsplatz in Vienna, Carl Menger began preparatory work on his *Principles* (Lehmann Jg. 1867, 207; cf. Yagi 1993, 700). In structure it complied

with the usual text books of the time. Regarding content, it addressed the goods, value and price theories of the German economists, supplementing and developing them further. However, within the confines of this conservative format, Menger then accomplished a radical break with tradition and completely rearranged his results on the basis of a thoroughly individualistic view of the world and of humanity. He dedicated his work to the doyen of German economics, Wilhelm Roscher (1817-1894). Even though Menger called himself, with regard to German economics, a “collaborator” (Menger 2004 [1950], 49) and complied in many ways with its structure and also with its terminology, he did not become its “consummator” (cf. Streissler 1997, 65), but rather its vanquisher. Hitherto, German economists had invariably referred to a moral, religious or political framework, be it “state welfare” (Hildebrand 1998 [1848], 31), “God’s plan” (Mischler 1857, XI), a normative “collective requirement” (Hermann 1870, 100), “moral law” (Mangoldt 1871, 7), a “moral [...] consciousness” (Schäffle 1873, Vol 1, 162) or to religion as “firmest foundation and highest aim” (Roscher 1878, 88). Closely connected with this was the view that institutions like “the People”, “the Economy”, “Tradition”, “Law”, “Nation” or “Language” were in some way entities in their own right, or had an essence of their own and that these entities actually existed. Thus, German economists’ understanding of the structure and functioning of the social universe was inclined towards metaphysical essentialism (cf. Milford 1997, 103).

By contrast, the *Principles* did without any religious or quasi-religious references and thus became the first secular economics text book in the German language. Menger proceeded on an anthropocentric maxim which he only years later astutely formulated thus: “There is no economic phenomenon that does not ultimately find its origin and measure in the economically acting human and his economic deliberations” (Menger 1889a, 2). Fundamental economic laws, such as the creation of value, could thus also be demonstrated in an “isolated” economy or in one “free of communication”, or by using the solitary figure of Robinson Crusoe (cf. Menger 2004 [1950], 295, 134-136.). The Viennese Economist Joseph A. Schumpeter (1883-1950) was later to name this approach as *methodological individualism* (cf. Schumpeter 1908, 88-98). In the course of this approach to a modern individualistic foundation, Menger replaced the hitherto common terms “singular economy” and “individual economy” with the term of the “individual” and also of the “person” (Menger, 2004 [1950], 51, 136, 137).

In the key part of the *Principles*, the theory of value, the idea of the “economically acting individual” as standard and engine of the economy is then extended to a comprehensive theory. Classical economics had already encountered the so-called value paradox, when economists wanted to explain the value of a good with its “utility”: some goods were “useful”, but had only minimal

value or none at all, as for example water in regions where water is plentiful. On the other hand, other goods were considered to be of little or no “use”, but were viewed as “valuable” in economic commerce, as for example diamonds. It then seemed paradoxical that the valuation of water and diamonds invariably reverses in the setting of a hot, dry desert. To solve this paradox, the classicists drew on the costs or the expenditure of human labor of manufacturing the respective good. However, pedantic authors soon realized that goods could very well be laborious to produce and yet still be without value on the market—such as badly written books.

This inadequacy of the “objective theory of labor cost and value” led some German economists, as early as the first half of the 19th century, to gradually discover the role of the individual as a value-imputing subject and as an agent in the economic process. Renowned contemporaries of the young Menger were adherents of this “German utility value school”; others demonstrated at least rudimentary elements of this kind of subjectivism (cf. Ikeda 1997, 77–85). However, their decades-long endeavors to create a consistent theory of subjective value stalled halfway. The reason for this was an institutional and epistemological dilemma which they could not solve. Institutionally, almost all of them were economics professors at state-supervised universities, and as public servants were more or less part of the ruling order, so that they also, generally speaking, pursued studies compatible with this ruling order. Epistemologically, the metaphysical essentialism which they philosophically subscribed to, constituted an additional and almost insurmountable barrier. There was no room in this scholarly and political world view for the individual as autonomous agent, or if at all, then only in a very restricted fashion.¹

In contrast, Menger explained that the attributes of goods or products is nothing “inherent” or a “property” of them, but result only from their relationship to human beings and their needs (Menger 2004 [1950], 52, 58, 101, 116, 120, 145). Nevertheless, Menger held on to two “objective” criteria: to the objective ability of goods to satisfy needs (*ibid.*, 52) and to the distinction between “imaginary” and “true” needs (*ibid.*, 53), something a consistent subjectivist would later reprove as a “notorious slip” (cf. Mises 1976 [1960], 5.2.).

Menger, who had adopted the term “importance” (“Bedeutung”) from Albert Schäffle, defined value in the following way: as “the importance that individual goods or quantities of goods attain for us because we are conscious of being dependent on command of them for the satisfaction of our needs.” (Menger 2004 [1950], S. 115). For humans, Menger said, the only important thing is the satisfaction of needs, but this “importance” is also transferred to

¹ This is why the valiant attempts to create a connection between scholastic precursors and the Viennese School are only possible at the cost of a completely distorting “de-contextualization” (cf. Huerta de Soto 2007, 49).

goods. How important individual acts of needs are is revealed in an accordingly graded valuation of the goods (*ibid.*, 139). As an example of this grading of needs, Menger cites a “farmer” who has “two hundred bushels of wheat” at his disposal. The first two parts he uses for food for himself and his family, the third as seed-grain for the next year, with the fourth he produces beer and the fifth part serves to fatten the cattle. The remaining bushels “he allots to the feeding of pets.” In reply to the question of what the value basis of the wheat stockpile or of a part of it is, Menger answers that the value of the whole stockpile is crucially determined only by that part with which the need of “smallest importance”, thus the “feeding of pets”, can be secured (*ibid.*, 129–133).

It was Friedrich von Wieser (1851–1927), one of Menger’s later Habilitant², who then called that utility of goods “at the margin of [...] utilization” the “marginal utility”. This being the “basis for the valuation of every single good constituting the stock” (Wieser 1884, 128). Eugen von Böhm-Bawerk (1851–1914), another Habilitant, would come up with an even more concise phrase: “The value of a good is determined by the amount of its Marginal Utility” (Böhm-Bawerk 1930 [1891], 149). Furthermore, Menger was to logically apply this concept, which pertained equally to consumer goods, land, capital and labor, to the production and distribution of goods as well. He demonstrated the “causal connections between goods” using the example of the production chain field-grain-flour-bread. Thus the value of the field—here as a good of the fourth and highest order ultimately arises from the value of the bread as a good of the “first order” (Menger 2004 [1950], 55–58; 149–152). The principle of marginal utility also made it possible to plausibly demonstrate how the often diverging price expectations represented the respective margins of valuation of those willing to exchange, margins within which “bargaining” or a “price duel” takes place (*ibid.*, 195). According to this, the price is a “resultant of subjective valuations” (Böhm-Bawerk 1930 [1891], 210).

Menger was of the opinion that he had presented a comprehensively valid

²“Habilitation is the highest academic qualification a person can achieve by their own pursuit in certain European and Asian countries. Earned after obtaining a research doctorate (Ph.D. or equivalent degrees), the habilitation requires the candidate to write a postdoctoral thesis based on independent scholarly accomplishments, reviewed by and defended before an academic committee in a process similar to that for the doctoral dissertation. Sometimes a book publication is required for the defense to take place. Whereas in the United States, the United Kingdom and most other countries, the PhD is sufficient qualification for a senior faculty position at a university, in other countries only the habilitation qualifies the holder to supervise doctoral candidates. [...] The word *habilitation* can be used to describe the qualification itself, or the process of earning that qualification. [...] A successful habilitation requires that the candidate (called Habilitant in German) be officially given the *venia legendi*, Latin for “permission for lecturing,” or the *ius docendi*, “right of teaching” a specific academic subject at universities for a lifetime.” (Source: <http://en.wikipedia.org/wiki/Habilitation>, 19/01/2009.)

price theory (cf. Menger 2004 [1950], 49). His critics, however, saw in these results nothing more than “independent [...] analysis of terms” (cf. Roscher 1874, 1040) or else reacted with incredulous amazement (cf. Schmoller 1873, 143). Soon, the *Principles* were in danger of sinking into oblivion. However, even more so than the fabulous economic boom, or the cultural and political liberalism of the second half of the 19th century, perhaps the shock of the great stock market crash (1873) was to prepare the ground for the belated reception of these ideas. With his perpetual neediness, his delusory conceit, his susceptibility to errors and his persistent worries about the future (cf. Jaffé 1976, 521), Menger’s “economically acting subject” was bound to appear like a real life role model.

It was Menger’s Habilitanten, together with Emil Sax (1845-1927), who in the 80s popularized the theory of subjective value and developed it in diverse ways. They felt strengthened in this research program after the forgotten work of Herman Heinrich Gossen (1810-1858), with his formulated theory of marginal utility and his graduation of goods in n numbers of “classes”, had been rediscovered, and when they became aware that the Englishman William Stanley Jevons (1835-1882), the Frenchman Marie Esprit Léon Walras (1834-1910) and the American John Bates Clark (1847-1938) had arrived at very similar conclusions to Menger’s, without any of these authors knowing about each other. Böhm-Bawerk, who was the first to call the *Principles* an “epoch-making work”, saw in these concurrences an “assurance of no small measure for the rightness/validity” of the aforementioned theory (Böhm-Bawerk 2006 [1881], 15 a. 1886, 45).

It was also Böhm-Bawerk, who in 1886, in the widely read *Conrads Jahrbücher* (“Conrad’s Annuals”), described in detail the new value theory with linguistic clarity, didactic talent and a cheerful love of debate. However, at that point, neither had Menger’s achievement been appropriately acknowledged, nor had the value theory research of his Habilitanten regarding business profits (Gross 1884a, Mataja 1966 [1884]), tax equity (Meyer 1884) or Wieser’s *Über den Ursprung und die Hauptgesetze des wirthschaftlichen Werthes* (“On the origins and the main laws of economic value”) (1884) been able to find positive resonance in Germany. There, the “theoretical” research was largely rejected. Furthermore, those who did concern themselves with the value theory, revealed once more their epistemological and institutional dilemma: the new value theory was disparagingly described as a “template” (Kleinwächter 1884, 1281), the figure of Robinson Crusoe derided as a “very boring experiment/trial boy of the exact method” and the foundations of the marginal utility theory contested, because an “economic value” could only emerge in a “society” (Schäffle, 1885, 451-453). Another, Heinrich Dietzel (1857-1935), was even of the opinion that Wieser’s *Über den Ursprung* was not a work about economics (cf. Dietzel 1885, 162).

Nevertheless, during the controversies of the 80s the principle of marginal utility became a kind of shining torch of the developing Viennese School. Its supporters were able to make good use of the new value doctrine as a productive tool for explaining economic theory, although they arrived at quite different answers. In his *Positive Theorie des Kapitals* (*Positive Theory of Capital*) (1889a) Böhm-Bawerk coherently presented anew the value and price theory, on the basis of which he developed his famous agio theory of interest. While he was first analyzing the sphere of production, and applying the marginal utility principle over periods of time (intertemporally), his brother-in-law Friedrich von Wieser was extending this principle to the “costs” which he defined as “forgone use” or as “opportunity costs” (cf. Wieser 1884, 100), later adopted in writings as “Wieser’s Law”. Wieser’s notion of the “calculability” of utility and his so-called theory of imputation (cf. Wieser 1914, 188–195) led to profound controversy for decades within the Viennese School and “produced more heat than light” (Schumpeter 1954, 916). That subjective value is not measurable and therefore also not calculable was then first proven by Franz Cuhel (1862–1914) (cf. Cuhel 1907, 195). After many endeavors and mistakes, the following generations finally realized that the value of goods of a higher order can never directly, i.e. without “market transmission”, be converted into prices of goods of a lower order (cf. Mises 1963 [1949], 334).

Toward the end of the 80s the theory of subjective value was considered a permanent part of the young Viennese School. Emil Sax even saw in it a kind of natural law: “An apple falls from the tree and the stars move according to one and the same law, that of gravity. In economic action, Robinson Crusoe and an empire with a population of 100 million follow one and the same law, that of value” (Sax 1887, 24f. a. 160). Other Habilitanten of Menger, such as Johann von Komorzynski (1843–1911) and Robert Zuckerkandl (1856–1926) further consolidated the position of the School with their value and price theory research (Komorzynski 1889; Zuckerkandl 1889 a. 1890); Hermann von Schullern zu Schratthofen (1861–1931) also applied the subjective value theory to ground rent (Schullern-Schrattenhofen 1889). With his successful text book, *Grundriss der politischen Ökonomie* (1893), which was reprinted 18 times up to 1926, Eugen von Philippovich (1858–1917), a colleague of Menger at the University of Vienna, also contributed to a further dissemination of the theory.

In the early 1890s the Viennese version of the marginal utility theory began to establish itself internationally. Böhm-Bawerk’s *Kapitaltheorie* and Wieser’s *Der natürliche Werth* (*Natural Value*) were translated into English. Both had previously described “Austrian Economics” or “the Austrian School” at length in English language academic journals (Wieser 1891; Böhm-Bawerk 1891b a. 1891c). In his own rousing style, Böhm-Bawerk raved about the new developments from Vienna: “The idea of final utility is to the expert the open

sesame, as it were, by which he unlocks the most complicated phenomena of economic life and solves the hardest problems of the science.” (Böhm-Bawerk 1891c, 209). What a powerful and fertile “new ferment” (Schumpeter 1914a, 113) the marginal utility theory was in actual fact to become could be seen 40 years later in the comprehensive bibliographical appendix to the article “Grenznutzen” (“marginal utility”) in the *Handwörterbuch der Staatswissenschaften*, which encompassed about 630 titles of literature (Rosenstein-Rodan 1927, 1213-1223).

CHAPTER 4

The emergence of the Viennese School in the Methodenstreit

The only critic who seems straight away to have surmised the momentousness of Menger's *Principles* was Gustav Schmoller, an ambitious advocate of the young generation of the *Historical School*, who wondered, astonished, whether with Menger "economic problems became purely private business problems" (Schmoller 1873, col. 143). This is the early emergence of the central issue in a controversy which would later go down in academic history under the rather inaccurate term "Methodenstreit" (a dispute over the best methodology [Transl.]).

What can be described, on the level of events, as a decades-long enduring feud with numerous fierce, even bitter clashes in writing, is the turbulent reinvention of a science trying to unify various strands of tradition—cameralistics, political science and political economy – in addition to having to process a large influx of ideas from law, history, philosophy and the natural sciences. It is therefore hardly surprising that this "aggregate of sciences" (Hasbach 1887, 587) lacked common ground and terms, and that the view of the actual heart of the controversy, which ultimately was about the foundations, conditions and limits of the economic and social sciences, was blocked by a kind of Babylonian confusion of language and terms (cf. Mäki, 1997, 476; Wentzel 1999, 12 a. 29f.; Hansen 2000, 308).

As previously mentioned, the Verein für Socialpolitik had tried, with Schmoller's substantial involvement, to establish a new role model for future economists. The fact that their analysis of economic phenomena was almost exclusively historical-empirical and they made the results available to politicians, especially to find an answer to the "social question", complied with their view of themselves, and at the same time amounted to something of an employment

program.¹ With this in mind Schmoller compared economics to the chorus of Greek tragedy, which may comment on the events, but does not itself appear on the political stage (cf. Schmoller 1881, 9). The economy itself Schmoller described as being like a clockwork kept in motion by egoism but needing to be regulated (cf. Schmoller 1904, 110). This view was subsequently the central theme of the *historical-ethical strand* of German economics.

At the same time, during the 1870s, the divides between the Austrian and German economists were confirmed over old and new politico-cultural resentments. Austria's defeat against Prussia in 1866, the war against France and the founding of the German Empire in 1871 had left the academic elite of the Austrian monarchy "deeply alienated against Prussia" (cf. Plener 1911, 189f. a. 272). At the University of Vienna this had even led to brawls between German and Austrian students (cf. Leisching/Kann 1978, 28f.). On the other hand, the Historical School "encountered [...] [a] powerful trait of national feeling of unity" (cf. Dietzel 1884b, 125). They openly supported the German pursuit of empire-building and its nationalistic expansion plans (Winkel 1977, 119f.). Carl Menger put these antagonisms to one side when he first publicly criticized the Verein für Sozialpolitik for its bias (cf. Menger 1873), and accused it of systematically taking action against "moderate individualism in Germany" (cf. Menger 1875).

In the mid-70s Menger began work on a methodology of economics, the manuscript of which was already completed in 1879, when he was appointed professor (cf. Boos 1986, 39f.; Tomo 1994, 68). However, Menger deferred publication and for the time being pressed ahead with educating the next generation of academics: Böhm-Bawerk received his habilitation in 1880, followed four years later, in short succession, by Friedrich von Wieser, Robert Meyer, Gustav Gross, Eugen von Philippovich und Viktor Mataja (cf. Howey 1960, 162). This group, gathered around Menger, by far surpassed the foreseeable staff requirements of the six German speaking universities in the Austrian monarchy, however served the ambitious plan of reorienting economics as a whole in German speaking countries, as indeed Menger had personally foreseen (Menger 1883, XXI f.; differently Alter 1990, 79 a. Mises 2009, 29).

In his *Untersuchungen über die Methoden der Socialwissenschaften und der Politischen Ökonomie insbesondere*, ("Inquiries into the methods of the social sciences and of political economy in particular") which he published in 1883, Menger drew distinctions between "historical", "theoretical" and "practical" strands of economics (Menger 1883, 8-10 a. 252f.) and accused the *Historical School* of confusing theoretical economics with its history (ibid.,

¹ Between 1872 and 1914, the Verein für Sozialpolitik published 256 research compilations and almost 200 conference reports (cf. Hagemann 2001, 187f.).

Zwischen 1872 und 1914 publizierte der Verein für Sozialpolitik 256 Forschungsbände sowie annähernd 200 Tagungsberichte (vgl. Hagemann 2001, 187f.).

23). The practice, meaning economic policy, said Menger, required a theoretical foundation, just as applied chemistry assumes a knowledge of theoretical chemistry (ibid., XII f.; appendix III 246 f.; cf. Menger 1970c [1889], 194 FN1). With powerful eloquence, Menger challenged a series of firmly held basic suppositions of the *Historical School*: Visible economic phenomena did not alone guarantee the validity of the “exact laws of economics” (Menger 1883, 59 f.); economic phenomena were by no means “inextricably” bound to the social and governmental development of populations (ibid., 70); the term “people” (“Volk”) described neither a “large, needy, working, producing and competing subject”, nor “a large single economy”, but rather a “complication of single economies” (ibid., 86 f. a. appendix I, 232–237) and the “dogma of self interest” did not mean that all humans always acted in the same way, because error and ignorance alone created differences (ibid., 80). Furthermore, the *Historical School* strictly rejected “laws” of economics, was searching, on the other hand, for “laws of development” in history, to then “endow these with the characteristics of ‘natural laws’” (ibid., 125, FN42). And finally, the terms used by the *Historical School* were “ambiguous” throughout, as the varying definitions of the term “economics” by altogether 16 of its representatives blatantly showed (ibid., appendix II, 238–244).

Moreover, in his *Untersuchungen* Menger devoted himself in-depth to the emergence of “social entities”, by which he meant law, language, the state, money, markets, prices of goods, interest rates, ground rents, wages and “a thousand other phenomena of social life”. These were “to no small extent the unconscious results of social developments” (ibid., 164). Thus, “the economic interest of the individual economic agent [...] [led], without any accord or legislative force, indeed even without considering public interest” to the use of “goods [...] which our forebears called money” (ibid., 176). Menger thereby insinuated that the *Historical School* demanded measures of social policy often without proper knowledge of the underlying causal correlations.

Reactions to Menger’s *Untersuchungen* were numerous and ranged from encouraging agreement and objective criticism to harsh rejection. The fiercest remarks came from Schmoller: one would need “a very escapist, bookish naïvety” in order to “see ultimate simple elements, in the scientific sense of the word, in the assumption of human needs, of the procurement drive or of self interest” (Schmoller 1883, 979). Menger wasn’t able to understand the *Historical School* at all, “because he lacks the necessary organ” (ibid., 983). Schmoller ended his largely scathing review in the style of a verdict: “We have finished with this book!”, Menger lacked the “universal philosophical and historical education, as well as a naturally broad vision” (ibid., 987). In a reprint, the affronting passages were tacitly toned down (cf. Schmoller 1888a).

Menger’s response appeared initially in the form of a letter in Conrads *Jahrbücher* (cf. Dietzel 1884b, 111–114). It’s possible that Schmoller had re-

fused the publication of a similar text in his *Jahrbücher*, because it expressed an accusation of the “tyranny of the historical school” (ibid., 131). In 1884, Menger supplemented this with his *Irrthümer des Historismus in der deutschen Nationalökonomie* (“Errors of historicism in German economics”). His criticism *ad hominem* became more severe, and in addition he angrily questioned Schmoller’s integrity: “Like no other scholar in Germany,” he was “inconsiderate in his choice of means”, “master of both a personal as well as vulgar style” (Menger 1884, 6), a “prototype of the ‘problematic’ kind in the area of academic studies” (ibid., 59). Consequently, Menger’s final words were full of derision: “As much as the methodologist Schmoller may stride like a lion in the sand of the Spree, shake his mane, brandish his paw, yawn epistemologically; only children and fools will henceforth take his methodological gesticulations seriously” (ibid., 86f.).

These written exchanges between Menger and Schmoller were the spectacular climax of the *Methodenstreit*. However, the angry vehemence of the *Irrthümer* proved to be counter productive for Menger, for even his fellow campaigners felt he had gone too far in style and form (cf. Dietzel 1884b, 111 a. Wagner 1892, 55); behind his back, people were whispering about signs of nervous exhaustion (cf. Grimmer-Solem 2005, 264). At any rate, Menger’s standing at the Viennese faculty was shaken to such an extent, that his proposal, made during consultations about the reform of law studies, to separate economic theory from political economy in the curriculum, was outvoted (cf. Gutachten 1887, 55-57). Menger was also unable to influence procedures to appoint the successors of von Stein and Brentano (cf. Tomo 1994, 156-162). The ministry even considered the appointment of Schmoller to Vienna (cf. Grimmer-Solem 2003, 268 FN114). After that Menger avoided any further personal attacks.

In the following two decades, a complex and multifaceted debate generated over 50 relevant titles, not to mention the many annotations and digressions constantly appearing in publications during that time. The topic areas of the continuing *Methodenstreit* were primarily the classification of economics, functions of the sub-disciplines, re-evaluation of the classical economists, emergence of social institutions, and the interplay of theoretical and empirical research, individualism and collectivism and also induction and deduction (cf. Bostaph 2005, 116).

However, in the field of economic theory, the historical-ethical orientation proved to be anything but satisfactory. The exceptions were Adolf Wagner (1835-1917), a colleague of Schmoller at the University of Berlin and his pupil Heinrich Dietzel (1857-1935). Regarding economic policy, both were close to the historical-ethical school of thought, while in methodological questions they vehemently advocated Menger’s position. In other respects, many papers of the *Historical School* were comparable to “high school seniors’ essays”, as

even one of their more brilliant exponents admitted (Hasbach 1887, 588; cf. also Hasbach 1895, 465). Not exempt were those economists of the Austrian monarchy, who were classed as part of the historical-ethical school, such as Friedrich Kleinwächter (1838-1927), professor in Czernowitz, Richard Hildebrand (1840-1918), professor in Graz or Lujo Brentano (1844-1931), at the time of his professorship in Vienna.

The position of the "Austrians" was supported by Emil Sax, by Eugen von Böhm-Bawerk and a range of young Viennese lecturers. Sax, who advocated a methodological individualism, developed an interpretation all of his own, in which he saw the individual determined above all by egoism, mutualism and altruism (cf. Sax 1887, 4-33). However, because of his abstract and cumbersome style, the impact of his contributions was limited. Böhm-Bawerk, on the other hand, who made use of gripping and visual language, became a rousing champion of the "Austrian" cause, albeit at the cost of substantial simplification (cf. e.g. Böhm-Bawerk 1891b). With the exception of some methodologically relevant annotations by Wieser (cf. Wieser 1884, 1-42; Wieser 1911 und Wieser 1914, 8f.), the other exponents of the emerging Viennese School authored no further contributions to methodology. Instead they applied Menger's approach and thereby contributed to the emergence of the school of thought, which was soon to gain the reputation of particular "logical astuteness" (cf. R.F. 1886, 77). In the 80s, the Viennese lecturers Robert Meyer, Gustav Gross, Viktor Mataja, Robert Zuckerkandl and Johann von Komorzynski produced monographs on the basis of Menger's teachings; these were followed in the 90s by Hermann von Schullern zu Schrattenhofen, Siegmund Feilbogen und Richard Schüller.

The Gesellschaft der österreichischen Volkswirte played a decisive role in the consolidation of the young Viennese School. Current financial, social and economic-political affairs were discussed at regular lecture evenings, to which politicians of every shade were often invited. In 1897, the exceedingly active society had a total of 232 members (cf. ZfVSV 1897, 308), who also made important moves towards approaching the German Verein für Socialpolitik. After holding its annual general meeting in Vienna in 1895, the Verein's Austrian membership jumped from around 10 to 144 of a total of 489 members (cf. Boese 1939, 74). This contributed significantly to the Methodenstreit being conducted more rationally. However, that is not say there were no further skirmishes. Thus, Schmoller spoke disparagingly of the "Austrian circle of scholars" (cf. DZ 12.2.1995) and, as principal of the University of Berlin, announced his intention of barring from teaching all tendencies not belonging to the *Historical School*, including the "Austrians" (cf. Schmoller 1897, 1406).

Eventually, the Gesellschaft der österreichischen Volkswirte sponsored the newly founded magazine Zeitschrift für Volkswirtschaft, Socialpolitik und Verwaltung (ZfVSV), which from 1892 onwards was published by Eugen von

Böhm-Bawerk, Karl Theodor von Inama-Sternegg (1843-1908) and Ernst von Plener (1841-1923). Right from the start it offered space to international authors and readers and was the first German language professional journal to provide an overview of the most important international articles. The program outline was set by Böhm-Bawerk, who in his opening essay unambiguously rejected all forms of “bias” and “intolerance”: “Declaring theory for redundant means having the arrogance to say one does not need to know what one says when speaking, nor what one does when acting” (Böhm-Bawerk 1892b, 3f.).

When the *Zeitschrift* first appeared, ten further professors and lecturers already belonged to Menger’s circle. Four more habilitierte scholars would join them by the turn of the century. Step by step, not only the academic identity, but also the name of the school of thought had already been established. The first verifiable link of Menger’s circle with the term “österreichisch” (“Austrian”) happened at the climax of the *Methodenstreit* (cf. Dietzel 1884b, 116 u. 118). Shortly afterwards one could read about a “Menger School” (vgl. R.F. 1886, 77; Blumenthal 2007, 53 u. 77) and it was Schmoller, who in a review in 1888 finally acknowledged the “younger Viennese School” (cf. Schmoller 1888c, 730). The term *Austrian School* was initially used in foreign publications as “scuola austriaca” (cf. Graziani 1889, 165; Loria 1890) or as “Austrian School of Economics” (vgl. Bonar 1888; Wieser 1891). An “Austrian School of Economists” was first mentioned in a newspaper article of Menger’s in 1889 (cf. Menger 1889b, 2; Menger 1970d [1891], 261). Soon afterwards, the label *Österreichische Schule* was used in a widely read essay by Heinrich Dietzel (Dietzel 1890, 570) and finally adopted in a textbook by Schmoller’s colleague Adolph Wagner (1835-1917) (cf. Wagner 1892, 187 u. 308). In the following years, the terms *Österreichische Schule* or *Wiener Schule* gradually became established (cf. Elster 1894, 452; Böhm-Bawerk 1894a, 209, Böhm-Bawerk 1894b, 328; Hasbach 1895, 772). The claim, upheld to this day, that the giving of these names was intended to be perjorative (vgl. Mises 1984 [1969], 19; Smith 1986b, VII), in any case cannot be proven.

CHAPTER 5

Carl Menger: Founder of the Viennese School

Let us take a step back into the past and consider the biography of the founder of the Viennese School. Far removed from the metropolis, Vienna, in the small, nondescript Galician town of Neu Sandez (today Nowy Sącz, Poland), Carl Menger was born on Sunday, 23rd February 1849, as the third of ten children.¹ His mother, Karoline, came from a wealthy merchant family which had bought the Maniowy estate in the surrounding area. His father, Anton, was the descendant of a family which had once come from Bohemia and who held the aristocratic title of “Edler von Wolfensgrün” (cf. Boos 1986, 3f.).

Carl was raised in a strict catholic family (cf. Grünberg 1908, 2). For him and his two brothers, Max (1838-1911) and Anton (1841-1906), who would also gain great prominence as a German-liberal member of Parliament and as a socialist university teacher, this must have been constricting to such an extent, that all three of them later emphatically distanced themselves from the Church, with Anton even becoming an avowed atheist. There is no proof that the Menger brothers were of Jewish origin and, in the light of the above, this is extremely unlikely (differently Ikeda 1997, 47-54 a. Biehl 1980, 929).

The scanty biographical records passed down indicate a childhood overshadowed by serious misfortune and suffering. Carl lost four siblings, and in 1848 his father too. The consequences were dearth and hardship (cf. Kästner 1974, 3f.). The fatherless child grew up partly in Biala, and partly on his grandparents’ remote country estate in the Dunajec river valley, today flooded by the reservoir Jezioro Czorsztynskie. There he also acquired his secure knowledge

¹ On the biography of Carl Menger cf. Wieser 1923; Hayek 1968b (Introduction); Streissler 1989; Alter 1990; Streissler 1993; Salerno 1999 a. Hülsmann 2007a (esp. 101-140).

of the Polish language, which he would require later as a journalist in Lemberg (cf. Ikeda 1997, 42).

After changing schools several times (cf. UA, Personalblatt Menger), Carl graduated from high school in Krakow and in the fall of 1859 began studying law in Vienna. Often in poor health (Ikeda 1997, 23f.), he completed his further studies in more tranquil Prague, in difficult financial circumstances (cf. Kästner 1974, 6). Traces of his economics teachers at that time, Leopold Hasner von Artha and Peter Mischler (1824-1864), can be found repeatedly in his first work, the *Grundsätze der Volkswirtschaftslehre* (1871) (*Principles of Economics* (2004 [1976])), although fundamentally there was a great distance between him and Mischler because of the latter's insistent and antiquated piety (vgl. Streissler 1997, 66-70).

Already as a student, Carl Menger displayed a trait that was later to appear often. He had an assertive, sometimes aggressive character and was not readily prepared to back away from authority. Two vehement arguments with professors are well-known from his time in Prague (cf. Ikeda 1997, 33). In the course of his Habilitation he also did not shy away from overtly challenging the senior examiner (ibid., 162). This characteristic was then later expressed in a decidedly forceful and uncompromising way in his *Irrthümer* (1884). Even though the *Methodenstreit* evidently put him under physical strain, he nevertheless did not want to back down.

In 1867, Carl Menger obtained his doctorate of law at the University of Krakow. While he was studying he earned his living as a journalist in Lemberg, as co-founder of the *Wiener Tagblatt*, as editor of the *Wiener Zeitung* and as author of a serialized novel (ibid., 41-65). After gaining his doctorate, he worked for a short time in an attorney's office, then once again as a freelance journalist for various newspapers in Vienna. Meanwhile he began, from September 1867, the preliminary work for his eventual *Principles* (cf. Yagi 1993, 700). Until 1875 he enhanced the press office of the *Ministerratspräsidium* ("ministerial council's chair").

After his *Principles* were published, Menger succeeded in June 1872 in obtaining his *Habilitierung* for Political Economy at the University of Vienna. Just a year later he received a non-tenured professorship; he declined subsequent offers from Karlsruhe, Basel and Zürich (cf. Hayek 1968b, XIX). In 1876 he was appointed teacher of Crown Prince Rudolf (1858-1889) and accompanied him in 1877/78 on his travels across Europe. To the crown prince, who was as highly gifted as he was erratic, Menger imparted a liberal appreciation of economics and a great sensitivity for social problems (cf. Streissler/Streissler 1994). In 1878 he assisted Rudolf with an anonymous publication, in which the Austrian aristocracy was reprehended for being politically passive and economically inept (cf. Hamann 2006 [2005], 101-105). Menger's own aristocratic title, which he had used in 1867 for book signing,

was eventually given up (cf. Menger, 1963, I). The reason for this was possibly not just “citizen’s pride” (cf. Hamann 2006, 81), but – as often the case with Galician aristocratic titles—the impossibility of unequivocally proving the origin of the title (cf. Dörfering 1989, 629).

After attaining his full professorship in 1879, Menger began training junior academics and thus created the personnel resources of the future Viennese School. He was concerned with in total 15 Habilitationen, and in addition involved in five further Habilitationen in related subject areas (cf. Ikeda 1997, 1f.). Menger was considered an “excellent, conscientious and stimulating teacher” (Zuckerandl 1910, 252), who had an aptitude for combining simplicity and clarity with philosophical depth in his teaching (cf. Seager 1893, 255). With help of the latest numerical data he sought to emphasize the practical relevancy of his lectures. If students showed interest, he readily made his private library available to them, disputed patiently with them, every so often invited them to Sunday outings and was keen to introduce younger students to former members of his seminar (cf. Grätz 1921). With many of them he maintained lifelong friendships, to which the almost complete collection of their books and special editions in his library testifies.

On committees, Menger was “neither a leader nor a follower” (cf. Zuckerandl 1910, 253). It seems he was able to impress with his generally complex and analytically astute contributions, but was by no means always able to persuade. With his suggestions regarding university reform he remained just as much in the minority (cf. Gutachten 1887, 55–57) as he did on the “inquiry commission on currency” for the preparation of a currency reform, in which he, as one of 37 experts, delivered a well-heeded statement (cf. Stenografische Protokolle [“shorthand minutes”] 1892). He also got into a minority position when, as a member of the inquiry commission on housing tax in 1903, he voiced his skepticism about the state and criticized social affairs (cf. Stenographisches Protokoll 1904, 268–273). Perhaps this was one of the reasons why Menger, who from 1900 was a member of the Herrenhaus (the upper house of the Austrian Imperial Assembly [Transl.]), did not take part in the debates there.

In the 1890’s, after the republication of his *Principles* had been postponed yet again, Menger began once more to pursue extensive studies in adjacent subject areas (cf. Menger 1923, VIIf.). He devoted himself to biology, physiology, mathematics and ethnology, which resulted in his acquiring about 1,100 books for his library on ethnology, anthropology and various research expeditions (cf. Katalog I, 849–948). The aim of these endeavors was his plan to publish a work on sociology, which however was never accomplished, as he unexpectedly took early retirement (cf. Somary 1959, 31).

A fateful turn had led to a considerable change in Menger’s life. His affair with the Galician-born feature writer Hermine Andermann (1869–1924),

29 years his junior, had produced an illegitimate son, the later mathematician Karl Menger (1902-1985) (cf. Klose 1902, Vol. I, 224). Social conventions forced him to go into early retirement in 1903 and subsequently to withdraw from public life to a great extent. Menger, now well advanced in years, resolved upon marriage. Until his death, on 26th February 1921, he lived with his family, surrounded by his books, which in the end constituted a library of 25,000 volumes, in the 9th municipal district of Vienna, in the Fuchsthalergasse 12. His publications were now only sporadic, but he kept in regular touch with his pupils well into old age. These adamantly adhered to the version of his voluntary retirement for further studies, as if they wanted, with this “true Viennese secret”, which everyone in Vienna knew but did not talk about in public, to demonstrate to the last the *esprit de corps* of the School.

CHAPTER 6

Time is money: The Austrian theory of capital and interest

Even during the *Methodenstreit* the young and developing Austrian School received support from abroad. In the preface to his *Theorie de la monnaie* (1886), Leon Walras mentioned already well-known supporters of the new value theory in Romance countries. In English publications, the subjective theory of value was also increasingly gaining acceptance (cf. Böhm-Bawerk 1889c). The fact alone that it had been discovered, almost at the same time, by three authors (Walras, Menger and Jevons) was considered by Böhm-Bawerk as substantive evidence for its veracity (Böhm-Bawerk 1930 [1891], 132 FN 1). In contrast, Gustav Cohn (1840–1919), an advocate of the *Historical School*, interpreted this brisk publishing activity in such a way that the discovery of the marginal utility merely constituted a “meager morsel” which “a number of like-minded discoverers” would have to share (Cohn 1889, 23).

Yet, within months, the derisive phrase “meager morsel” was impressively refuted. In 1889 alone, members of the Austrian School published a considerable number of essays offering productive suggestions for further development: *Positive Theorie des Kapitals* (Böhm-Bawerk), *Zur Theorie des Preises* (Zuckerkanndl), *Der natürliche Wert* (Wieser), *Untersuchungen über Begriff und Wesen der Grundrente* (Schullern zu Schrattenhofen), *Neueste Fortschritte in der nationalökonomischen Theorie* (Sax) and *Der Wert in der isolirten Wirtschaft* (Komorzynski). By far the most lasting impact was achieved by Böhm-Bawerk. With his *Positive Theory* he not only laid the foundations for an “Austrian” theory of capital and interest, but also contributed crucially to the international reputation of the Austrian School. He became one of the most discussed and quoted economists of his time.

As a scholarship holder at the University of Heidelberg, Böhm-Bawerk

had already, during a seminar led by Carl Gustav Adolf Knies (1821-1898), thoroughly considered the relationship between the present and the future, posing the question, why a debtor is prepared to pay the creditor interest for a loan, on top of paying back the amount of the loan itself. He answered this by explaining that future goods have a lower value than present goods and the result of this is a difference in value between the present and the future, between loan and repayment. Payment and return are deemed equivalent when the difference in value has been balanced by a “quantitative plus”, namely the interest. A “self induced creation of capital value” (cited after Yagi 1983, 32), he argued without specifying further, would make repayment of such amounts economically feasible for a debtor.

The publication of *Positive Theory* was preceded by a wide-ranging, virtually complete collection, and appraisal, of all the established theories of capital and interest. Böhm-Bawerk dealt with more than 150 authors and presented an exemplary history of dogma, the structure of which suggests that he had already compiled the complete draft of *Positive Theory* (cf. Tomo 1994, 92). For the further development of the Viennese School, *Die Geschichte und Kritik der Kapitalzinstheorien (Capital and Interest)* (1884) was to be trend-setting, in two ways especially: firstly, Böhm-Bawerk subjected the socialist labor theories of value by Johann Karl Rodbertus (1805-1875) and Karl Marx (1818-1883) to detailed, consistently deprecatory criticism, and thus laid the foundations for the critique of Marxism in the tradition of the Viennese School (Böhm-Bawerk 1890a [1884], 328-392). Secondly, he dismissed Carl Menger’s utility theory, according to which capital rent is the remuneration for the hired use of capital. Böhm-Bawerk’s objection was that Menger considered a “good” and the “disposal over goods” as two separate value repositories, which led to an incorrect double count (ibid., 260). This was simply the logical outcome of his definition of the term “good”, differing from Menger’s, which Böhm-Bawerk had already presented in his revised postdoctoral thesis (cf. Böhm-Bawerk 2006 [1881], 16f. a. Menger 2004 [1950], 52f.). This divergence and its consequences resulted in the founder of the Viennese School taking a detached view, throughout his life, of its definitive theory of capital and interest.

In his *Positive Theory*, the publication of which was held up for years, Böhm-Bawerk defined “capital” as “a group of products destined to serve towards further production” or as “a group of Intermediate Products” (Böhm-Bawerk 1930 [1891], 38). Based on this notion of capital, three kinds of capital yield were conceivable: revenue from a loan, revenue from renting out a durable good, or revenue from a production process. All three kinds of revenue could ultimately be explained by the subjectivist value theory. The starting point had been the observation that in general, present goods were valued more highly than future goods of equal kind and number, for which there were two reasons. Firstly, the ratio between demand and supply varied at different

points in time, because personal circumstances and future expectations were constantly changing (*ibid.*, 249). Secondly, we systematically underrated our “future needs” as well as the “means to meet them.” The causes of this misjudgment were our hazy picture of the future, our weakness of will and our “consideration of the brevity and incertitude of life” (*ibid.* 253-256; cf. Menger 2004 [1950], 150f.). Böhm-Bawerk concluded from all this that “we look at the marginal utility of future goods diminished, as it were, in perspective” and that thus “[t]he agio on present goods moves upwards.” (Böhm-Bawerk 1930 [1891], 258f.).

However, there was a third reason for the upward pressure on this agio (“premium”), which did not reside in the sphere of the consumer but in that of the producer. According to Böhm-Bawerk, this was because it is in the nature of capitalist production, that the elementary economic productive forces—labor and land use, possibly also in combination with natural forces—are combined in such a way that consumer goods are created either directly or indirectly. As a general rule, such “indirect production” would also lead to a greater result in output. Thus one could use nothing but one’s hands to break stones out of a rock face, or one could first extract iron, using it to make hammer and chisel, and then get to work. An even greater and more time-consuming form of indirect production would be to take sulfur and sodium nitrate to manufacture gun powder, fill it into drilled holes and thus blast the rocks out. Such a procedure would increase the result in output many times over (*ibid.*, 19). However, this rule would only apply for a “wisely chosen capitalist process” (*ibid.*, 82). With increasing productive diversion, the additional revenue would, after a certain point, then decrease again (*ibid.*, 85f.).¹

Interest, according to Böhm-Bawerk, thus has psychological and productive-technical causes. It also exists independently of the prevailing economic and social system. Even in a “socialist state” a difference in value would exist between present and future goods. The “interest principle” can thus in no way be conceived as “exploitation”, because it is not a “historico-legal”, category, “but an *economic* category, which springs from elementary economic causes” (*ibid.*, 367 a. 371).

Böhm-Bawerk, who considered the basic principles of his theory of capital and interest to be “unusually simple and natural” (Böhm-Bawerk 1930 [1891], XXVI.), had to add and expand his work considerably to combine the subjectivist value theory with his capital theory. Thus he made a clear distinction

¹ Böhm-Bawerk borrowed the concept of “productive diversion” and its “additional revenue” from a number of predecessors, whose ideas he developed and formulated more stringently. Later it would turn out that John Rae (1796-1872), a Scotsman who had emigrated to Canada and fallen into oblivion, had already in 1834 pre-empted the *Positive Theory* in key points (cf. Böhm-Bawerk 1959 [1921], 208-240).

between the reasons for the origin of interest and those which were responsible for the specific interest rate. Furthermore, as he had subsumed the heterogeneous intermediate products with their variously long indirect production paths under the term "capital", he had to introduce the term "average period." This was illustrated with a simple diagram of figures (*ibid.*, 89). Moreover, he adopted Stanley Jevons' concept of "wage funds" (cf. Jevons 1979 [1871], chap. 8), because the laborers involved in the indirect production paths had to be supported for the duration of the production process (Böhm-Bawerk 1930 [1891], 318f.). And finally, he had to first reconcile the subjectivist value theory with the law of costs, which states that in the long term, the market price of reproducible goods will equal the production costs (*ibid.*, 223-234). These and some other "additions" meant that the basically elegant theoretical structure appeared increasingly contrived and plethoric.

Nevertheless, Böhm-Bawerk's *Positive Theory* had an enormous impact internationally. It was translated into English as early as 1891, and soon afterwards into French as well. In 1892 the Swedish economist Knut Wicksell (1851-1926) transformed it into mathematical formulas. By the turn of the century Böhm-Bawerk was considered one of the most famous and debated economists worldwide (cf. Kurz 1994, 151). The second edition, which included a considerably expanded criticism of Marx, was published in 1900; a third in 1913. Both editions included excursuses, in which responses were given to raised objections (cf. Böhm-Bawerk 1921, Vol.3). Finally, in 1921, Friedrich von Wieser arranged for a fourth publication, a complete edition in three volumes, to be published under the title *Kapital und Kapitalzins*.

Menger, whose notion of capital fundamentally differed from Böhm-Bawerk's, took up an extremely critical stance towards it. To a few chosen people he even went so far as to call Böhm-Bawerk's theory "one of the greatest errors ever committed" (Schumpeter 1954, S.847 FN 8). There has been much speculation about what might have led Menger to this strict rejection. It could hardly have been Böhm-Bawerk's insufficiently consistent subjectivism, as even Menger's definitions of value theory retained some traces of objectivism (cf. Gloria-Palermo 1999, 39-50; Mises 1976 [1960], 2.4. and 5.2.). A distinctive dividing line was, however, their differing methodological approach. Menger took Böhm-Bawerk to task for the "obvious artificiality" of some of his theories (Menger 1970f [1915], 11 a. 16). And in methodological questions Böhm-Bawerk did indeed demonstrate an almost unconcerned, pragmatic-eclectic attitude. Characteristic of this attitude was his rejection of the use of mathematics in economics, not for fundamental epistemological reasons, as was the case with Menger, but because he, along with most of his faculty colleagues, simply lacked the necessary mathematical skills (cf. Böhm-Bawerk 1894c, 163-165). Furthermore, *Positive Theory* seems in some respects to point in the direction of modern macro-economics. Unlike (the) other key works of

the “Austrians”, it contains an unmistakable tendency to create highly abstract aggregates, and demonstrates a rather frivolous propensity to quantify, albeit still in the modest guise of simple forms of calculation.

Böhm-Bawerk’s theory also encountered reservations, or even rejection from the following generation of the Viennese School. Thus, Joseph A. Schumpeter (1883-1953), aged only 28 years old, developed his own “dynamic theory of interest” (Schumpeter 1961b, 157-211), which was bound to appear to Böhm-Bawerk as a defamation of middle-class economic morality as well as praise for inflationist daredevil policies, and which he rejected with unusual forcefulness (Böhm-Bawerk 1913a a. Böhm-Bawerk 1913b). Schumpeter’s response was accordingly subdued (Schumpeter 1913, 599-639). During a Böhm-Bawerk-Seminar, Ludwig von Mises (1881-1973) also made the criticism that his theory of capital and interest had proceeded on the assumption of a “neutrality of money”. According to Mises, by the end of Böhm-Bawerk’s life, he had already moved far beyond his published theories (cf. Mises 2009, 47; also Elster 1923, 164).

It was finally Emil Sax who, in *Der Kapitalzins* (1916), presented the first comprehensive critique of Böhm-Bawerk and compiled all the arguments which future authors would also bring up against him. Böhm-Bawerk’s theory of capital and interest was “a chain of thought too elaborately spun out and, owing to its unevenness, unable to withstand a tensile test” (Sax 1916, 229). Above all, Sax believed he could prove that the three reasons for a value difference between present and future goods were each questionable, that durable goods (fixed capital) as such could not yield any interest, that the term “average indirect production path” was too indeterminate and that the *Positive Theory* did not account for compound interest. In this way *Der Kapitalzins* simply documented a further step in the drifting apart of the Vienna School at the height of its international eminence. However, external events, such as Menger’s permanent withdrawal from university activity, Böhm-Bawerk’s death in 1914 and the outbreak of the First World War scarcely allowed this inner split to come to the surface (cf. Elster 1923, 163).

In the last analysis, no economist of note agreed with Böhm-Bawerk on every point. However, his concepts continued over decades to have an unusually inspiring and fruitful impact (cf. Schumpeter 1954, 930; Kurz 2000, 153). Among the representatives of the Viennese School, Böhm-Bawerk was always revered as one of their greatest (thinkers). The academic generation which came after the First World War felt compelled to make multiple changes, qualifications or shifts in emphasis. However, this scarcely did any harm to the remarkable academic fascination with which Böhm-Bawerk’s theory of capital and interest is treated to this very day. The reason for its undiminished appeal might be that Böhm-Bawerk’s monumental theory reveals a part of the “hidden logic” or the “grammar of economic phenomena” (Orosel 1986, 127f.).

CHAPTER 7

Friedrich von Wieser: From economist to social scientist

His tall, lean, slightly stooping appearance, his narrow, bearded face, his blue eyes and hair turned white with age always made a lasting impression on students and listeners. As a lecturer he spoke calmly and at a leisurely pace, without notes, expressing himself in classical style (cf. Schams 1926, 446). His admirers classed him among the “greatest stylists of academic prose” (Menzel 1927, 2). In the culturally aware cities of Prague and Vienna, he was regarded as an art connoisseur and music lover, who would sometimes play the piano himself to demonstrate his (musical) ability.

Friedrich von Wieser, whose stature and demeanor signaled distance and aloofness, rarely tolerated questions and interruptions even in his lectures. A student who sought personal contact with him would have to come up with some “interesting questions” (cf. Hayek 1926, 526). When this succeeded, he “dominated the conversation in truly royal fashion” (Mayer 1929, 191). The “born thinker” (Schumpeter 1954, 848) avoided directly disputing other people’s writings and ideas. Wieser, who in his publications usually managed without footnotes and bibliographies, spoke and wrote above all about the results of his own “intense observations” (cf. Wieser 1926, II), and one frequently felt/thought one was witnessing the escapist inner monologue of a brooding mind. By the end of his academic career, his reflections on his own intellectual development took up marginally less space than all his references to other authors put together; he was like a learned narcissist whose cognitive paths merely circled around his own ego (cf. Wieser 1907, esp. 335-339; Wieser 1924, VII-X; Wieser 1926, II-VII).

Friedrich von Wieser was born in Vienna in 1851, the fourth of nine

children.¹ His father, Leopold, was initially director of supplies in the war ministry, later vice president of the audit office and was knighted in 1859. Friedrich attended the Viennese *Schottengymnasium* at the same time as the young Eugen von Böhm-Bawerk, which would result in a life-long bond and (later) a marriage between members of the two families. Coming to grips with Roman law while studying law at the University of Vienna introduced him to economic problems; the writings of the English sociologist, Herbert Spencer (1820-1903), directed his attention to the “great impersonal forces of human society” (Wieser 1907, 4). However, only when reading Menger’s *Principles* did he find the perspective he was looking for, which he later in life conceived as liberation from “cognitive distress” (Wieser 1923, 88).

After achieving his doctorate in 1875, Wieser was able, as a result of Carl Menger’s intermediation, to gain a scholarship and deepen his expertise with the ‘great minds’ of economics in Heidelberg, Leipzig and Jena. After that he spent a number of years in the state Finance Authority of Lower Austria, until he presented his *Habilitation* thesis *Über den Ursprung und die Hauptgesetze des wirtschaftlichen Werthes* (1884) (“On the Origin and Main Laws of Economic Value”). Going further than Carl Menger and William Stanley Jevons, he interpreted costs as “forgone use” or as “opportunity costs” and introduced the term of marginal utility to economics (cf. Wieser 1884, 128).

Wieser’s first publication met with little response outside Vienna. Nevertheless in 1884 he received, as Emil Sax had before him, a non-tenured professorship in Prague. Due to national disputes, the local university had just been split into a German and a Czech university. However, Wieser was able to quickly settle into the small-scale structures of the *Deutsche Universität*, which only had twelve university lecturers and 572 students (cf. Pliwa 1908, Nr.9 a. 45). In 1886 he married the daughter of a Prague architect; the marriage would remain childless. The publication of *Der natürliche Werth* (1889) (*Natural Value*) finally earned Wieser a tenured professorship. In this work he applied the marginal utility theory not only horizontally, i.e. to trading/exchanging, but also vertically, i.e. to production processes. He defined the value of higher order goods (productive goods) via the value of the consumer goods produced with them, which led to his development of the imputation theory. Wieser, who possessed a certain “obsession with compulsive computability” was one of the first economists to realize the information value of prices (cf. Streissler 1986, 77).

His analysis of economic processes was soon considered (as) a kind of standard model of the Viennese School and was presented comprehensively for the first time in *Theorie der gesellschaftlichen Wirtschaft* (1914). However, Wieser’s notion of an “economic equilibrium”, which he conceived as an image of real-

¹ On the biography of Friedrich von Wieser, see especially Hayek 1926, Mayer 1929, Streissler 1986, Hoppe/Salerno 1999, Hennecke 2000 and Hülsmann 2007a, 150-162.

ity, ran distinctly counter to the principal ideas of Menger and Böhm-Bawerk. Ludwig von Mises would later explain, with regard to Wieser, that without market activities the subjective valuations of the market participants could not be transformed into prices.

In the 1890s, Wieser published several economic-historical and statistical analyses of the crown lands Bohemia and Moravia, revealing a moderate German nationalist position (cf. Hayek 1926, 521; Schams 1926, 447). As president of the *Deutsche Gesellschaft für Kunst und Literatur* ("German Society for Art and Literature") he played an important part in the cultural life of Prague. In 1901 he was even elected principal of the *Deutsche Universität* Prague. Despite all this, after Menger's withdrawal from his Viennese professorship, Wieser seized the "longed for" chance of "returning to the beloved homeland" (Mayer 1929, 187). In Vienna too, he participated actively in cultural life. His house in Döbling became a well regarded meeting place for artists, politicians and academics. Early on he had also encouraged composers like Hugo Wolf and Anton Bruckner considerably in their work (cf. Mahr 1929, 189).

Having written quite a few works on monetary theory, after the turn of the century Wieser turned increasingly to sociological questions. In his *Theorie der gesellschaftlichen Wirtschaft* (1914) (*Social Economics*), although he remained formally within the boundaries of methodological Individualism, he nevertheless created an image of the individual which was, unlike the self-determining and rebellious actor described by Carl Menger, no more than a feeble caricature. Wieser saw people as thoroughly "tamed" creatures: "Even the sense of self [...] is bred by the forces of society and is thus oriented in a way which is no longer purely personal." Egoism is thus nothing more than a "selfishness of powerlessness" (cf. Wieser 1914, 240f.).

Only a few weeks after his *Theorie* was published, the First World War broke out. He was one of very few "Austrians" to write several pieces that were moderate in tone but nevertheless decidedly in favor of war (cf. listing by Hayek 1926, 529). At the height of the "war and transition economy", old Austria's experiment with central planning, the convinced statist Friedrich von Wieser became a Member of the *Herrenhaus*. In the three final governments of 1917/18 he held the office of minister of trade, and for a while also the office of minister of "public works". Thus, the disintegration of the monarchy hit this staunch German-Austrian particularly hard (cf. Schams 1926, 447; Mayer 1929, 193).

After retiring from his lecturing duties in 1922, Wieser lived, partly in seclusion in Vienna, partly in his summer residence in Brunnwinkel by the Wolfgangsee, and put together his work on sociology and political science in his magnum opus *Gesetz der Macht* (1926) ("The Law of Power"). In a rather disjointed manner (according to Menzel 1927, 4; appraised differently

by Morgenstern 1926, 674), he presented a medley of comments, clever observations and sociological and historical analyses. Likewise, anti-Semitic statements can be found and also (abstract) leader worship (cf. Streissler 1986, esp. 63–65), for which he was later labeled a “fascist” (ibid., 81). However, this attribution is only partially fair to the “unfocused mind” (ibid., 60), as there are enough sources which indicate the contrary (cf. Wieser 1926, 17, 69, 90, 201, 274; also Wilmes 1985, 10).

Wieser died in July 1926 in his summer residence after contracting pneumonia. The sophisticated, cultivated teacher had educated, during his time in Vienna alone, an estimated 15,000 male law graduates and, from 1919, female law graduates as well, in economics. Apart from this he left no mark worth mentioning, either as a minister or as a sociologist. As doyen of the Viennese School he paved the way for Hans Mayer, his successor, who, however, was not capable of following in the steps of his great predecessor. As an economist, Wieser built upon a strongly qualified subjectivism. His “value calculation” failed due to his notion of imputation. The following generations of the Vienna School would then largely consider him not as part of their camp, but as belonging to the *Lausanne School* traced back to Léon Walras (cf. Mises 2009, 28; Schumpeter 1954, 848; Hoppe/Salerno 1999, 117f).

CHAPTER 8

Eugen von Böhm-Bawerk: Economist, minister, aristocrat

Hardly any other economist has achieved the same kind of fame in Austria, and with no other have such wide sections of the population come into contact so often as Böhm-Bawerk, admittedly in a wholly trivial sense: his portrait used to adorn the 100-Schilling banknote, which was in circulation from 1984 to 2001. In professional circles too, Eugen von Böhm-Bawerk was in many respects considered exceptional: he was one of the most quoted economists of his time, earned a good reputation internationally, taught at the biggest law faculty in the world and more than once occupied the office of finance minister of a major European power. Together with Carl Menger and Friedrich von Wieser, he constituted the founding triumvirate of the Viennese School. Looking back, the economist Ewald Schams, a former military officer, glorified events, speaking of a “campaign” characterized by “harmonious cooperation and downright tactical unity.” Menger had “declared the fundamental principle”, Wieser had provided the “factual structure” and Böhm-Bawerk had taken on the “duty to fight”: “He was the fighter in the cause of modern theory.” (cf. Schams 1926, 435f).

Eugen Böhm was born in Brünn in 1851 as the third of four children.¹ His father, who was knighted (as Ritter von Bawerk) in 1854 when vice president of the Moravian governorship, died young. Subsequently, his son, aged only six years old, moved with his mother to Vienna. At the Viennese *Schottengymnasium*, as mentioned in the previous chapter, he met Friedrich von Wieser, with whom he would develop a lifelong friendship, which would later also lead to a marriage between their families. The two friends always sought

¹ On the biography of Böhm-Bawerk see especially Hennings 1969, Tomo 1994, Hennings 1997 (7-25) and Hülsmann 2007a (93-96 u. 141-150).

to outdo each other in school and later graduated together with degrees in law (cf. Tomo 1994, 29f). After his graduation, Böhm-Bawerk joined the Lower Austrian Finance Department.

In 1875, with the help of Carl Menger, the two friends received a traveling scholarship for the universities of Heidelberg, Leipzig and Jena. In Heidelberg Böhm-Bawerk then dealt for the first time, in a seminar paper, with that subject which would occupy him for the rest of his life: the relationship, in economics, between the present and the future (cf. Böhm-Bawerk 1930 [1891], 237 FN 1). One year later, he put the “prototype of his later agio theory” into writing (Tomo 1994, 49–51). On his return to Vienna, he continued working in the finance department, and was then the first of Carl Menger’s students to receive his *Habilitation für Rechte und Verhältnisse vom Standpunkt der volkswirtschaftlichen Güterlehre* (1881). In the same year, the young lecturer and civil servant married his friend’s sister, Baroness Paula von Wieser. The marriage, described as harmonious, remained without offspring (cf. Schumpeter 1925, 67). In 1882, Böhm-Bawerk was entrusted with the position of supply lecturer in economics at the University of Innsbruck. Compared with Vienna, then the world’s fifth largest city, the University of Innsbruck, having the smallest law faculty in the Austrian monarchy with few more than 200 students and 16 lecturers (cf. Pliwa 1908, No. 9 a. 45), did not appear as a particularly attractive career step: “Condemned to Czernowitz, pardoned to Innsbruck,” is an adage handed down to this day in Vienna university circles. Nonetheless, the Innsbruck years were for the glowing enthusiast of the Tirol mountain ranges the “happiest time of his life” (cf. Kamitz 1956, 53).

Soon he was appointed as a non-tenured and in 1884 as a tenured professor. The same year saw the publication of *Geschichte und Kritik der Kapitalzinstheorie* (*History and Critique of Interest Theories*, Vol. 1 of *Capital and Interest* [1959]), in which he “dissected practically all theories of capital interest [...] with tremendous rigor and astuteness” (Schumpeter 1925, 69). The promised second volume was delayed, one reason being Böhm-Bawerk’s election to dean of faculty, and another that, as mentioned, the combination of the theory of subjective value with his theory of capital proved to be rather difficult. In 1886, he published in *Conrads Jahrbücher*, as a kind of preliminary study, a two-part essay about the theory of subjective value. This was then slightly modified and included in the already promised second volume, the *Positive Theorie des Kapitals* (1889a). With this easy-to-read and polished presentation, Böhm-Bawerk was able to distinguish himself as “sword of the new school of thought”, thus crucially contributing to a further promulgation of the Viennese School (cf. Schumpeter 1925, 68). The two volumes—*Geschichte und Kritik der Kapitalzinstheorie* and *Positive Theorie des Kapitals* – published several times under the single title *Kapital und Kapitalzins*, were translated into English and established Böhm-Bawerk’s “international reputation” (Schum-

peter 1914b, 460). This was enhanced even more by lively controversies and polemics, since Böhm-Bawerk was fighting on four academic fronts simultaneously: against the Historical School's aversion to theory, the Marxists' exploitation theory, the various cost value theories, as well as the efforts of some to show that the Viennese School had no socio-political responsibility.

Böhm-Bawerk's attempts to return to a professorship in Vienna, and to be the successor of either Lorenz von Stein or Lujo Brentano, remained unsuccessful (cf. Tomo 1994, 157-162). Finally, he took a post in the Finance Ministry, which at that time managed with a staff of just 121 civil servants and 67 porters (cf. Kamitz 1956, 58). One of his first tasks was to revive the abandoned preparations for a comprehensive tax reform. Böhm-Bawerk remained a civil servant up until 1904; three times he was Finance Minister (1895, 1897/1898, 1900-1904) and in 1899 he was awarded life-long membership of the *Herrenhaus*. Apart from working on the tax reform of 1886, in the course of which a progressive income tax of no more than five percent was introduced (cf. §172, RGBl. [government document] Nr.220/1896), he also succeeded in reducing the government's interest burden by converting public debt (cf. Weiss 1924/25, Vol. 1, V). A balanced budget was of particular importance to him, because he believed only this would secure the stability of monetary value. He also did not balk at impeding, with all the tricks of an experienced bureaucrat, politically motivated status-seeking projects lacking secure funding, such as a shipping canal network for the whole of the monarchy (cf. Gerschenkron 1977, 81 a. 120-127). His maxim was that a finance minister must always be prepared to resign, but at the same time should always behave as if he never wanted to resign (cf. Schumpeter 1925, 79). Finally, when excessive demands from the military threatened to strain the budget, he resigned from the post permanently in 1904.

In addition to his work in administration, Böhm-Bawerk devoted two hours a day to academic studies and remained in close contact with the University of Vienna, initially as an examiner and after 1891 as an honorary professor. In 1892 he contributed to the founding of the magazine *Zeitschrift für Volkswirtschaft, Socialpolitik und Verwaltung* and also had an important integrative role in the *Gesellschaft Österreichischer Volkswirte*. After he had resigned as minister the third time, he accepted a professorship which had been specially created for him. Böhm-Bawerk's lectures were "masterpieces", thanks both to "his clarity of system throughout and to his calm, considered, one might say intellectually humorous presentation" (Engel-Janosi 1974, 37). Among those who later met in his seminar, in which an unusually open discussion culture prevailed (cf. Mises 2009, 32), were such eminent names as Ludwig von Mises, Franz Weiss, Richard von Strigl, Felix Somary, Emil Lederer, Rudolf Hilferding, Otto Bauer, Nikolai Bucharin or Joseph Schumpeter (cf. Hülsmann 2007a, 145). Altogether, Böhm-Bawerk came across as a somewhat formal,

but warmhearted person full of empathy (cf. Hennings 1997, 19). The “political economist” (cf. Hülsmann 2007a, 150) in the true sense of the word, who from 1911 onwards held the office of president of the *Akademie der Wissenschaften*, died in August 1914 during a vacation in Kramsach in Tirol, aged 63.

CHAPTER 9

Emil Sax: The recluse of Voloska

Within the body of the Viennese School, Emil Sax occupied an original, but now largely forgotten position.¹ Just a few years younger than Carl Menger, he was, at the start of his economic research, more a competitor of Menger's than a colleague, and only began supporting and developing the subjective theory of value and methodological individualism after becoming professor in Prague. A few years later, he once again distanced himself from the Viennese School and disappointed, retired from university life. However, after a quiet period lasting almost 20 years, he resumed his research and, in the last decade of his life, became an unusually productive author.

Emil Sax was born in 1845 into a family of cloth manufacturers and civil servants from Javorník-Janský vrch (previously Jauernig-Johannesberg in East Silesia, today the Czech Republic). His father died a few months after his birth. He studied in Vienna, gained a doctorate of law and worked initially as secretary of the "Austrian commission at the world exhibition in Paris" and as trainee legal officer at the Viennese chamber of commerce. In 1870, Sax began teaching economics at the *Polytechnisches Institut* in Vienna, the precursor of the *Technische Hochschule*. An abridged version of his very first lecture, a theoretical foundation of railroad economics, was published in 1871.

The renowned railway expert subsequently took over the post of secretary to the director of the Kaiser-Ferdinand-Nordbahn railroad, and in 1874 received his *Habilitation* in "economics and finance" from Lorenz von Stein. In 1879 the academic staff of the University of Vienna had unanimously voted for a tenured professorship for Menger and a non-tenured professorship for Sax. In Menger's case, the Ministry for Education complied with the proposal. Sax

¹ On the biography of Sax see Beckenrath 1930, Schraut 1966, Prisching 2005 and Blumenthal 2007.

however, who had just published his two-volume work *Verkehrsmittel in der Volks- und Staatswirthschaft* (1878/79) ("Means of Transport in Economics"), received a non-tenured professorship in distant Prague, where he was fully tenured one year later (cf. Schraut 1966, 15). At the end of the 80s he was elected dean, and later principal, of the German University of Prague. At the beginning of his university career, Sax was also, as a member of the *Deutsch-Liberale Partei*, an elected representative in the Imperial Assembly for the constituency of Troppau (present day Opava, Czech Republic), a mandate he held until 1885. In his role as politician, he warned of the dangerous consequences of national strife (cf. Schraut 1966, 17) and of the "great political dangers" it posed for the Austrian monarchy (cf. Sax 1881, 15).

Early on, Sax joined Menger's circle and was one of the first to support him in the *Methodenstreit* (Sax 1884). Yet from the start he developed a clearly autonomous position, which he presented in one of his main works, the *Grundle-gung der Theoretischen Staatswirthschaft* (1887) ("Foundation of Theoretical Political Economy"). In the same way that an apple falls from a tree and the stars move according to the law of gravitation, the law of value in economic action is followed by Robinson Crusoe just as much as it is followed by an empire with a population of 100 Million (cf. Sax 1887, 308). The driving forces of humanity, said Sax, were egoism, mutualism and altruism. Human needs were the "most important basic concept of economics" (ibid., 172). In doing so, Sax drew a distinction between "collective needs" and "individual needs" and correspondingly between "state economy" and "private economy" (ibid., 179). Both, however, were interlocked by the law of value: "Value controls and guides human relations through the variety of the world of goods and therefore also relations between people, which are based on the composition of the world of goods" (ibid., 249). Value would thus result not only from the relationship of humans to the world of goods, but would also be a "fruit of social coexistence" (cf. Beckerath 1930, 353).

While the theory of value was developed within the Viennese School into a "logic of values" (Schumpeter 1954, 1058), Sax pursued mainly psychological considerations, talked about "valuation" or "feeling of value" and regarded the value theory as "applied psychology" (cf. Sax 1889, 9). This resulted therefore in significant differences within the mainstream of the Viennese School: unlike Böhm-Bawerk, Sax did not consider labor to be an economic good; he rejected Wieser's imputation theory, and saw interest as being a result of a barter economy and not as an economic category. For Sax, Böhm-Bawerk's theory of interest was untenable and irreconcilable with the imputation theory (cf. Sax 1916, esp. 19-24 and 228-249). Finally, he also disagreed with the tax theory of the renowned and acknowledged expert of the school, Robert Meyer (1855-1914), whom he accused of lacking "precise scientific thinking" (cf. Sax 1892, 53). When in Vienna the second professorship next to Menger's became

vacant once again and Eugen von Philippovich was appointed, Sax must have realized that his intended return to the University of Vienna had failed for probably a long time (cf. Schraut 1966, 17). It was obvious that his work was not getting the recognition that he had expected. Bitterly disappointed, he took early retirement (cf. Beckerath 1930, 348).

Up to his death he lived with his wife in Volosca, a small fishing village in Istria, in a remote house with a view of the sea. With a “resigned distance” toward life, he looked for solitude as if “contemplation [were] his greatest need” (ibid., 354f). After a mostly unproductive period of more than 20 years, with only a few and insignificant interruptions, Sax began—almost sublime in the face of all the unfavorable events of the time, such as war and post-war hardship—to publish a succession of books again: *Der Kapitalzins* (1916) (“Capital Interest”), the second edition of his monumental *Verkehrsmittel in Volks- und Staatswirtschaft* in three volumes (1918-1922) and also a longer contribution for *Wertungstheorie der Steuer* (1924) (“Valuation Theory of Taxes”).

Emil Sax lived to see his tax theory and his theory of public economy come to fruition, particularly in Sweden and Italy (cf. Blumenthal 2007, 217-233). In 1926, by that time an Italian citizen, he was made an honorary doctor of the University of Cologne. He was soon forgotten in the successor countries of the Austrian monarchy, the collapse of which had affected him badly. However, due to its originality, its astuteness and its profundity, his complex, comprehensive and linguistically complicated work still fascinates today.

CHAPTER 10

Other supporters and students of Menger

With only a few exceptions, the members of the old Viennese School studied directly under Carl Menger. Eugen von Böhm-Bawerk and Friedrich von Wieser received their *Habilitation* from Menger, although they hadn't studied under him. Hermann von Schullern zu Schrattenhofen studied under Böhm-Bawerk and received his *Habilitation* from him. Emil Sax was the only one to already have a teaching qualification, having independently arrived at an understanding of value theory and methodology similar to Menger's. In his application to the Ministry for Education in 1903, requesting his retirement, Menger listed all the post-doctoral students he had supervised; the only one missing was Gustav Gross (cf. Ikeda 1997, 1f.).

Robert Meyer (1855—1914; *Habilitation* in 1884)¹

After studying law in Vienna and Berlin, the native Viennese pursued an exemplary career as a civil servant in finance administration, where he reached the position of head of directorate, [the highest civil service position within a ministry]. In 1910 he was made president of the *Statistische Zentralkommission* [central commission for statistics] and for a short time even finance minister. After that he went into retirement, a year later however he was again asked to be president of the *Statistische Zentralkommission* and retained this office until his death.

As an academic expert on finance, whose teaching qualification was extended to political economy in 1887, Robert Meyer lectured at the University of Vienna and at other Viennese educational institutions. In his *Habilitation* treatise, the subjectivist value theoretician justified progressive taxation (Meyer

¹ See Plener 1914 (Nachruf [Obituary]), ÖBL 1972, Vol. 5, 442f. with further information and Blumenthal 2007. Regarding the publications see catalog of the Carl-Menger-Bibliothek, Vol. 1, 1926, columns 262f.

1884, 332f), which he was actually able to implement as a senior civil servant, together with Böhm-Bawerk, during the reform of direct personal taxation (cf. Tomo 1994, 147-153 a. 164-178). From 1911 onward he served as co-publisher of the journal *Zeitschrift für Volkswirtschaft, Socialpolitik und Verwaltung*. In social and economic policy matters he was a champion of full-blown statism.

Gustav Gross (1856—1935; *Habilitation* 1884)²

Originating from Reichenberg (today Liberec, Czech Republic), Gustav Gross was the son of a railway director. After studying law in Vienna and Berlin, and working at the governorship of Lower Austria, he received his *Habilitation* with a thesis on the economist Johann Heinrich von Thünen (1783-1850) (cf. Deschka 1966, 6; Gross 1883). Gross, who published among other things a treatise on business profits (Gross 1884a) and the first academic biography of Karl Marx (Gross 1884b a. 1885), devoted himself in later years largely to social and taxation questions. From 1889 onward he was a representative of the *Deutsche Fortschrittspartei*.

Gross, who considered himself following in the tradition of Albert Friedrich Eberhard Schäffle and Adolph Wagner (cf. Gross 1888, preface), was not mentioned in the list of *Habilitation* students which Menger compiled when he became an emeritus professor (cf. Ikeda 1997, 2). Gross saw laws at work in the state economy, which he called the public sector (“*Gemeinwirtschaft*”), that differed fundamentally from those in the private sector (Gross 1900, 165) and supported Wagner’s thesis about the steady expansion of the state’s functions, which he saw in the long term being limited only by the family (ibid., 168f). What Richard S. Howey otherwise wrongly said of the less well-known “Austrians”, namely that they hardly wrote anything or nothing at all about the theory of marginal utility (Howey 1960, 163f), is applicable to Gross.

Gross taught as an unsalaried lecturer at the University of Vienna until 1897, (and) in the end as an untenured professor. Toward the end of the First World War, when the war economy had fully expanded into central bureaucratic planning, he was elected the last president of the monarchy’s House of Representatives.

Eugen Philippovich von Philippsberg (1858—1917; *Habilitation* 1884)³

The descendant of an Austro-Bosnian family of officers, Philippovich grew up with only one parent still living, graduated from the Theresianum high school and studied law in Vienna. After periods of study in Berlin and London

² See ÖBL 1957, Vol. 2, 73 and Deschka 1966 with further sources. Regarding the publications see catalog of the Carl-Menger-Bibliothek 1926, column 178.

³ See ÖBL 1983, Vol. 8, 43f; Milford 2001; HdStW, 4th edition 1925, Vol. 6, 864f; Mises 1926; Palgrave [The New Palgrave], 3 Vol., 856f. Regarding the publications see catalog of the Carl-Menger-Bibliothek, Vol. 1, 1926, columns 88f. and columns 288-290.

he received his *Habilitation* for research on the *Bank of England* (cf. Philippovich 1885).

After a non-tenured, and later, a tenured professorship at the University of Freiburg, Philippovich, who was only 35 years old at the time, was offered a position in Vienna. In economic policy, he was close to the *historical-ethical* school, in methodological and value theoretical questions he had already, during his time in Freiburg, strongly oriented himself toward Menger (cf. Mises 1926, 54; cf. Philippovich 1886). In 1896, as a member of the Viennese *Fabian Society*, a circle of sponsors with ambitious social policy aims, he became a co-founder of the *Sozialpolitische Partei*, and for one term of office was one of its four representatives in the *Niederösterreichische Landtag*, the regional parliament of Lower Austria. However, the sophisticated academic was hardly capable of defending himself against the rude and polemic attacks of his political opponents (cf. Holleis 1978, 58f.).

In 1905, Philippovich became president of the University of Vienna and in 1909 a member of the *Herrenhaus*, the House of Lords of the Austrian monarchy. Correspondingly important was his role as promoter of the Viennese School, which he indeed actively advanced with his successful textbook *Grundriß der Politischen Ökonomie* (1893). For many years, he officiated as chairman of the *Gesellschaft der Österreichischen Volkswirthe*, and from 1904 to 1917 he was co-publisher of the journal *Zeitschrift für Volkswirtschaft, Sozialpolitik und Verwaltung*.

Viktor Mataja (1857—1934; *Habilitation* 1884)⁴

After a commercial apprenticeship and studying law in Vienna, Mataja, who was working in the Vienna chamber of commerce, received a *Habilitation* for a thesis on ground rent and business profits (cf. Tomo 1994, 74). One work particularly stands out among his diverse publications: his trailblazing *Recht des Schadenersatzes vom Standpunkt der Nationalökonomie* (1889) (“The Economics of Indemnity Rights”), which prepared the area of modern law economy on the basis of the theory of marginal utility. In 1890, Mataja became an untenured and, two years later, as Böhm-Bawerk’s successor, a tenured professor at the University of Innsbruck. Later that year, however, he returned to Vienna to establish a “Department for Trade Statistics” and “Labor Statistics” in the ministry for trade (cf. Pellar 1986, 165f). In later years he was one of the first in the German-speaking world to deal with the “nature of announcements” and created, with *Die Reklame* (1910, 4th edition 1926), the seminal document of the modern science of advertising. Toward the end of his life he published a textbook for economic policy, *Lehrbuch für Volkswirtschaftspolitik* (1931), which included some contributions of his own.

⁴ See ÖBL 1975, Vol. 6, 135; Höbelt 1990; HdStW, 3rd ed. 1910, Vol. 6, 622f. Regarding the publications see catalog of the Carl-Menger-Bibliothek, Vol. 1, 1926, columns 251f.

Mataja was the quintessential bureaucrat. First he became head of directorate, then twice minister for trade (1909 and 1911) and finally president of the *Statistische Zentralkommission* (1914-1917 a. 1919-1922). By the end of the war he had served in turn as minister for trade, minister without portfolio and minister for “social welfare”, the first in a European industrial nation. His statistical work made the versatile and original thinker a valued partner for representatives of employers and employees; the “third camp” appreciated his German-Austrian centralism. Of all people it was thus a representative of the Austrian School who created the core of what would later become industrial relations (cf. Pellar 1986). From Mataja’s career we have gained the remarkable insight that “warfare” and “welfare” can easily derive from the same state doctrine.

Robert Zuckerkandl (1856—1926; *Habilitation* 1886)⁵

A member of a Jewish family from Győr (Raab), Hungary, Robert Zuckerkandl received his *Habilitation* from Carl Menger, after finishing his law degree. Prior to his accreditation as court and bar solicitor in Vienna, he published *Zur Theorie des Preises* (1889), his only monograph on doctrinal history. In 1894, he became Emil Sax’ successor as an untenured professor, alongside Friedrich von Wieser, at the *Deutsche Universität Prag* and received his tenured professorship in 1896. Zuckerkandl’s teachings, his main work and some further printed articles contributed significantly to the dissemination of Viennese School ideas (literature overview at Howey 1960, 165f. and HdStW, 3rd edition 1911, Vol. 8, 1084).

Johann von Komorzynski (1843—1911; *Habilitation* 1890)⁶

At the age of 26, Johann von Komorzynski was reputedly only unable to accept an appointment at the University of Vienna because of “external circumstances” (cf. Komorzynski 1911). After working successfully as court and bar solicitor for over twenty years, Komorzynski became the founder and president of the *Wiener Advokatenclub*. He received his *Habilitation* for a paper on value theory, linking it to earlier research on the same subject (Komorzynski 1869). In his later works he resolutely opposed von Thünen’s wage theory and in particular Marx (Komorzynski 1893 a. 1897). *Die nationalökonomische Lehre vom Credit* (1903), which he published in the last decade of his life, was rejected by the Viennese School, as it was incompatible with Wieser’s imputation theory and Böhm-Bawerk’s theory of interest (cf. Meyer 1904, 103).

⁵ See HdStW, 4th ed. 1928, Vol. 8, 1183; HdStW, 3rd ed. 1911, Vol. 8, 1084. Regarding the publications see catalog of the Carl-Menger-Bibliothek, Vol. 1, 1926, columns 405f.

⁶ See Komorzynski Nachruf [Obituary] 1911, ÖBL 1966, Vol. 6, 103 with further sources. Regarding the publications see catalog of the Carl-Menger-Bibliothek, Vol. 1, 1926, columns 223f.

Hermann von Schullern zu Schrattenhofen (1861 – 1931; *Habilitation* 1889/1892/1895)⁷

In 1889, after having practiced law, Hermann von Schullern zu Schrattenhofen, a born Tyrolean, received a license to teach economics at Innsbruck. In 1892 this licence was carried over to the University of Vienna, where in 1895 it was extended to the teaching of all aspects of political economy. He subsequently worked in the *Statistische Zentralkommission* in Vienna and in 1899 held professorships for economics at the *Technische Hochschule*, the *Hochschule für Bodenkultur* and, from 1915, at the University of Innsbruck. From 1903 to 1905 he held the office of principal at the *Hochschule für Bodenkultur* in Vienna, and from 1922 to 1925 that of principal at the University of Innsbruck. In later years, Schullern zu Schrattenhofen, who in his youth had still vehemently advocated the theory of marginal utility (Schullern-Schrattenhofen 1885), turned to agricultural policy and history. His easy-to-read economics text book, *Grundzüge der Volkswirtschaftslehre* (1911), is founded on the subjectivist theory of value.

Julius Landesberger (1865—1920; *Habilitation* 1895)⁸

He completed his law studies at the University of Vienna in 1889 with a doctorate, for which he received the highest distinction, “sub auspiciis imperatoris”. Self-assured, he had his doctoral ceremony speech published right away (Landesberger 1889), subsequently went into attorneyship and over a period of time published several articles on monetary and currency policy. After his *Habilitation*, Landesberger was a sought-after business attorney for his expert knowledge in anti-trust law. After receiving the noble title, “von Antburg”, in 1906 he was appointed to the general council of the *Anglo-Österreichische Bank*, where he rose to the position of president. At the German “Juristentag” (convention of lawyers) of 1902, borrowing the English word “concern”, he coined the term “Konzern”, which is used to this day (cf. Nörr 1994, 22f.).

Eugen Peter Schwiedland (1863—1936; *Habilitation* 1895)⁹

Originating from a scholarly Protestant family in Budapest, Schwiedland studied law in Vienna. From 1890, having already worked a few years as a lawyer, he taught economics and economic policy at the *Technologisches Gewerbemuseum* and eventually received his *Habilitation* from the University

⁷ See ÖBL 1995, Vol. 11, 330f. with further sources. Regarding the publications see catalog of the Carl-Menger-Bibliothek, Vol. 1, 1926, columns 336-338.

⁸ See Reichspost of 06/22/1920, 3; WZ of 06/22/1920, 5 and UA-Personalblatt Landesberger. Regarding the publications see catalog of the Carl-Menger-Bibliothek Vol. 1, 1926, column 229f.

⁹ See ÖBL 2005, Vol. 12, 56f. with further sources. Regarding the publications see catalog of Carl-Menger-Bibliothek, Vol. 1, 1926, columns 96, 243, 345-350, 670f and 740.

of Vienna (Schwiedland 1894). In 1902 he was given an untenured professorship at the University and in 1904 a tenured professorship at the *Technische Hochschule*. From 1908 to 1921 he functioned as a high ranking advisor in the Ministry for Public Works and in the General Commission for War Economy and Transition Economy. In his text books, written in plain language, (Schwiedland 1909 a. 1910; Schwiedland 1918 a. 1922/23) he described the subjectivist value theory as the psychological foundation of the economy (cf. Schwiedland 1910, 117-130). He kept his distance from Menger, both personally (cf. Nautz 1990, 89) and intellectually. After the First World War, Schwiedland shifted towards “romantic-organic” economics.

Siegmond Feilbogen (1858—1928/1929?; *Habilitation* 1895)¹⁰

The son of a Moravian rabbi family, Siegmond Feilbogen completed his law degree in Vienna and in the early 90s made a name for himself with several works on Adam Smith, Jacques Turgot and David Hume (Feilbogen 1889, 1890 a. 1892). In 1895 he received his *Habilitation* from the University of Vienna and subsequently taught economics at the Viennese *Exportakademie*. Initially Feilbogen also supported the Zionist movement.

A peculiar story ended his career abruptly. On April 9th 1908 Feilbogen, along with his wife and sister-in-law, took part in an Easter mass celebrated by Pope Pius X. in Rome. Witnesses apparently observed Feilbogen disposing of the consecrated host in a handkerchief. This incident became widely known. Feilbogen's assurances and avowals of respect for the Catholic Church fell on deaf ears in a Vienna turned noticeably anti-Semitic (cf. Reichspost of April 22nd a. 23rd 1908, 3). He was subsequently dismissed from his position as teacher at the *Exportakademie*. Isolated and virtually ostracized, he continued to teach at the University of Vienna, to the smallest of audiences.

Rudolf Sieghart (1866—1934; *Habilitation* 1900)¹¹

A rabbi's son from Troppau (present-day Opava, Czech Republic), Rudolf Sieghart, had to pay to study law in Vienna himself, having only one remaining parent. In 1895 he converted to Catholicism, married the daughter of Carl Samuel Grünhut (1844-1929), who was (lecturing) professor for trade law at the University of Vienna, and joined the finance ministry. With his treatise on public gambling, *Die öffentlichen Glückspiele* (1899), Sieghart was able to receive his *Habilitation* and later on went into politics. As the closest associate of Prime Minister Körber (1850-1919), he played a powerful and sometimes controversial role, particularly in those personnel decisions regarding top level positions in the bureaucracy (cf. Nautz 1990, 112). In 1912 he

¹⁰ Uncertain data; DBE, Vol. 2, 357, 323 and UA-Personalblatt Feilbogen. Regarding the publications see catalog of the Carl-Menger-Bibliothek, Vol. 1, 1926, column 161f.

¹¹ See ÖBL 2005, Vol. 12, 239; Ableitinger 1964 and Strejcek 2003. Regarding the publications see catalog of the Carl-Menger-Bibliothek, Vol. 1, 1926, columns 355f a. 740.

became a member of the “Herrenhaus” and, as governor of the *Boden-Credit-Anstalt* with its associated industrial concerns and newspapers, remained an influential leader in the business world well on into the First Republic.

Richard Schüller (1870—1972; *Habilitation* 1903)¹²

Carl Menger’s “favorite pupil” (cf. Nautz 1990, 89) and last postdoctoral student, Richard Schüller, came from a Jewish family in Brünn; because his parents’ company had gone bankrupt, he had to pay for nearly all of his university education himself. With his first work, *Die klassische Nationalökonomie und ihre Gegner* (1895) (“Classical Economics and Its Enemies”), Schüller demonstrated once more the fighting spirit of the *Methodenstreit*. With *Schutzzoll und Freihandel* (1905) (“Protective Tariff and Free Trade”), he at last received his *Habilitation* and was thus the first of the Viennese School to venture into the terrain of foreign trade policy. As an untenured professor he published two noteworthy contributions on workforce demand and on the employment market (Schüller 1970 [1911]). After Menger’s death he supported the publication of the second edition of the *Principles* (Menger 1923) with a very personally written foreword.

Schüller made his career in the ministry of trade and just before his abdication emperor Karl I. promoted him to “Sektionschef” (the highest ranking civil servant [Transl.]). States and monarchs may be transient, but not the legal status of an Austrian civil servant, once obtained: Schüller remained in this position until his retirement and contributed significantly to the foreign trade policy of the First Republic (Nautz 1990). Up until 1928 he lectured at the University of Vienna, and from 1930 to 1937 he was co-publisher of the *Zeitschrift für Nationalökonomie*, however he diverged noticeably from the Viennese School (cf. Schüller 1936). In 1940, Schüller was forced to emigrate to the USA, where he continued teaching until 1952.

Statisticians and public finance economists¹³

Menger repeatedly assisted with *Habilitierungen* in areas related to his field of expertise (cf. Ikeda 1997, 2), as with the commercial law specialist Karl Adler (1865–1924, *Habilitation* in 1893), the public finance economist Gustav Seidler (1858–1933, *Habilitation* in 1883) and the statisticians and public finance economists Isidor Singer (1857–1927, *Habilitation* in 1885), Ernst Mischler (1857–1912, *Habilitation* 1885 in Prague, 1887 in Vienna) and Ignaz Gruber (1842–1919, *Habilitation* in 1893). These practitioners and university lecturers had no direct influence on the teaching body of the Viennese School,

¹² See Bös 1974 and Nautz 1990. Regarding the publications see catalog of the Carl-Menger-Bibliothek, Vol. 1, 1926, column 335.

¹³ See ÖBL with further verification. Regarding the publications see catalog of the Carl-Menger-Bibliothek, Vol. 1, 1926 under the respective authors.

but they shaped the intellectual milieu of the Viennese School in as much as they reinforced proximity to the state bureaucracy. Menger himself had promoted institutional closeness between political economy and state bureaucracy, since every one of his postdoctoral students was required to spend some years in practical administration (cf. Tomo 1994, 75).

Students of Menger as publishers in professional journals¹⁴

In the 80s and 90s, Carl Menger also brought together people in his seminar who had graduated, were already employed and interested in economics. Many of them later played a part in disseminating the teachings of the Viennese School by publishing articles in professional journals. One of the most outstanding of these students was the Hungarian-born Julius Friedrich Gans von Ludassy (1858-1922), who as editor of various papers regularly reviewed economics books and himself wrote an impressive, methodological work over 1000 pages long called *Die wirtschaftliche Energie* (1893). Noteworthy is his early criticism of the mechanical image of *homo oeconomicus* (cf. *ibid.*, 403-425) and his conclusion that “economics [...] [is] the science of action” (*ibid.*, 982). Five decades later Ludwig von Mises would productively develop this action-oriented approach further, without however explicitly referring to Ludassy.

Another professional editor from the milieu of Menger's circle was the native-born Czech Franz Cuhel (1862-1914), who today is largely forgotten, as is von Ludassy. The lawyer and imperial-royal government councilor in Vienna constructed one of the first mechanical calculators and published an extensive work on needs, in which he defined 29 categories of needs (with altogether 73 further sub-categories) (Cuhel 1907).

In his biography of Menger, Friedrich A. von Hayek cited further Menger students (Friedrich A. von Hayek: Introduction to: Menger 2004 [1950], 35 FN 1) of whom only the following however, as publishers of professional journals, are mentioned here: Moriz Dub (1865-1928), who from 1891 was editor for economics at the *Neue Freie Presse*; Richard Reisch (1866-1938), a finance lawyer with *Habilitation*, who in the First Republic was president of the “Nationalbank”; Markus Ettinger, attorney for cartel, competition and economic administration law, who was one of the first to predict the failure of any centrally planned economy, because “only the market price [is] a reliable regulator” (cf. Ettinger 1919, 10); Wilhelm Rosenberg (1869-1923), lawyer and expert on banking and finance, who helped greatly in stabilizing the currency after the First World War (cf. Mises 1923); Hermann Schwarzwald (1871-1939), highest ranking civil servant in the ministry of finance and author of several articles on currency and economic policy; and Ernst Seidler (1862-

¹⁴ See ÖBL with further verification. Regarding the publications of the individual authors see catalog of the Carl-Menger-Bibliothek, Vol. 1, 1926.

1931). In a groundbreaking paper, the latter applied the principle of marginal utility to the sentencing of criminals (Seidler 1890). As professor for public law, he tutored the heir to the throne, Karl, and in 1917 became minister and subsequently prime minister, or rather the last chairman of the monarch's cabinet. The others Hayek mentioned either never published anything of significance, or were no longer grounded in the Viennese School, or else were successful as scientists in other areas, such as Christian Richard Thurnwald (1869-1954), who devoted himself permanently to ethnology.

CHAPTER 11

Money makes the world go round: the monetary theory of the business cycle

In his first work, the *Principles of Economics*, Menger considers whether money developed “*without any agreement, without legislative compulsion, and even without regard to the public interest*” (Menger 2004 [1950], 260; emphasis in the original). Accordingly, money originated “naturally” and is not an “invention of the state”. “Even the sanction of political authority is not necessary for its existence” (ibid., 261f.). Menger did not move beyond this original explanation. Later economists then had to ascertain that determining the value of money with the principle of marginal utility led to a circular argument, because the exchange value of money determines the demand for money, the demand itself, however, in turn depends on the value of money (cf. Wicksell 2006 [1898], 38 a. 50 and Helfferich 1903, 487f). This reminded a young Viennese economist of the “everlasting circle” in a Viennese song, in which jollity comes from gaiety and gaiety in turn is derived from jollity (cf. Weiss 1910, 515).

During his inaugural lecture in 1903 in Vienna, Friedrich von Wieser tried to explain the phenomenon of rising prices, for the first time using the theory of marginal utility. Wieser emphasized that increasing incomes lead to decreasing marginal utility and so to lower exchange value, thus to increased prices. As the increases in income result from the steady expansion of monetary economy at the expense of household economy, a rise in prices would thus be nothing but “a necessary syndrome of development of the spreading monetary economy” (cf. Wieser 1904, 64). Wieser’s income theory of money had hardly any adherents and changed little in the older Vienna School’s abstinence from monetary theory. However, this changed abruptly when Georg Friedrich Knapp (1842-1926) of Strasbourg, a statistician and agrarian economist of the

historical-ethical school, caused a spectacular furor with his *Staatliche Theorie des Geldes* (1905). For him, money was purely a “creature of law”, based on an act of the sovereign and not on an agreement within society. Knapp’s thesis clashed irreconcilably with Menger’s evolutionary thesis. Some saw it as further evidence of the academic mediocrity, and compliant trust in the state, of a large number of German economists (cf. Schumpeter 1954, 1090f.). Furthermore, upon nearer inspection, serious factual mistakes were found (cf. Mises 1909, 165-171; Mises 2009, 33ff).

The visible tendency of the older Viennese School generation, to always view state intervention in the money market as possible abuse, had its origin in the sound judicial education of its members, which resulted in a certain sensitivity on their part regarding basic rights. Experiences from the currency history of the Austrian monarchy also contributed to this stance. Carl Menger had taught crown prince Rudolf early on that governmental monetary policy was “despotism” and implied “violence against the citizens” (cf. Streissler/Streissler 1994, 136). During the currency reform consultations, Menger made similar comments (cf. Menger 1970c [1892], 228f. or Menger 1892, 198f. a. 220). Menger’s notes in Knapp’s book and verbal comments, which have been handed down, point in the same direction (cf. Boos 1986, 77-82; Mises 2009, 27; cf. Silberner 1975). And of all people, Ludwig von Mises, who later founded the Austrian theory of money and business cycles, as a young researcher uncovered a large scale foreign exchange deception with a related “black money fund”, which had taken place in the state-monopolized *Österreichisch-Ungarische Bank*. Mises even suspected bribery attempts (cf. Mises 2009, 36f.).

Mises was already, in his *Habilitation* thesis *Theorie des Geldes und der Umlaufsmittel* (1912) (*The Theory of Money and Credit* (2000 [1980])), aiming to apply the principle of marginal utility to monetary theory, in order to “return the theory of money to the study of economics” (Mises 2009, 44). He avoided the “eternal circle” with the so-called regression theorem: when evaluating money, the individual proceeds from a notion of purchasing power derived from previous exchanges. Those earlier exchanges in turn were influenced by even earlier exchanges. In theory, these experiences can be traced back to distant past times, in which money as a means of exchange still had a purely goods character and it was thus possible to value its direct use (cf. (Mises 2000 [1980], II.8.1-II.8.5). This bold but simple solution was bound to provoke ironical comments: for some, it was more “ancient history” than economics (cf. Somary 1913, 446), for others, money had become, as it were, a “ghost of gold” (cf. Hicks 1962 [1935], 14).

In his analysis, Mises picked up the thread of Böhm-Bawerk’s theory of capital and of Wicksell’s distinction between the natural rate of interest and the monetary rate of interest. Further developing Böhm-Bawerk’s theory of

interest, Knut Gustav Wicksell (1851-1926) had drawn a distinction between a “natural rate of interest” and a “money rate of interest”. The former would appear in a barter economy, meaning one without intermediation of money, as soon as supply and demand were in accord. In modern economies, supply and demand certainly do not just meet in the “form of goods”, but usually in the “form of money”, so that divergences from this “natural rate of interest” may occur, since banks can, by expanding the money supply, push the “money rate of interest” even below the “cost price” or the “natural rate of interest” (Wicksell 2006 [1898], 150f).

As Mises had proceeded on the assumption of an economic, and not a legal, concept of money, he had added to money the so-called fiduciary media (“Umlaufsmittel”), by which he understood “claims to the payment of a given sum on demand, which are not covered by a fund of money” (Mises 2000 [1980], III.16.1). Fiduciary media are used in the form of checks, drafts or credit notes or as “circulation credit” (ibid., III.15.12) which are guaranteed by the banks and are effectively used as money, and thus expand the money supply of an economy (ibid., III.15.17). The established quantity theory assumed that changes in the money supply affected all individuals and prices in equal measure. In contrast, Mises thought that the effects differ depending on every individual situation (ibid., II.8.58-II.8.65). For the individual economic subjects receive the additional money supply neither simultaneously nor uniformly. Accordingly, the beneficiaries of the monetary expansion are privileged compared with those people who are the last to receive the additional money or who only have a fixed nominal income at their disposal (ibid., II.12.29-II.12.34). Friedrich A. von Hayek compared this process to that of pouring clear honey, which spreads unevenly and exhibits a little mound at the point of inflow (cf. Hayek 1978, 173). Thus, contrary to popular belief, which both Menger and Böhm-Bawerk also held, Mises considered money to be anything but “neutral” (cf. Mises 2009, 47).

The reception of Mises’ considerations was anywhere between reserved and critical. Noteworthy is the (mis-) judgment by John Maynard Keynes (1883-1946), who considered the book to be insufficiently “original” (cf. Keynes 1914, 418). For Knut Gustav Wicksell, much of it was “too obscure” (cf. Wicksell 1914, 14f). And in Joseph A. Schumpeter’s first doctrinal history, Mises’ accomplishment did not get even a short mention (cf. Schumpeter 1914a, 121).

When Mises had his *Theory of Money* republished twelve years later (1924), his analysis had evidently already been confirmed by the collapse of some European currencies. While preparing for war, as early as 1912, both Germany and Austria had gone off the gold standard completely, not without encouraging acclamation from renowned economists. Schumpeter too, in his *Theorie der wirtschaftlichen Entwicklung* (1912) (*The Theory of Economic Development*

[1961b]), had argued for increasing credit as a means of stimulating growth. Böhm-Bawerk, who early on had already recognized the ominous link between expanding the money supply and arming for war, warned the public in three newspaper articles against expanding the government budget and thus living beyond existing means (cf. Böhm-Bawerk 1914a). Shortly before his death, Böhm-Bawerk once more strongly emphasized the existence of economic laws “against which human will, even if embodied by the mighty will of the state, remains powerless” (cf. Böhm-Bawerk 1914b, 205).

In spite of all this, the First World War was financed with a limitless expansion of the money supply. “Inflationism”, wrote Mises, was “[t]he most important economic element in this war ideology” (cf. Mises 2000 [1980], III.19.42-III.19.43; Mises 2000 [1980], HP. 15 a. III.19.43f). In Vienna, the income of a worker’s family sank from the index figure 100 (1913/14) to 34 (1917/1918), while that of a civil servant’s family sank from 100 right down to 19 (cf. Winkler 1930, 159 a. 206). Inflation was a relentless social leveler: in 1915, a Viennese privy councilor still earned 8.6 times the amount of the lowest earning civil servant, in 1920 it was only 3.3 times as much (cf. Sandgruber 2005 [1995], 354). After the war, the inflationary policy was carried over. For the socialist government, according to Otto Bauer, inflation was “for two years the means to stimulate industry and to improve the lifestyle of the working population.” At the same time, subsidies for food imports and unecological state enterprises were financed with the help of extreme increases in the money supply. Soon, food subsidies had become the main source of this essentially self-inflicted inflation (Bauer 1923, 254), and put a heavy burden on the government budget, in 1920/21 constituting no less than 59 percent of its total (cf. Bachinger/Matis 1974, 26). Thus, the money supply expanded in 1920 from 12 to 30 Billion *Kronen*, by the end of 1921 to 174 *Kronen*, and reached the level of one Trillion in August 1922 (cf. Sandgruber 2005, 354f). The inflationary policy had profoundly shattered both the economy and the government budget.

Repeatedly, members of the Viennese School, with Ludwig von Mises leading the way, spoke out in the daily press and in professional journals against the “evil of inflation” and demanded serious stabilization measures (cf. Hülsmann 2007a, 350-360). More explicitly than in the first, in the second edition of his *Theory of Money* Mises blamed the crisis on the “unrestricted extension of credit” (cf. Mises 2000 [1980], III.19.42-III.19.44). Since banks and politicians had a common interest in further lowering the interest rate, to facilitate “cheap” money, a money system “independent of deliberate human intervention” (Mises 2000 [1980], II.13.52) would have to be established, which would mean a return to money backed by gold (ibid., II.13.52 a. III.20.76-III.20.86.). Indeed, the recovery of the Austrian government budget succeeded in 1922, only after politicians had committed themselves to

self-restraint, amidst ferocious attacks from right- and left-wing statistes (cf. Hanisch 2005 [1994], 282).

Thus, the monetary theory of the Viennese School stood in stark contrast to the large majority of German economists, whose competency in monetary theory seems, in retrospect, to be stunningly inadequate (cf. Pallas 2005, 12 FN 6). Faced with the destruction of their currency, they were quite powerless and even their publications, which played down the significance of inflation, were delayed because the funds designated for their printing had become casualties of the hyperinflation (cf. Pallas 2005, 104; Boese 1939, 181). However, in their publications, even economists such as Schumpeter, Keynes and Carl Gustav Cassel (1866-1945) supported the policy of monetary expansion and argued more or less eloquently against a gold-backed currency (cf. Pribram 1983, 473f.).

At the same time, Ludwig von Mises had developed, despite some animosity (as an unsalaried lecturer at the University of Vienna he was an outsider), his “private seminar” into a legendary nucleus of internationally renowned monetary and business cycle research (cf. Mises 2009, 81-83). A succession of gifted economists in his circle submitted remarkable contributions: the banker Karl Schlesinger (1889-1938) wrote analyses based on Walras (Schlesinger 1914) and a well-researched report on practical banking experience (Schlesinger 1916 and 1920); Gottfried von Haberler (1900-1995) published a critique of Schumpeter’s monetary theory (Haberler 1924) and a monograph on index numbers, in which he demonstrated the limits of the measurability of economic variables (Haberler 1927); Fritz Machlup (1902-1983) wrote a dissertation on the gold bullion standard (Machlup 1925), Margarethe Stephanie Braun (1898-1990) reviews on monetary theory and banking, and Friedrich A. von Hayek (1899-1992) reviews on currency policy and banking (cf. Hennecke 2000, 81 a. 394).

Before joining Mises’ private seminar, Hayek, soon to become the person on whom the hopes of the Viennese School rested, had already considered the questions of currency policy and business cycle data, while on a 14-month study visit in the US (ibid., 66–70). Hayek became the first principal of the *Österreichische Institut für Konjunkturforschung* (“Austrian Institute for Business Cycle Research”), today’s *Wirtschaftsforschungsinstitut* (Wifo), when, after judicious preparation by Mises, it first commenced operations in 1927. Before long the institute became a European pioneer of empirical economic research. Oskar Morgenstern (1902-1977), who had published his first work, *Wirtschaftsprognose*, in 1928, became Hayek’s first associate and succeeded him in 1931 as principal of the institute.

Hayek’s assumption in his *Habilitation* thesis *Geldtheorie und Konjunkturtheorie* (1929) was, in accordance with Mises, that the ups and downs of the business cycle are invariably caused by credit expansion. An expansion of the

money supply “always bring about a falsification of the pricing process, and thus a misdirection of production” (Hayek 1933). The credit expansion is fuelled by the banks’ business model, as they want to provide their customers with as much liquidity as possible (*ibid.*). The interest demanded by the banks is therefore not “natural” interest or (in Hayek’s terminology) “equilibrium rate of interest”, but interest that is determined by the liquidity considerations of the banks (cf. Hayek 1929b, 103f.; cf. Schlesinger 1914, 128). Due to these theoretical deliberations, Hayek was able, in February 1929, to predict a severe economic crisis in the US which, in October of the same year, did indeed occur (cf. Steele 2001, 9).

In 1931 Hayek was invited to hold a series of lectures at the *London School of Economics*, in which he developed, among other things, the notion of “forced saving”. Changes in the money supply or in the interest rate, according to Hayek, would invariably lead to a shift in demand for consumer goods and investment goods, so that, in contrast to “voluntary” saving, which is based on true consumer desires, consumers as a whole would, in the case of monetary expansion for example, be “forced to forego part of what they used to consume. [...] because they get less goods for their money income” (Hayek 1935a [1931], 57).

Within a short time, Hayek’s theses earned him a considerable international reputation, although the abstract and complex constructs were not easy to understand (cf. Haberler 1933a, 97, Lachmann 1986, 226; Steele 2001, 100). Mises, who by then had refined his “circulation credit theory”, dared to state, in a preparatory text for the 1928 Zurich convention of the *Verein für Sozialpolitik*, that there was only one monetary theory left, namely the “monetary theory of business cycles” (cf. Mises 1928, 1). With the combined contributions of Machlup, Haberler, Morgenstern and Richard von Strigl (1891-1942), the Viennese School was able to present itself in Zurich as the authoritative research group in monetary and business cycle theory. Some years later, in a commemorative publication containing 62 contributions, it again presented itself as something of an avant-garde (cf. Festschrift für Spiethoff 1933).

In this commemorative publication however, it became clear that the divergent forces had increased considerably. Hans Mayer (1879-1955), who was for a long time the only tenured professor of the School, and his circle contributed little to monetary and business cycle theory (*ibid.*, 171-174). But even in the non-university Mises seminar the views on methodology and political economy were moving increasingly apart. Thus Strigl, who had analyzed the effects of the business cycle on the production process from a Viennese School point of view, with his *Angewandte Lohntheorie* (1926), was considered in questions of economic policy to be an “interventionist” (cf. Mises 1929, 38). Braun’s *Theorie der staatlichen Wirtschaftspolitik* (1929) also ultimately represented a (moderate) statism. Highly controversial was also the

question of whether the purchasing power of money could be measured at all. Mises denied this (cf. Mises 1928, 22), while Haberler reproached him for not even being able to define the supposedly non-measurable (cf. Haberler 1927, 109f.; Haberler 1933a, 95). In addition, Haberler considered Hayek's *Preise und Produktion* (1931) to be fragmentary and unfinished (Haberler 1933a, 97-100).

The differences grew when Mises began to view economics more and more as an a priori science. Oskar Morgenstern strictly rejected Mises' apriorism (cf. Morgenstern 1934, 8-10 u. 134). His keen interest in mathematics and statistical-empirical research, which had led to an analysis of capital depreciation of companies listed on the Viennese stock exchange (cf. Morgenstern 1932), established another divide. Neither did Hayek want to follow Mises' philosophical shift, and in terms of methodology gradually moved away from him. The old polarities, once represented by Böhm-Bawerk, Wieser and Sax, were thus conspicuously revived and divided the united forces.

In this situation, as the internationally most exposed representative of the Viennese School, Hayek became involved in several disputes. Well known is his literary feud with Keynes, which was so intense that letters were even exchanged on Christmas Day, 1931 (cf. Dimand 1988, 57). As he had already done seven years previously (cf. Hayek 1924, 389f), only this time more broadly and thoroughly, Hayek had weighed Keynes' theses on money and monetary policy and found them wanting. Keynes disputed the capacity of the market to regulate itself and recommended interventions to guide the economy and the currency system. Hayek rejected this emphatically, because he saw in these very interventions the cause of the crises (cf. Butos 1994, esp. 473).

While Hayek was well able to hold his ground during the intense debate with Keynes, with Keynes mitigating or even revoking some of his positions, the astute and aggressive critique of Piero Sraffa (1898-1983) left behind an unsettled professional audience. Hayek's distinction between "voluntary" saving and "forced saving" had begun to topple, as had the assumption of the Viennese School, taken almost for granted, that the "equilibrium rate of interest" in a barter economy without money and banks could not be interfered with (cf. Kurz 2000, 169f).

Hayek's "Reply" was unable to clear up these sustained doubts any longer (cf. Lachmann 1986, 240). Some people later thought the reason for this was ultimately that his grounding in capital theory was inadequate (cf. Kurz 2000, 170; Steele 2001, 140). Over the following four years Hayek tried to corroborate his position with ten additional articles. However, during this phase of fundamental re-orientation in English economics, the charm of the "Austrian theory of money and business cycles" had already begun to lose its fresh appeal and allure. Works by Machlup about *The Stock Market, Credit and Cap-*

ital Formation (Börsenkredit, Industriekredit und Kapitalbildung [1931]), by von Schiff about capital consumption – *Kapitalbildung und Kapitalaufzehrung* (1933)—and by von Strigl about business cycles and production—*Kapital und Produktion* (1934) –, reflecting the “Austrian” theory, were still being published, but for the time being they made no impact on the discourse in English-speaking countries. The political turmoil in central Europe, generating the first victims but also the first offenders among economists, brought the onset of the gradual exodus of the Viennese School. Suddenly the “Austrian monetary and business cycle theory” lacked active propaganda. After a fulminating start in the early 30s, the academic discourse about the theoretical construct of the Viennese School now almost came to a standstill.

By the time Haberler had completed his standard work on business cycle theories in 1936 and in so doing had erected a monument to the “Austrian” contribution (cf. Haberler 1937, 33-72), he was already living outside Austria, as indeed were many of his colleagues. Because of the political events of the times, the Viennese School was paralyzed and reacted in feeble or subdued fashion, or in some cases not at all to Keynes’ *General Theory of Employment, Interest and Money*. Looking back, Hayek would call it his “greatest strategic mistake” not to have taken a more extensive stance on Keynes’ *General Theory* (cf. Hennecke 2000, 107; see also Caldwell 1998 a. Hawson 2001). Only Gottfried Haberler, who was staying in Geneva, demonstrated the accustomed professional-critical rigor and considered Keynes’ “multiplier theory” to be indefensible (Haberler 1936); in this he was later supported by Fritz Machlup (Machlup 1939/40). Other than that, Keynes’ work was treated with the utmost caution (cf. Schüller 1936; Steindl 1937). It took more than two decades before Henry Hazlitt, an American inspired by the Viennese School, submitted the *General Theory* to strong criticism in *The Failure of the New Economics* (1959).

By the time Hayek brought his magnificent attempt at a modified “Austrian theory of money and business cycles” to a close during the war (Hayek 1939 a. 1941), the scene had already changed dramatically. The Viennese School had become a little regarded outsider. Keynes’ theses dominated economic theory in English speaking countries. During the traumatic experience of the economic depression, politics and public opinion readily followed the man who had so brilliantly and, on the surface, convincingly proposed to secure the future welfare of the world through government control of the economy, currency management and state investment programs (cf. Steele 2001, 6). In addition to all this Keynes provided “welcome arguments for a radical change of the social functions of economists; whom he qualified as indispensable advisers on economic policies” (Pribram 1983, 513; cf. also Steele 2001).

CHAPTER 12

Joseph A. Schumpeter: A colorful maverick

Schumpeter's ancestors, Moravian cloth manufacturers from Triesch (today Třešť, Czech Republic), were of German origin, Catholic and very popular among the people, owing to their charitable behavior.¹ Joseph Alois was born in 1883. After the early death of his father, his mother moved to Graz, where in 1893 she married Lieutenant Field Marshal Sigismund von Kéler, who was 32 years her senior, and relocated with him to Vienna. Kéler's excellent connections enabled "Joschi" to attend the Theresianum, a high school primarily reserved for the aristocracy, which played a significant part in shaping his character. A lifelong friend and fellow student would describe Schumpeter later in this way: He "never seemed to take anything in life seriously. He had been educated in Theresianum, where the pupils were taught to stick to the issue [...] One should know the rules of all parties and ideologies, but not belong to any party or believe in any one opinion." (Swedberg 1991, 12).

After graduating with a distinction, Schumpeter began studying law, but influenced by Menger's pupils Friedrich von Wieser, Eugen von Böhm-Bawerk and Eugen von Philippovich, it was principally economics which he addressed. In the seminars, a colleague remembers, he "attracted general attention through his cool, scientific detachment" and with the "playful manner, in which he took part in the discussion" (ibid., 15). After graduating, he went to the *London School of Economics* and also to the universities of *Oxford* and *Cambridge*, complementing his "Austrian" education with an English one, which in those days was still rare (cf. Seifert 1993, 6f). At the age of 24, this "fashionable young man," to whom the doors of English high society stood open, married

¹ Regarding the biography, see März 1989, Swedberg 1994 [1991], Kurz 2005; plenty of information but with a number of mistakes and errors McCraw 2007 and Schäfer 2008.

the apparently breathtakingly beautiful Gladys R. Seavers, daughter of a high ranking dignitary of the Anglican Church. However, the marriage proved to be unhappy. After only a few months, the couple separated (Swedberg 1994 [1991], 15).

While employed in an Italian attorney's office, Schumpeter traveled in 1907 to Egypt, where, after work in the evenings, he drafted his first monograph: *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie* (1908) ("The Nature and Content of Theoretical Economics"). For this, which contained a balanced account of the *Methodenstreit* and a forthright plea for *methodological individualism*, he received his *Habilitation* in the same year and in 1909 took on a non-tenured professorship in Czernowitz in present-day Ukraine. In 1911, at the age of 28, he was appointed as the youngest tenured professor in the whole monarchy to the chair of "political economy" at the University of Graz. Toward the end of the same year, he published his *Theorie der wirtschaftlichen Entwicklung* (*The Theory of Economic Development*), in which the publication date was erroneously given as 1912. This work soon found international recognition and would later become a classic. The *Epochen der Dogmen- und Methodengeschichte* (1914) ("Epochs of the History of Dogmas and Methods"), in which, at Max Weber's (1844-1919) suggestion, he described the economic phenomena with help of related social sciences, was also published before the outbreak of the World War. During this period, Schumpeter took up a guest professorship at *Columbia University* in New York and delivered 17 lectures at other American universities (cf. Seifert 1993, 9). Returning from America, he was immediately elected dean of the law faculty in Graz.

Schumpeter thought of himself first and foremost as a scientist. He repeatedly emphasized that he wished to refrain from making any political judgments, and if at all, only wanted to offer theoretical decision support for economic policy measures. Despite this, he took on political jobs and capacities. Thus, with the help of several memoranda, he tried during the First World War to prevent a planned customs union with the German Reich, because he feared an economic take-over from Germany (cf. Swedberg 1994 [1991], 48-54). Immediately after the war, solicited by friends with Marxist leanings, he joined the German *Sozialisierungskommission* (committee to prepare for the nationalization of German industry). To everyone's astonishment, Schumpeter advocated the complete and immediate nationalization of the coal mining industry, whereupon the Viennese author, cultural critic and journalist Karl Kraus (1874-1936) derided him as a "exchange professor in convictions" and added that he had "more opinions" than "were necessary for his advancement" (ibid. 60).

In 1919 Schumpeter was even appointed as finance minister in the socialist government. However, seven months later he had to resign because his

budget had been completely rejected and he was accused of having thwarted a nationalization program and thus of counteracting government policy (cf. März 1986b, 189). At every opportunity, Schumpeter made upbeat remarks about the economic independence of the young republic. In contrast to this, Otto Bauer, undersecretary for foreign affairs, pursued the goal of unification with Germany and argued the case for this on the basis of economic necessity. At the peace negotiations in Saint-Germain the chancellor, Karl Renner, also emphasized the economic non-viability of the radically shrunken Austria (cf. McCraw 2007, 100f.; Schäfer 2008, 254). Since Schumpeter allowed himself, at a time when the Viennese were going hungry, a noble riding horse paid for out of his politician's salary, and appeared in public accompanied by prostitutes, his political reputation was soon destroyed irrevocably destroyed. Many months later he was appointed president of the Viennese *Biedermann-Bank*. Within three years, the bank went bust, whereupon the owners dismissed him in disgrace and with a mountain of debt. "Without capital, with a miserable reputation as a business man and without political renown", Schumpeter had reached the low point of his life (Schäfer 2008, 101).

In 1925 Bonn made Schumpeter an offer, which he immediately accepted. His tenured professorship for political economy was a sensation from the start. "For the first time [in decades], theory was being taught at a German university" (ibid., 103). Bonn became the meeting place for economists from all over the world. Moreover, his lectures in the areas of finance, monetary theory, history of economic theory and sociology were considered to be flamboyant and unconventional, as one former student remembers: "He was very relaxed as he began his lectures, always speaking without notes [...] He had a clear and agreeably Viennese way of talking, slightly playful, but nevertheless very measured and emphatic; when he spoke, from all four sides of the lectern—usually slightly leaning on it—with one hand in his coat pocket, he didn't stint on his gestures; he had calm, steady hands, his handwriting was large, the graphic characters interesting" (ibid., 105). Later, Schumpeter considered the essays he wrote in that time, for example *Die sozialen Klassen im ethnisch homogenen Milieu* (1927) ("The Social Classes in the Ethnically Homogenous Milieu"), to be his most important works.

However, Schumpeter also suffered staggering blows of fate in Bonn. In 1926 his mother Johanna died, then, a month later, his second wife Annie died of childbed fever, along with their newly born son. At just seventeen years of age, Annie, the daughter of the janitor of his parent's tenements, had fallen deeply in love with her "Schumi". After their wedding in 1925 they moved into a grand villa in Bonn, in which they held jamborees. Schumpeter was devastated by the loss. Everyone who knew him noticed a radical change in his personality. For years, he wouldn't touch Annie's clothes, went daily to the cemetery and developed a positively religious cult around her death.

In 1932 Schumpeter quit teaching in Germany and transferred to *Harvard University* in Cambridge, USA. As he had previously done in Bonn, he was able to gather around him an illustrious circle of enthusiastic students and young researchers, for example the later Nobel Prize winners Paul A. Samuelson (born 1915), Wassily Leontief (1905-1999) and James Tobin (1918-2002), the Austrians Gottfried Haberler and Fritz Machlup, but also socialists like Oskar Lange (1904-1965), Paul Sweezy (1910-2004) and Richard M. Goodwin (1913-1996) (cf. Seifert 1993, 11). In this way, Schumpeter made a crucial contribution to the “golden age of economics”. His works on entrepreneur theory and on capitalism made him the best known economist in the USA. In 1947 he became the first foreigner to be elected president of the renowned *American Economic Association*; one year later he even took over the chair of the *International Economic Association*, which then had a membership of 5,300 worldwide (cf. McCraw 2007, 409f. a. 421). From Schumpeter’s ambitious plans, which he had undertaken after his arrival in the US, he was able to accomplish three other large works: *Business Cycles* (1939), *Capitalism, Socialism, and Democracy* (1942) and *History of Economic Analysis* (1954), whereby the latter work remained unfinished and was published posthumously by his third wife, the economist Elisabeth Boody.

The story goes that Schumpeter once said that he had three goals in life, namely to be the world’s greatest economist, Austria’s greatest horseman and Vienna’s greatest lover (cf. Swedberg 1994 [1991], 76). At least with regard to economics, during the 1930s it became increasingly clear to him that this goal was probably out of his reach. The Briton John Maynard Keynes, who was the same age as Schumpeter, had plunged him into a deep creative crisis, with *A Treatise on Money* (1930), as Schumpeter had himself just written a manuscript on monetary theory and was just getting it ready for printing (cf. Swedberg 1994 [1991], 111). Schumpeter could hardly bear his students looking forward to the latest works by Keynes with such excitement. Although Schumpeter was always able to captivate colleagues, students and audiences with his polyglot education, his skill in inventing stories and his tremendous intellectual flexibility, he never managed to build up a following of students for long. Self-critical, he blamed his lack of “leadership” and “conviction”: “I [...] have no garment that I could not remove. Relativism runs in my blood. That is one of the reasons why I can’t win—not in the long run,” he noted in his diary (cf. Schäfer 2008, 107 a. 195).

During the Second World War Schumpeter revealed his politically most disagreeable side. Time and again, he inveighed against Slavs and Jews and sympathized with Adolf Hitler, although at the same time he was helping many of the refugees arriving in the US. After 1945 he spoke of a “Jewish victory” and questioned the Nuremberg war tribunal (cf. Piper 1996, 101). Schumpeter, relentlessly driven and seeking for stability, who was often beset with despair,

depression and premonitions of death, wrote several times in his diary that he considered his life to be a failure and that he wished nothing more for himself than a gentle death (cf. Schäfer 2008, 186, 195 a. 218). When the American president Franklin Roosevelt (1882-1945) died suddenly of a brain hemorrhage, Schumpeter, who had been unhappy all his life, remarked in an obituary: “Lucky man: to die in fullness of power” (cf. McCraw 2007, 488).

CHAPTER 13

Schumpeter's theory of economic development

In both his political and academic convictions, Joseph A. Schumpeter always took the middle ground, meaning that even now his work cannot be clearly categorized. On the one hand, he felt obliged to the Viennese School and later was happy to introduce the American students in Harvard to the teachings from Austria. On the other hand, he also made all kinds of concessions to socialism and in the 1920s held the German *Historical School* and Gustav Schmoller in particular in high esteem (cf. Schumpeter 1926a). As a starting point of his later famous *Theorie der wirtschaftlichen Entwicklung* (1912) (*The Theory of Economic Development*), which he wrote when he was 28 and in which he strove to combine these differing traditions, he applied the equilibrium theory of the Lausanne economist Léon Walras (1834-1910), which is also strikingly inconsistent with the Viennese School. In contrast to Walras, however, Schumpeter took the view that a static theory alone was insufficient to fully explain economic phenomena. So, for example, one would have to assume a kind of “internal source of power” upsetting the equilibrium of economies, as external factors alone could not be made responsible for such a change (Schumpeter 1989 [1937], 166). Furthermore, in his strongly psychologically- biased description of the role of entrepreneurs, Schumpeter drew on the groundwork of the Berlin political economist Adolph Friedrich Johann Riedel (1809-1872) and Albert Eberhard Friedrich Schäffle, yet without citing either of them (cf. Streissler 2000a, 103f and Kurz 2005, 50).

To date, Schumpeter's *Theory of Economic Development* has been published nine times and has been translated into several languages including Japanese and Hungarian. In the second edition of 1926, he so radically streamlined the original text, that the result was almost a new book (cf. Röpke/Stiller 2006,

Vf), which gave rise to many of his memorable expressions that are still to be found, largely unchanged, in the later editions. Discourse in the German speaking world usually referred back to this second edition or later ones. The reception of the work in the Anglo-American world was based on an abridged and poor translation of 1934, which was also based on this second edition. This has had the remarkable consequence of the original text remaining to this day largely unknown; indeed Schumpeter's name is linked in many cases to theses which he had explicitly opposed in his original work (*ibid.*, VIII f.).

Schumpeter, who proceeded on the assumption of a categorical distinction between static and dynamic economics, stated more precisely in his second edition that "economic development" didn't just mean the usual adjustments, but only those changes "where economic life itself changes its own data by fits and starts" (Schumpeter 1961b, 62). These changes would come about while implementing new combinations of production goods, for example the manufacturing of a new product, the introduction of a new production method, the opening up of a new market, the access to a new source of natural resources, or the creation or breaking of a monopoly (*ibid.*, 66). These processes of "industrial mutation", which "continuously revolutionize the economic structure from within," wrote Schumpeter in the preface to the Japanese edition, amount to a process of "Creative Destruction" and constitute the essential reality of capitalism (Schumpeter 1976b [1943], 83f.). It is in the nature of capitalist markets to be in a condition of dynamic imbalance. Old structures would be periodically replaced by new. If a capitalist society were in equilibrium, it would be doomed. In this sense "innovation" and "creative destruction" are its pivotal aspects.

Ultimately it is the entrepreneurial will, the leadership of the entrepreneurs, which spurs on economic growth and social change. Entrepreneurs even "force" their products onto the market (cf. Schumpeter 2006 [1912], 133). In the fewest of cases, however, are the entrepreneurs themselves also the creators. It is not part of the entrepreneur's function "to 'find' or to 'create' new possibilities. They are always present, abundantly accumulated by all sorts of people. [...] Plenty of people as a matter of fact did see it. But nobody was in a position to *do* it. Now, it is this 'doing the thing,' without which possibilities are dead, of which the leader's function consists." (Schumpeter 1961b, 88). Schumpeter repeated later in the first volume of his *Business Cycles* (1939; German *Konjunkturzyklen*, 1961a) that without doubt, "the great majority of changes in commodities consumed has been forced by producers on consumers" In most cases, the consumers had resisted and had first to be educated "by elaborate psychotechnics of advertising." "Railroads have not emerged because any consumers took the initiative in displaying an effective demand for their service in preference to the services of mail coaches. Nor did the consumers display any such initiative wish to have electric lamps or rayon stockings, or to travel

by motorcar or airplane, or to listen to radios, or to chew gum." (Schumpeter 1939, 73).

In the revised second chapter of his *Theory of Economic Development* (second edition), Schumpeter described the driving force of the entrepreneur as follows: "First of all, there is the dream and the will to found a private kingdom, usually, though not necessarily, also a dynasty. [...] Then there is the will to conquer: the impulse to fight, to prove oneself superior to others, to succeed for the sake, not of the fruits of success, but of success itself. From this aspect, economic action becomes akin to sport—there are financial races, or rather boxing-matches. [...] Finally, there is the joy of creating, of getting things done, or simply of exercising one's energy and ingenuity. This is akin to a ubiquitous motive, but nowhere else does it stand out as an independent factor of behavior with anything like the clearness with which it obtrudes itself in our case." (Schumpeter 1961b, 93).

Schumpeter's fundamental distinction between "entrepreneurs" and their imitators—the latter he called "mere managers"—can be traced back to the leadership-elite theory of his teacher Friedrich von Wieser. According to Wieser, only "human beings of a very special kind" occupied an "exceptional position" by having the "courage of innovation" and wanting to form "the world in their image". They play the part of trendsetter as "founders of joint-stock companies", as "leaders of political parties" or as "strike-leaders" just as they do in the world of fashion (Wieser 1910, 26). Because "leading and following," writes Wieser, "is the basic form of all social action. Masses do not unite because of contracts, [...] they unite through leading and following [...]" (ibid., 31). However, although Wieser understood "leadership" in terms of a social function and hardly saw it based on human drives or character traits (cf. Wieser 1925 a. 1927a), even in the first edition Schumpeter placed special emphasis on the psychological make up of the "business leader".

The psychological side of this image of the entrepreneur was unmistakably related to Friedrich Nietzsche, also to Max Weber's "charismatic leader" and Oswald Spengler's "Faust-like" human being and thus recalls the emerging leader cult in Germany. In the first edition, Schumpeter had still seen the entrepreneur as corresponding much more to the creative artist and thinker (cf. Schumpeter 2006 [1912], 24f., 133, 142 or 148) or had described him as "chieftain specializing in business matters" (ibid., 173). From the second edition onwards, more emphasis was placed on the function of the entrepreneur. An elite is depicted which enjoys flaunting its accomplishments and strengths, and which, with restless ambition, molds social reality, casting a spell over it (Schumpeter 1926b [1913], 137). Members of this elite can be found among property owners or company founders, but the "leading man" might also be a manager, a majority share owner or even someone who has no capital at his disposal: "It is leadership rather than ownership that matters" (Schumpeter

1939, 103).

In order to produce something innovative and to offer it on the market, an entrepreneur would have to withdraw already existing production goods from their previous use. For this purpose, he would need “purchasing power and not goods” (Schumpeter 2006 [1912], 94f). However, he rarely possesses investment capital. The entrepreneur doesn’t usually save up to acquire the necessary means; “he also doesn’t accumulate goods prior to production” (ibid., 288). Therefore, in order to introduce new combinations, funding is needed. Entrepreneurs could only invest with the help of credit. Accordingly, it is ultimately the banker who enables the introduction of new combinations, who “as it were, in the name of the economy, delegates the mandate to implement them. He is the steward of the market” (ibid., 198).

“The entrepreneur,” writes Schumpeter, “is never the risk taker. The lender will suffer a loss if the venture fails. [...] Taking on the risk is certainly not an element of the entrepreneur’s function. Even if he risks his reputation, economically he is never made directly liable for a failure” (ibid., 290). The main fact about the lender, the banker, is that he simply transfers “purchasing power”, yet by no means actual stock. Therefore, one could say “without bending the truth, that the banker creates money” (ibid., 197). All “industrial” development ultimately requires credit (ibid., 212). An entrepreneur only becomes an entrepreneur, “if he has first become a debtor” (ibid., 208). In the second and later editions, Schumpeter refined the language of his explanatory model even further: such credit was not “purchasing power, which already exists in someone’s possession, but [...] the creation of new purchasing power out of nothing [...] this is the source from which new combinations *are* often financed, and from which they would have to be financed *always*, if results of previous development did not actually exist at any moment” (Schumpeter 1961b, 73).

With the help of loans, an entrepreneur could quash others’ attempts and establish his new products on the market. This would provide him with substantial profits, since he “has no competitors when the new products first appear, the determination of their price proceeds wholly, or within certain limits, according to the principle of monopoly price” (ibid., 152). However, his success would soon attract imitators, so that in turn his profit margin would decrease and finally suffer competition. The entrepreneur’s profit “slips from the entrepreneur’s grasp as soon as the entrepreneurial function is performed. It attaches to the creation of new things, to the realisation of the future value system. It is at the same time the child and the victim of development.” (ibid., 153f). The appearance of imitators taking advantage of the pioneering work of the entrepreneur, would however on balance cause an economic boom, which would be evident on the one hand in the creation of new jobs, and on the other in wage increases and a higher interest rate. Though as a result of this,

there would also be a decrease in the demand for credit and many of those new companies—in contrast to the established ones which could fall back on accumulated resources—would go bankrupt, i.e. the wave of innovation would subside again and the economy would slide into a crisis. After a certain period of economic recession, innovative entrepreneurs would again appear in some branches of industry and the cycle would begin anew.

The idea that the modern economy is mainly financed with the help of credit had been discussed years earlier in Böhm-Bawerk's seminar by Rudolf Hilferding, who also later on published it (Hilferding 1910, 140); Schumpeter, however, made no reference to this. Even at that time critics thought it was easy to prove empirically that innovations were indeed not (or by no means exclusively) financed by debt. All in all, Schumpeter's *Theory of Economic Development* enjoyed a mixed reception (Röpke/Stiller 2006, X). He later remarked that the book had generally been rejected (cf. McCraw 2007, 534, FN 23). Schumpeter's denial of capital interest in static economics and his thesis of the inflationary financing of innovative production processes certainly chagrined his former teacher Eugen von Böhm-Bawerk, who warned, in an in-depth critique, against the "danger of false teaching presented in such an ingratiating manner full of spirit and powerful eloquence" (Böhm-Bawerk 1913a, 61). Schumpeter's meek response (Schumpeter 1913) and Böhm-Bawerk's rejoinder (Böhm-Bawerk 1913b) showed all too clearly how deep the rift had become between Schumpeter and the Viennese School.

After the First World War, the Viennese School researched in depth the link between credit financing and business cycles. In contrast to Schumpeter, they viewed the creation of purchasing power "out of thin air" as a beguiling illusion, which would undermine and ultimately destroy the functioning of the economy (cf. Machlup 1931, 215; Hayek 1929b, 92). Nevertheless, in the last decades of the twentieth century, Schumpeter's *Theory of Economic Development* enjoyed a remarkable renaissance and was an inspiration in many different ways, particularly for the so-called "evolutionary economics" and modern research on innovation (Kurz 2005, 61-65).

During the Second World War Schumpeter wrote his famous work *Capitalism, Socialism and Democracy* (1942; German *Kapitalismus, Sozialismus und Demokratie*, 1946 or 2005), in which he considered the question, among others, of whether capitalism could survive in the long term. Schumpeter answered in the negative. Increasingly, large corporations would take on the role of innovator. Key decisions would no longer be made by brash small entrepreneurs, driven on by their desire for social advancement, but by paid managers: "Instead of lively contact between all the people and things involved in production," Schumpeter had already written in *Sozialistische Möglichkeiten von heute* (1922) ("Socialist Possibilities of Today"), there would be "increasingly more administration from some distant board room" (Schumpeter 1922,

319). In addition, the capacity for technical innovation increases with the size of the company, so that it is systematically carried out in the R & D departments of large businesses. In the late capitalist era, key business decisions were no longer made by the innovative entrepreneurs, but increasingly by the business administrators in large concerns, whose actions resemble those of civil servants: "Everywhere we find industries which would not exist at all but for protection, subsidies, and other political stimuli, and others which are overgrown or otherwise in an unhealthy state because of them" (Schumpeter 1939, 13). Thus, the traditional entrepreneur had lost all area of operation. Therefore, bureaucratic capitalism was slowly metamorphosing into centrally planned socialism.

CHAPTER 14

The Viennese School's critique of Marxism

Shortly after the First World War, council republics modeled on the Russian Soviets were installed in Hungary and Bavaria. Violent revolts erupted in many places in Germany. Vienna, too, was dominated by this revolutionary atmosphere, which middle-class circles embraced with calculated opportunism. Ludwig von Mises, who at that time was a civil servant in the chamber of commerce of Lower Austria, recalled the following: "People were so convinced of the inevitability of Bolshevism that their main concern was securing a favorable place for themselves in the new order. [...] Bank directors and industrialists hoped to make good livings as managers under the Bolsheviks." (Mises 2009, 14f.).

Mises knew Otto Bauer very well, who was then state undersecretary in the foreign department, the leading Austro-Marxist and later chairman of the nationalization commission. They had attended Böhm-Bawerk's economics seminar together. "At the time," wrote Mises about the winter of 1918/19 in his *Recollections*, "I was successful in convincing the Bauers that the collapse of a Bolshevik experiment in Austria would be inevitable in a very short time, perhaps within days. [...] I knew what was at stake. Bolshevism would lead Vienna to starvation and terror within a few days. Plundering hordes would take to the streets and a second blood bath would destroy what was left of Viennese culture. After discussing these problems with the Bauers over the course of many evenings, I was finally able to persuade them of my view." (ibid.). Finally, in January 1919, Bauer announced in the *Arbeiter-Zeitung* that he wanted to carry out expropriations with reimbursement in the heavy industry and in large scale land-holding. For other industries too, organizational measures were to be taken to prepare for "nationalization" (cf. Bauer

1919).

Mises' efforts to persuade in those memorable nighttime conferences were mainly aimed at the socialists whose political measures were likely to endanger the already precarious and insufficient supply of the Viennese population. In the considerable amount of literature produced during the subsequent debate on socialization—about which, Schumpeter said, even the most able people wrote the most banal things (cf. Schumpeter 1922, 307)—Mises was one of the few who, with sobriety and a sense of reality, kept his focus on the possible consequences of state intervention. The government-run “war and transitional economy” had provided numerous examples of the inevitable failure of central economic planning, and had also proven the “poor productivity” of nationalized companies more than adequately (Mises 1919, 152). Moreover, Mises realized early on that the interests of the Viennese “Sozialisierungskommission” (nationalization committee) were by no means identical with the interests of the federal states (Mises 1920b). In any case, these nighttime crisis talks put such a strain on his relationship with Bauer, that later Mises even thought Bauer had tried, for this reason, to have him removed from the University of Vienna teaching staff (cf. Mises 2009, 15). In any case, when the position of tenured professor in Vienna became vacant in 1919, Mises was no longer considered for it; instead Othmar Spann (1878-1950) was appointed, a former colleague of Bauer in the *Wissenschaftliche Komitee für Kriegswirtschaft* (Academic Committee for War Economy) in the imperial-royal war ministry.

During the nationalization debate of 1919, Mises had defended private property and the market economy predominantly with the argument of economic efficiency of supply. With regard to this, however, he had to argue the position almost single-handedly, as many members of the Viennese School had been appointed to senior positions in the central “war and transition economy” offices and had thus joined the statist camp. It almost seemed as if in the course of their career they had completely forgotten that at no university had the academic dispute with Marxism been as profound and productive as in Vienna. In the 80s, as the subjective theory of value had started to get established, other theories, competing with those of the Viennese School, for example the labor theory of value, had come to the fore. In *Capital and Interest: A Critical History of Economical Theory* [1884], Eugen von Böhm-Bawerk devoted a complete section to socialist notions (“The Exploitation Theory”) and subjected them to fastidious and detailed criticism. In 1885, Gustav Gross authored a first biographical article on Karl Marx. In the very same year he presented a separate biography – *Karl Marx. Eine Studie*—and shortly thereafter reviewed the second volume of *Das Kapital*. Hermann von Schullern zu Schrattenhofen's first published scholarly work was *Die Lehre von den Produktionsfaktoren in den sozialistischen Theorien* (“Study of the Factors of Production in Socialist Theories”) (1885).

The dispute with the socialists was soon to become a permanent feature of the Viennese School, and it is ironic that it was this school of thought which first introduced the academic discourse about socialism into the libraries and seminar rooms of established economics departments. Criticism was aimed primarily at the labor theory of value, the contradictions and shortcomings of which people thought had been overcome once and for all with the subjective theory of value. Thus, the socialist theory of value did not represent progress for them, but rather regression (cf. Zuckerkandl 1889, 296). The competition between these two doctrines came to a climax with the fierce controversy between Böhm-Bawerk (1890b, 1892a) and Dietzel (1890, 1891), in which Zuckerkandl (1890), amongst others, was also involved. Dietzel adhered to the labor theory of value and vehemently advocated the view that the principle of marginal utility is ultimately nothing but the old law of supply and demand (Dietzel 1890, 570).

The disputes with socialism soon went beyond the labor theory of value and challenged the "socialist state" in many respects. For example, Böhm-Bawerk regarded interest as an economic category wholly independent of the social system. Thus, interest would exist even in the "socialist state" (Böhm-Bawerk 1930 [1891], 365-371). Wieser criticized socialist writers for inadequate teaching about the role of value in the socialist state and came to the conclusion that "with that structure of values" a state "could be managed [...] not for one day." For Wieser, "just about everything [was] wrong with the socialist theory of value" (cf. Wieser 1889, 64-66). Johann von Komorzynski extended the analysis to political science: he distinguished between a "true," "philanthropic socialism" and a "delusory socialism" merely aimed at class interests (Komorzynski 1893).

After the posthumous editing of the third volume of *Das Kapital* (1895), two in-depth contributions of the Viennese School marked the temporary conclusion of its critique of Marxism. In one perceptive essay, Komorzynski tried to prove that the Marxist theories were "at the greatest possible odds with the true economic processes." The contradiction stemmed "from the basic principle, not from the utopian dream" (Komorzynski 1897, 243). Finally, Böhm-Bawerk, in his famous *Zum Abschluß des Marx'schen Systems* (1896) (*Karl Marx and the Close of His System*), summarized the critique he had presented so far and came to the conclusion, based on the well-known contradictions between the first two volumes and the third volume of *Das Kapital*, that the final Marxist theory "exhibit[s] as many cardinal errors as there are points in the arguments." They "bear evident traces of having been a subtle and artificial afterthought contrived to make a preconceived opinion seem the natural outcome of a prolonged investigation" (Böhm-Bawerk 1949, 69). "The Marxian system," thus Böhm-Bawerk, "has a past and a present, but no abiding future [...] A clever dialectic may make a temporary impression on the human mind,

but cannot make a lasting one. In the long run facts and the secure linking of causes and effects win the day.” Böhm-Bawerk foresaw, that the “authority [...] rooted” in Marxist apologists “forms a bulwark against the incursions of critical knowledge” but which “will surely but slowly be broken down.” But even then “Socialism will certainly not be overthrown with the Marxian system,—neither practical nor theoretic Socialism.” (ibid., 117).

At the end of the 1880s, the law faculty of the University of Vienna became a center of research into socialism. In his sensational work *Das Recht auf den vollen Arbeitsertrag in geschichtlicher Darstellung* (1886) (“A Historical View of The Right to Full Labor Revenue”), Anton Menger (1841-1906), one of Carl Menger’s brothers, professor for civil litigation law and the first socialist of the monarchy with a tenured professorship, made a case for nationalization of the means of production. From 1892 Carl Grünberg (1861-1940), a “scientific Marxist”, taught economics there; inter alia he was also one of Mises’ teachers. In 1924 he was appointed to Frankfurt, where he founded the *Institut für Sozialforschung* and edited the works of Marx. Anton Menger, Carl Grünberg and later also Böhm-Bawerk subsequently attracted the young socialist elite: Max and Friedrich Adler, Otto Bauer, Karl Renner, Julius Tandler, Emil Lederer, Robert Danneberg, Julius Deutsch and Rudolf Hilferding. From Hilferding’s pen came the first Marxist anti-critique directed at Böhm-Bawerk (cf. Rosner 1994). A remarkable result of this seminar culture was also Hilferding’s *Das Finanzkapital* (1910), which commented on the role of banks and their symbiosis with the state, and thus seemed to anticipate the monetary and business cycle theory of the Viennese School, which was skeptical both about banks and government (cf. Streissler 2000b). The continuing exchange of ideas of all these talented young people fuelled in Böhm-Bawerk the belief, on the eve of the First World War, that the labor theory of value had “in most recent time, among theorists in all countries, the principle has lost ground” (Böhm-Bawerk 1959 [1921], 249 FN 21).

Initially in the post-war debate on nationalization, the theoretical arguments, which had evolved over the years, were hardly an issue. In fact, ideas about the organization of the economy and economic policy were prevalent. It soon appeared that the concepts of the nationalization operators had been inadequate. Numerous nationalized establishments quickly ran into economic trouble (cf. Weissel 1976, 299-320). Faced with the announced expropriations, entrepreneurs proved reluctant to invest, which actually surprised Otto Bauer (cf. Bauer 1923, 163 a. 173). And in the federal states, the states’ claims made the nationalization process stall or fail altogether. However, more than anything, Vienna was threatened with starvation: in 1919, 150,000 of 186,000 school children were undernourished or severely undernourished, an indirect consequence of the controlled war economy, which had led to a quadrupling of fallow land (cf. Bauer 1923, 118f). Schumpeter, who in 1919 had had to

resign as finance minister over the question of nationalization, took stock two years later: "Nationalization with an easy life and at the same time an abundant provision of goods, the childish ideal of bedding oneself in existing affluence, all that has political appeal, but is actually nonsense. Nationalization which isn't nonsense is today politically possible only as long as one doesn't try it in earnest" (Schumpeter 1922, 308).

As the policy of nationalization was already losing its momentum, Mises gained recognition for his spectacular essay, *Die Wirtschaftsrechnung im sozialistischen Gemeinwesen* (1920) (*Economic Calculation in the Socialist Commonwealth*), which was published two years later, substantially expanded, as the book *Die Gemeinwirtschaft* (1922) (*Socialism*). Mises made the point that "rational" economic management, i.e. resource-conserving production and distribution of goods, which takes the consumers' preferences into account, can only be guaranteed with a free price system, the free exchange of goods and freedom to implement all possible uses of the goods, and that these goals can never be achieved by central planning. If the means of production are not privately owned, an efficient business leadership and the consequent satisfying of consumer interests cannot be ensured. The core problem, according to Mises, is that "in the socialistic community economic calculation would be impossible. In any large undertaking the individual works or departments are partly independent in their accounts. They can reckon the cost of materials and labour, and it is possible at any time [...] to sum up the results of [their] activit[ies] in figures. In this way it is possible to ascertain with what success each separate branch has been operated and thereby to make decisions concerning the reorganization, limitations or extension of existing branches or the establishment of new ones. [...] It seems natural then to ask why [...] a socialistic community should not make separate accounts in the same manner. But this is impossible. Separate accounts for a single branch of one and the same undertaking are possible only when prices for all kinds of goods and services are established in the market and furnish a basis of reckoning. Where there is no market there is no price system, and where there is no price system there can be no economic calculation." (Mises 1951, 131).

According to this, Socialism is not able to calculate, which is the main assertion of Mises' argument known as the "calculation problem". There would be "neither discernible profits nor discernible losses [...]; success and failure remain unrecognized in the dark. [...] A socialist management would be like a man forced to spend his life blindfolded." (Mises 1983 [1944], 31). Mises disagreed with the argument brought forward by many "bourgeois" economists, that socialism could not be realized because humans were still morally too underdeveloped. Socialism would be bound to fail, not because of morality "but because the problems, that a socialist order would have to solve, present insuperable intellectual difficulties. The impracticability of Socialism is the result

of intellectual, not moral, incapacity." (Mises 1951, 451).

Mises' brilliant analysis, presented with compelling logic, was not new. Its main features were already part of the inventory of the early marginal utility theoreticians, but these had been hardly acknowledged. Hermann Heinrich Gossen (1810-1858) had thus already established that only in a society based on private property could the economy be managed "adequately" and "most expediently": "The central agency, planned by the communists to allocate the various jobs," Gossen said, would "very soon learn it had set itself a task, which individual humans would not have the ability to carry out" (Gossen 1987 [1854], 231). In the earlier days of the Viennese School, Friedrich von Wieser had already clearly emphasized the necessity of economic calculation (cf. Wieser 1884, 166f a. 178). He was one of the first economists to recognize the relevance of the informational nature of "value" in an economy: "The value," Wieser stated, "is the computation of utility" (Wieser 1889, 33), and only when one is able to calculate utility in value does the latter become "the controlling device of the economy" (*ibid.* 36).

Until 1919, apart from a few sporadic contributions in foreign literature (cf. Schneider 1992, 112), the problem of economic calculation in socialism was hardly considered, not even by socialist economists. Erwin Weissel (1930-2005), the Viennese economist and historiographer of the Austro-Marxist debate on socialization, even claimed that "they wanted to ignore the problem" (Weissel 1976, 235). At the height of the socialization debate, in spring 1919, the Menger student and business attorney Markus Ettinger warned that "only the market price [...] [could be] a reliable regulator of demand" and for "in- and outflow of capital and labor from one to the other production" (Ettinger 1919, 10). It is interesting that Max Weber (1864-1920), who was in close contact with Mises during his stay in Vienna in 1919, also characterized "money calculation" in a book manuscript, unpublished at the time of his death, as a "specific device of the purposive-rational procurement economy" (Weber 1972 [1921], 45).

Mises' fundamental critique still received general international recognition in the 1920s. The notion that central planning without a price system would automatically be inefficient was scarcely denied any longer. Then in the early 1930s, economists in the English-speaking world began responding with models for a socialist calculation, including the idea of "competition socialism," as a response to Mises, and this prevailed and survived in socialist circles until the 1980s (cf. Socher 1986, 180-194). The concept involved here was that market developments could be sufficiently simulated by "trial and error loops" of the planners between the individual planning periods, so that subsequently calculations could be made. Both Mises and Hayek responded in detail. Furthermore, in 1935 Hayek presented a concise summary of the complete debate (Hayek 1935b), thereby centering particularly on the hubris of the notion of

being able to plan economic and social systems comprehensively: socialism in all its right- and left-wing varieties was “an ideology born out of the desire to achieve complete control over the social order, and the belief that it is in our power to determine deliberately in any manner we like, every aspect of this social order.” (Hayek 1973/76/79, Vol II., 53). In contrast to this, Hayek emphasized the indispensable information function of market-induced prices: “The decisive reason why the market economy performs better than any other economic system is that a market system gathers much more knowledge of facts than any single individual or even any organization can know” (Hayek 1969a, 11).

Mises' forceful attack on the utopia of an economically efficient socialism evoked little direct counter reaction (cf. Mises 1923). Because the instigators of nationalization were aiming only at partial socialization, they were able to “get out of a tight spot” (Weissel 1976, 234) by pointing to organizational issues. It took two years for the counter attack to come about, when Helene Bauer (1871-1942), in the party organ of the Socialist Party, diagnosed the “bankruptcy of the marginal theory of value” (*Bankrott der Grenzwerttheorie* [1924]). Using revolutionary rhetoric and warlike language, she alleged that the marginal utility theory served as a bulwark of a frightened bourgeoisie, who used it the predominant theory at university level to agitate against Marxism (Bauer 1924, 106f.). In one point however, Bauer touched the Achilles' heel of the marginal utility theories when she described their imputation theory as inadequate (ibid., 112). The denunciatory intention of presenting the marginal utility theory as an ideology of the “bourgeois” owner class was particularly obvious in *Economic Theory of the Leisure Class* (1927 [1919]), written by the Russian theoretical economist and philosopher Nicolai Ivanovich Bukharin (1888-1938). Bukharin's personal attacks on Böhm-Bawerk were scrupulously repudiated in an unemotional counter criticism (Köppel 1930).

Particularly Ludwig von Mises provided socialist authors with ample targets for such an evaluation. Mises expressed his conviction, that liberalism was the only idea that could effectively oppose socialism (cf. Mises 1985a [1962], 50). Liberalism, said Mises, is “applied economics” (ibid., 195) and, in another work, he even said: “Liberalism triumphed with and through economics” (Mises 1926, 269). In spite of this, in the 1920s the marginal utility theory found some support in Germany, even from socialist writers or others with socialist leanings (cf. Kurz 1994, 56). While preparing for the Dresden convention of the *Verein für Socialpolitik* in 1932, Mises repeated his junctim of modern economics and liberalism (cf. Mises 1931, 283) and was promptly criticized, even by advocates of the subjective theory of value (Weiss 1993 [1933], 51f.). Despite all this polarization, a young participant of the Dresden convention, the post-doctoral graduate, attorney and political scientist Hans Zeisel (1905-1992), sports correspondent of the *Arbeiter-Zeitung* and until

1938 contributor to the famous *Marienthal-Studie*, undertook in *Marxismus und subjektive Theorie* (1931) the very first attempt at a synthesis. According to Zeisel, the notion of value had developed into a concept of “human elective action.” The “goods concept” had “given way” to the “relational concept of possible uses” (Zeisel 1993 [1931], 180f). The so-called “laws” of the subjective theory of value were of a “statistical nature” and received their cognitive value “when they are applied to empirically discerned demand systems” (ibid., 191). If one replaces the demand systems with “demand with purchasing power,” one will immediately realize that demand is allocated “according to class.” The “crucial Marxist line of thought,” according to which the level of wages, of the interest rate etc. depends on the “class development,” would thus receive “its exact verbalization” from the subjectivist theory of value (ibid., 192f). The subsequent changes in the political arena rendered impossible any continued development of this interesting synthesis of praxeological thinking and the Marxist theory of distribution.

CHAPTER 15

1918 and the consequences: the impending collapse

Although during the *Methodenstreit* the Viennese School had still severely criticized the belief in the state within the historical-ethical school of thought, their stance had gradually changed at the turn of the century. Carl Menger's basically skeptical attitude toward the state diminished to the same degree that the number of his postdoctoral students entering the civil service increased. After Menger withdrew in 1903, this skepticism disappeared almost entirely and an increasingly symbiotic relationship with the state ensued.

It was especially disastrous for the Viennese School that the active involvement of its members in the state administration reached its culmination precisely in the years of the so-called "war and transition economy" (1912-1919). The School had never before had such opportunities for influencing people: it had representatives teaching at three Viennese universities and at the *Exportakademie*; these played a leading role in the *Gesellschaft Österreichischer Volkswirthe*, ("Society of Austrian Economists") and even had their own publication, the *Zeitschrift für Volkswirtschaft, Socialpolitik und Verwaltung*.

Five *habilitierte* students in succession had been appointed to the "Herrenhaus"¹, five had become ministers², some even several times, and two became members of the Reichsrat³. Five out of a total of 17 *habilitierte* economists and public finance experts had become "Excellencies" and as such were high ranking representatives of the monarchy (cf. Vorlesungsverzeichnis [course

¹ Carl Menger, Eugen von Böhm-Bawerk, Friedrich von Wieser, Eugen von Philippovich, Rudolf Sieghart

² Eugen von Böhm-Bawerk, Robert Meyer, Viktor Mataja, Friedrich von Wieser, Ernst von Seidler

³ Emil Sax and Gustav Gross

catalog] 1911, 10). Apart from in top positions in public administration⁴ and in the press⁵, members of the School held positions in the chamber of commerce⁶ and the higher echelons of large banks and industrial conglomerates, for example Rudolf Sieghart (*Boden-Credit-Anstalt*) and Julius Landesberger (*Anglo-Österreichische Bank*). Toward the end of the war, the influence of the School reached its height: among its members were a prime minister and head of the Emperor's cabinet (Ernst von Seidler), several ministers (Ernst von Seidler, Friedrich von Wieser, Viktor Mataja), the last president of the "Reichsrat" (Gustav Gross), representatives of university administration (Richard Schüller, Ignaz Gruber, Hans Mayer, Richard Reisch) and leading members of the central administration of the war economy (for example Joseph A. Schumpeter, Eugen Peter Schwiedland oder Julius Landesberger). The *Gesellschaft Österreichischer Volkswirthe*, which (in 1897) had a total of 232 members, served as a forum where representatives of administration, politics, press and business could meet (cf. ZfVSV, Vol. 6, 1897, 307). The banker Richard von Lieben (1842-1919), and the sugar magnate and member of parliament Rudolf Auspitz (1837-1906), for example, and politicians from all parties were regular visitors.

The basis of the so-called *war and transition economy* was the *Kriegsleistungsgesetz* ("war effort act") of 1912 (RGBl. Nr. 236/1912), which laid the foundations of a centrally controlled management of all the economic sectors deemed strategically important in war, i.e. for a "state penetration of the economy" (Hanisch 2005 [1994], 199). In vain, the ageing Carl Menger, who saw a catastrophe looming, warned against this development (cf. Nautz 1990, 113; Mises 1978 [1940], 20; Mises 2009, 26). The year he died, 1914, Böhm-Bawerk also reminded everyone on several occasions that neither politics nor administration could suspend the basic laws of economics—clearly referring to the government, which had begun to finance its costly war preparations by printing money (Böhm-Bawerk 1914a; 1914b, esp. 210).

During the war up to 91 central offices, some of which were in competition with each other, were established with the help of the *Kriegsleistungsgesetz*. The co-ordinator was head of directorate [the highest civil service position within a ministry], Richard Riedl (1865-1944), whose attempts at management led to large scale squandering and to an undesired decline in production, especially in farming (cf. Sandgruber 2005 [1995], 320). Even in those areas in which sufficient resources were available, there were massive shortages (ibid., 325), which quickly led to a flourishing black market. Riedl, who adopted the verb "durchorganisieren" ("to thoroughly organize") as his guiding term, considered the "level of black market prices" to be "a barometer of goods shortages", thus

⁴ Viktor Mataja, Robert Meyer, Ignaz Gruber, Ernst von Seidler, Richard Reisch

⁵ Max Garr, Julius Friedrich von Lovassy, Moritz Dub

⁶ Viktor Grätz, Ludwig Mises, as a young man also Ernst von Seidler

admitting with unintentional cynicism that even he could not dispense with the “market” (cf. Riedl, 1932, esp. 123). In March 1917, at the culmination of this “hyperstatism” or “war socialism” (cf. Hanisch 2005 [1994], 199), all central offices were answerable to a single *Generalkommissariat für Kriegs- und Übergangswirtschaft*.

Most Viennese School economists collaborated with institutions of the war economy. Only Ludwig von Mises seemed to have had serious scruples. The monarchy lacked “entrepreneurial spirit,” the government budget was inflated, the internal administration costly and deficient, and publicly-owned enterprises were on the whole badly managed (cf. Mises 1915). When von Mises was assigned to the war economy department of the war ministry, he reported back to the front (cf. Hülsmann 2007a, 278f). His decision may have been made easier by the fact that the department was run by Hans Mayer, and also that Otto Bauer and Othmar Spann were employed there. Mises didn’t hold Mayer and Spann in high regard.

After the war, the practice of central economic planning was maintained for the time being, which definitely suited the plans of the revolutionary socialists. The philosopher Otto Neurath (1882-1945) thus suggested taking advantage quickly of this “prepared ground”. Since the “war organizations” were still in existence, “the present moment is a particularly good time for nationalization” (Neurath 1919, 21). However, this *dirigisme* also prolonged the scarcities economy. In the winter of 1919/20, the University of Vienna had to close down for several weeks due to a lack of heating fuel (cf. Hennecke 2000, 41). The Viennese School was also directly affected by the universities’ poverty. After 26 years of continuous publication, the *Zeitschrift für Volkswirtschaft, Sozialpolitik und Verwaltung* was discontinued for financial reasons.

Many university lecturers from the German speaking universities of the former crown lands came to Vienna, some had to take early retirement and some were given positions in the administration. The number of professorships at the German speaking universities decreased from 2,254 (1913/14) to 1,206 (1917/18) (cf. Fleck 2004 [1987], 187f). Under these unfavorable circumstances, the institutional teaching of economics was reconfigured and a six-semester degree program of political science was set up in all law faculties. This provided a combination of the following subjects: economics, economic policy, administration studies, public finance, economic history, statistics, political science, international law, general history and economic geography (§2 StGBL. 49/1919). For the first time women were admitted as fully entitled students (StGBL. 250/1919). The title awarded on completion of the degree program was “Dr. rer. pol.” (Doctor rerum politicarum), which was not, however, recognized as a qualification for academic or legal positions in public administration.

Further paralyzing the Viennese School was the international isolation,

which had developed during the war. This hit a nerve center, since they had always championed universal understanding of science and had cultivated a lively exchange with economists from all over the world. Now, the war had destroyed this extensive network of contacts. Even more far reaching and no less devastating were the effects of the great social changes which occurred during and after the war. Members of the Viennese School were predominantly from the nobility⁷ or from the educated and propertied middle classes⁸, some had only recently been given titles⁹. "Strictly speaking, they were the true losers of the war," originally the "ruling classes of the Habsburg monarchy," who now saw themselves exposed to progressive material impoverishment as well (cf. Bauer 1923, 755f.). There was also the disturbing "experience of social powerlessness in the face of the dominance of the Left" (cf. Bruckmüller 1993, 69), which was clearly expressed, for example, by the crude ban of all aristocratic titles. At the University of Vienna, this "new era" became painfully apparent when von Philippovich's professorship became vacant, and was awarded to Othmar Spann, an outspoken and aggressive antagonist of the School. His collectivist or "universalist" economics appeared to the new ruling powers to be the lesser evil, and so the "obvious" candidates Joseph A. Schumpeter and Ludwig von Mises were simply passed over.

We can assume that many members of the School, looking back, saw their involvement with the centrally planned "war and transitory economy" as an "intellectus sacrificium" and felt they had compromised their own world view. Together with the economic hardship, social upheaval, international isolation and hostilities from right and left, this created a situation which they felt was both depressing and demoralizing. "Absolute desolation" and "complete hopelessness" prevailed, a later historian from the fringe of the Viennese School remembered (cf. Engel-Janosi 1974, 69). Owing to the events of the period, the Viennese School, like the Viennese middle class, seemed to be an "eagle with broken wings" (Heimito von Doderer, cited by Bruckmüller 1993, 69).

⁷ Johann von Komorzynski, Carl Menger von Wolfensgrün, Friedrich von Wieser, Eugen von Böhm-Bawerk, Eugen von Philippovich, Hermann von Schullern zu Schrattenhofen, Ludwig von Mises; at this point in time, Friedrich A. von Hayek and Gottfried von Haberler were just beginning their studies.

⁸ Robert Meyer, Gustav Gross, Viktor Mataja, Robert Zuckerkandl, Herrmann Schwiedland, Richard Schüller

⁹ Julius Landesberger (von Antheim), Ignaz Gruber (von Menningen), Ernst Seidler (von Feuchtenegg)

CHAPTER 16

Between the wars: from re-formation to exodus

After the First World War, Friedrich Wieser, then 70 years old, was considered the doyen of the Viennese School. In fact, he had moved away from several areas of the body of doctrines over the years and had devoted himself to questions of sociology and political science. The second edition of his *Theorie der gesellschaftlichen Wirtschaft* (1924) remained largely unaltered. The new edition of Menger's *Principles* (1923), compiled by his son Karl from his father's legacy, in many ways had also remained the same and thus likewise documented the torpidity which had in the meantime arisen in the School: the term 'marginal utility', which had long since become established, was not mentioned even once, causing some puzzlement (cf. Weiss 1924b, 152f). On the other hand, Menger securely integrated "collective need" in his revised demand theory (cf. Menger 1923, 7-9), which made people consider the new edition a regression compared to the first (cf. Mises 1976 [1960], 5.2.).

Wieser had designated his pupil Hans Mayer as his successor and was able to induce the widely respected legal scholar Hans Kelsen (1881-1973) to support Mayer in a newspaper article (NFP of December 7th, 1922, 7). Mayer was not uncontroversial. He had very few publications to his name, and had received his first untenured professorship in Freiburg without previously obtaining his *Habilitation*. Soon after Mayer's appointment, Carl Grünberg's (1861-1940) chair became vacant; he had moved to Frankfurt demoralized and worn out by the quarrels within the faculty (cf. Mayer 1952, 259). Once again, for different reasons, Mises and Schumpeter were not considered. In 1925, the latter accepted an appointment at the University of Bonn. In 1927, after much quarreling, the Viennese chair went to Ferdinand Degenfeld-Schonburg (1882-1925), whose writings to this day seem surprisingly unsophisticated.

After taking up his professorship in 1919, Othmar Spann had begun to train a growing number of young lecturers. In contrast, the only post-doctoral student whom the Viennese School produced after Mises was Richard Strigl. Expectations were thus very great where Mayer was concerned, and indeed he was able initially to recruit a succession of talented assistants, who would all later become successful, such as Oskar Morgenstern (1902-1977), Paul Rosenstein-Rodan (1902-1985) and Alexander Gerschenkron (1904-1978). However, Mayer was hardly in a position or willing to offer everyone interested in the Viennese School a university post. Owing to jealousies and a patronizing administration during his time as an external private lecturer, Ludwig von Mises felt so obstructed, that he even compared Mayer in this respect to Spann (cf. Mises 2009, 78f.). Spann himself missed no opportunity to publicly proclaim his contempt for the individualism of the Viennese School (cf. Hennecke 2000, 53). For a while, the feud was even fought out in newspapers and culminated in crude anti-Semitic diatribes from Othmar Spann and his circle, in which the theory of marginal utility was labeled as “spawn of Polish-Jewish minds” and Menger and Böhm-Bawerk were called “Jews” in a derogatory tone (cf. Mayer 1952, 250, 252 a. 256). It was therefore by no means a voluntary “decoupling from the university” (cf. Milford/Rosner 1997), but an unwanted marginalization within the university establishment, that forced the scattered remnants of the Viennese School and its new generation to attempt to reconvene outside the universities, in private initiatives, some of which were interlinked: in the *Rockefeller Foundation*, the *Mises-Privatseminar*, Hayek’s *Geistkreis*, the *Nationalökonomische Gesellschaft* and in the *Österreichische Institut für Konjunkturforschung*.

In 1924, the *Rockefeller Foundation* had begun to award scholarships to European social scientists. The person responsible for this was the historian, Karl Francis Pribram (1859-1942), who proved to be fortunate in his choice of students: Oskar Morgenstern, Alexander Mahr (1896-1972), Gottfried Haberler, Paul Rosenstein-Rodan and Ewald Schams (1889-1949) later all established good reputations for themselves. The scholarships funded study visits of one to three years’ duration in the USA, and later on in European countries as well, or else funded research and publication projects (cf. Fleck undated, 2-4).

Without doubt the most important educational center of the Viennese School was the *Mises-Privatseminar* (Mises’ private seminar). Although he was teaching at the University of Vienna, in 1919 Mises had started to gather young social scientists to his office in the Viennese chamber of commerce, at 8-10, Stubenring, every other Friday evening, to discuss “the important problems of economics, social philosophy, sociology, logic, and the epistemology of the sciences of human action.” (cf. Mises 2009, 81-83). The private seminar soon became an established institution. With a few exceptions (Mayer, Weiss and Mahr), all members of the Viennese School came here to meet. The group,

amounting to almost 30 regular participants (ibid., 83), included alongside trained economists also representatives of other disciplines, many of whom had studied two subjects or were exceptionally talented in more than one area. Apart from economists, seminar members later included well-known historians such as Friedrich Engel-Janosi (1893-1978), sociologists such as Alfred Schütz (1899-1959), constitutional law experts such as Eric [Erich] Voegelin (1901-1985) and law philosophers such as Felix Kaufmann (1895-1949). The meetings were held continuously for several years and, alone as a result of the intensive exchange of ideas, had the effect of forming a school of thought. The main topics included monetary theory, methodology and economic policy questions, and there were also regular lectures from visiting foreign speakers (cf. Braun 1981, 112-115). The ingenious Felix Kaufmann came up with a catchphrase for the seminar: “*Das Verstehen verstehen*” (“Understanding understanding”) (cf. Engel-Janosi 1974, 111f).

Another discussion group was started up by Friedrich August Hayek and Herbert Fürth (1899-1995), after Othmar Spann had prohibited the open exchange of ideas in his seminar in the fall of 1921. Only men were permitted to these discussion evenings, which prompted Vienna's first female doctoral student Stefanie Martha Braun, with tongue in cheek, to name it *Geistkreis*. Almost all of the (male) *Mises-Privatseminar* economists were also members of the *Geistkreis*. Furthermore attempts were made to attract outstanding representatives from other faculties. In this way the circle grew from 14 founding members in 1921 to 25 in 1938 (cf. Hennecke 2000, 54).

Members of both circles earned their livings in various ways: there were entrepreneurs (Engel-Janosi, Machlup), bankers (Bloch, Lieser, Herzfeld, Schlesinger, Schütz), managers (Kaufmann), attorneys (Fröhlich, Fürth, Schreier, Winternitz), chamber of commerce employees (Mises, Haberler), civil servants (Schams, Bettelheim-Gabillon), clerks at the chamber of employees (Strigl), a woman journalist (Braun) and staff members of the *Konjunkturforschungsinstitut* (Business Cycle Research Institute) (Hayek, Morgenstern, Mintz, Lovassy, Schiff, Gerschenkron) (cf. Hülsmann 2007a, 463). Through individual members, both groups were also connected with Hans Kelsen's, Moritz Schlick's (1882-1936) and Rudolf Carnap's (1891-1970) circles, and with Karl Menger's *Mathematisches Kolloquium*. This remarkable, intellectually inspiring atmosphere can be sensed in songs about the Viennese School's core issues, which were put into verse by the versatile Felix Kaufmann and sung after seminar sessions to Viennese melodies: “The Last Grenadier of the Marginal Utility School,” “The Mises-Mayer-Debate,” “The Mises Circle's Lament” and others (cf. Kaufmann 1992; Habeler 1981, 124f). After his escape, Mises wistfully recalled this time: “Within this circle Viennese culture experienced one of its last flowerings” (Mises 2009, 81; similarly Braun 1981, 115).

While these circles had started to take up the tradition of the Viennese

School again and to develop it further, Spann and Mayer had been dissipating their energies in a regular running battle which also affected Mises and the students (cf. Mises 2009, 77f.; Craver 1986, 12f). Right from the start, greatest tensions had existed between Spann, who was very active, and Mayer, who in some respects was out of his depth, so that even cursory observers noted that “they hate each other” (cf. Fleck undated, 4). The two of them got themselves into a perennial logjam affecting all the areas in which they worked together: the business of lecturing and examining, the postdoctoral graduation procedures, the *Nationalökonomische Gesellschaft* and the *Zeitschrift für Volkswirtschaft und Sozialpolitik* published by Friedrich von Wieser, Ernst von Plener und Othmar Spann. The delicate balance between the antagonists toppled after Wieser’s death in 1926. After a fierce clash, Spann was expelled from the *Nationalökonomische Gesellschaft*, the society Mises had established as platform for opinion leaders from business, administration, attorneyship and academia (cf. Mises 2009, 82; cf. also Leube 1998, 308f). Subsequently, from 1927 it was no longer possible to publish the *Zeitschrift für Volkswirtschaft und Sozialpolitik*. Yet ultimately, the Viennese School ended up stronger and more united as a result of these controversies (cf. Mayer 1952, 249). Mayer was elected president, Hayek secretary and Machlup bursar of the *Nationalökonomische Gesellschaft* (cf. Müller 2004a, 250) and at the *Österreichisches Institut für Konjunkturforschung*, which was founded at the same time, Mayer also became a member of the board of trustees. The institute soon developed into a key center of the School, as it provided a certain number of positions relevant to the discipline (Hayek, Morgenstern, Schiff, Lovassy, Gerschenkron), opportunities to publicize in the institute’s own book series and also a good network of international contacts.

At the 1928 Zurich convention of the *Verein für Sozialpolitik*, where participants of the *Mises-Seminar* set new standards and received much attention for their contributions on business cycle research, the reconfiguration of the Viennese School, in terms both of content and people, was presented in public for the first time. After that and up until the political upheavals in central Europe, the Viennese School blossomed spectacularly for a number of years. A clear sign of appreciation was set with the unveiling of a memorial to Carl Menger, as part of a grand academic celebration, in the *Arkadenhof* (inner courtyard) of the University of Vienna (cf. Mises, in: NFP of January 29th a. 30th, 1929). In 1928 and 1929, Friedrich A. Hayek, Oskar Morgenstern and Gottfried Haberler received their *Habilitation* and, with their lectures alongside Mayer, Mises and Strigl, for the first time in many years acted as a quantitative counterbalance to Spann and his circle of students (cf. Vorlesungsverzeichnis [course catalog] 1929/30, 12). Nevertheless, personal and content-related differences, in particular between Mises and Mayer, caused some irritation. Thus of all people, it was those in Mayer’s circle who questioned the foundations of

the “Austrian monetary business cycle theory” (cf. Weber 1966, 2).

The year 1930 saw the republication of the School’s traditional journal under the new name of *Zeitschrift für Nationalökonomie* (ZfN). In the hands of its publishers Hans Mayer, Richard Reisch, and Richard Schüller and editors Paul Rosenstein-Rodan and Oskar Morgenstern it set new standards: the first volume encompassed a good 800 pages with a total of 43 essays and shorter contributions, plus 83 collective and individual reviews of altogether 59 national and international authors. A non-German speaking readership was expressly targeted with abstracts in English and French of every essay.

During these years the Viennese School intensified its contacts with foreign economists, who were recurrently invited to lectures or events, particularly to those at the *Mises-Privatseminar* or at the *Nationalökonomische Gesellschaft* (cf. Mayer 1952, 251 a. Hülsmann 2007a, 674f). One outcome of these new contacts was the invitation of Hayek to the *London School of Economics* in 1931, which ultimately led to his being appointed to one of its professorships (cf. Hennecke 2000, 74). One high point of the international cooperation was the four volume anthology *Die Wirtschaftstheorie der Gegenwart* (Mayer 1927-1932), edited by Hans Mayer, Richard Reisch and Frank A. Fetter, which on more than 1,400 pages combined a total of 81 authors from 18 countries. It was only in the course of this intensive intellectual exchange that it became really apparent to the advocates of the Viennese School that in some crucial points they diverged decidedly from the marginalist mainstream, in particular from the mathematically oriented *Lausanne School* (cf. Bayer 1929, 499f.). Rosenstein-Rodan (1930) and Schams (1932), for example, pointed out that time is an important factor for the Viennese School, while the *Lausanne School*’s approach is basically static. Hans Mayer revealed further fundamental differences. In his academically most significant essay, he criticized the unrealistic nature of some of the assumptions of the *Lausanne School*. Thus, the utility of a good can neither be measured, nor infinitely divided nor indefinitely substituted. Also, the variable relationships between the economic factors are not readily “reversible,” because effects of quantitative changes in income on the variables of mathematical economic models are not proportional but unpredictable and disproportional. Mayer then compared he “functional,” “mechanical” price theory of the *Lausanne School* to the “causal-genetic” price theory, which did not display the cited shortcomings (Mayer 1932).

It is somewhat tragic that on the very eve of the seizure of power by the National Socialists, the general recognition the Viennese School enjoyed in Germany seemed to be greater than ever before. In 1931 Hans Mayer was able to take up a guest professorship for two semesters at the University of Kiel (cf. Mayer 1952, 254). And, with the tenaciousness typical of him, Ludwig von Mises had succeeded in placing the problem of value as one of the main subjects onto the agenda of the convention of the *Verein für Sozialpolitik*

in Dresden (1932) (cf. Mises 2009, 85). Though the most acrimonious adversaries of the subjectivist theory of value ultimately did not take part in the verbal discussion, the convention resulted in a marked gain in reputation for the teachings from Austria (cf. Mises/Spiethoff 1931/33).

The international presence and networking of the School encouraged the translation of further standard works into English, for example Wieser's *Theorie der gesellschaftlichen Wirtschaft* (1927, as *Social Economics*), Hayek's *Geldtheorie und Konjunkturtheorie* (1933, as *Monetary Theory and the Trade Cycle*) or the *Theorie des Geldes und der Umlaufmittel* (1934, as *The Theory of Money and Credit*) and *Die Gemeinwirtschaft* (1936, as *Socialism: An Economic and Social Analysis*) by Mises. Moreover, the many foreign scholarships had led to the first foreign language primary editions, like Hayek's *Prices and Production* (1932) or the biographical study *Carl Menger* (1934). Some of these publications were not, or only much later, translated into German, such as Rosenstein-Rodan's *La Complementarità* (1933) or Haberler's *Prosperity and Depression* (1937; German only in 1945). This reflects clearly the gradual disengagement of the Viennese School from its German language and Austrian intellectual and cultural tradition. Full of misgivings, Mises wrote to his student and friend Machlup in 1934, that as a consequence of "Hitlerism," the German language would lose its prominence and English would become the future language of economics (cf. Hülsmann 2007a, 694f).

By the early 1930s personal and academic connections with the English speaking world were already stepping stones to professional careers outside the country. Hayek and Rosenstein-Rodan received appointments in London in the same year (1931), Haberler accepted an invitation to *Harvard University* (1931), then switched to the *League of Nations* in Geneva (1934) and later returned to Harvard again. Indeed, the home environment contributed in no small part to the younger generation trying to make their fortune elsewhere. The smug to hostile treatment of intellectual elites at that time has aptly been described as "embezzlement" (Müller 2004, 238). The politically unstable situation, the establishment of a corporative state and the noticeable receptiveness for the social theories of Spann were accompanied by an increasingly aggressive repudiation of everything "liberal" or "individual" or what was thought of as such. For this purpose, Spann came up with the derogatory catchphrase "neoliberal" ("neo-liberal") (cf. Spann 1931, 658). When the advocates of the Viennese School, faced with censorship, finally gave up their attempt to influence public opinion, their retreat was the first step towards "inner emigration" (cf. Klausinger 2006a, 12).

Furthermore, increasingly more apparent anti-Semitism made some members of the School exiles in their own country. Thus Fritz Machlup, for example, was told at the University of Vienna that his application for *Habilitation* would not be facilitated due to anti-Semitic reservations (cf. Craver 1986,

23f). How serious and hopeless the situation had in the meantime become, was shown by Mises' relocation to Geneva, where he was able at least to obtain a very well paid teaching post (cf. Hülsmann 2007a, 693). After that the Viennese *Privatseminar* finally ceased to exist. In a letter to Machlup one year later, Hayek summed up a visit to Vienna, which he had just made, commenting that he had found the city comparatively unchanged, but that the intellectual atmosphere, in particular in the field of economics, had visibly declined (cf. Hennecke 2000, 126).

After the exodus of Mises, Hayek, Haberler, Machlup and Rosenstein-Rodan, the director of the *Institut für Konjunkturforschung*, Oskar Morgenstern, was nominated the most important representative of the School in Austria. Morgenstern carried out policy changes in two ways. Firstly, both the institute and the *Zeitschrift für Nationalökonomie* were opened up to mathematical economists. Between 1935 and 1937, five important essays were written, in close contact with the *Mathematisches Kolloquium* of the young Menger, by Karl Schlesinger, Abraham Wald (1902-1950) and Johann von Neumann (1903-1957), preparing the ground for the neoclassical theory of equilibrium (cf. Müller 2004a, 251). Secondly, Morgenstern attempted, with only modest success, to establish himself as advisor of the corporative regime, until he had no choice but to realize that the structure of the corporative state was inevitably based on lobbyism (cf. Klausinger 2006b, 25-30). Thus, the geographical distance of the Viennese School members who had emigrated was accompanied by a content-related and personal estrangement.

The annexation ("Anschluss") of Austria by Nazi Germany in March 1938 abruptly ended the beginnings of mathematically oriented economics rooted in the Viennese School. The Jewish Hungarian Karl Schlesinger, a long-time patron of the Viennese School and himself a qualified economist oriented towards mathematics, was one of the first victims: On the day of the invasion, he committed suicide. In the following days, his dismal assessment of the situation proved well-founded for most of the other remaining members of the school: Helene Lieser and Herbert Fürth were imprisoned for a short time, Erich Schiff was taken into custody and forced to clean toilets, Erich Voegelin had to endure a house search (cf. Hennecke 2000, 127). In the universities, all lecturers and professors who were either Jewish or otherwise disliked by the Nazis lost their license to teach, among them Schüller, Haberler and Morgenstern, and also Wilhelm Winkler, a statistics professor sympathetic to the School. Hans Bayer, who originated from the Viennese School and who sympathized with it, was suspended from duty by the University of Innsbruck (cf. Maislinger 1984, 418). At the time of the annexation, Morgenstern was abroad and he did not return. In Austria he was then replaced as director of the institute by his deputy, Richard Kamitz (1907-1993), who later became finance minister. Meanwhile, as president of the *Nationalökonomische*

Gesellschaft, Hans Mayer had implemented the “*Arierparagraph*” and excluded all Jews from the society. (Müller 2004a, 267f).

During the next few weeks most members of the Viennese School left the country, some of them in dangerous circumstances: Erich Voegelin, Felix Kaufmann, Alfred Schütz, Viktor Bloch, Marianne von Herzfeld, Helene Lieser, Erich Schiff, Gertrud Lovassy, Alexander Gerschenkron, Ilse Mintz-Schüller and her father Richard Schüller and also Martha Steffy Braun. Among those who stayed was Ludwig Bettelheim-Gabillon, who later died in a concentration camp. Leo Illy (Schönfeld) and Richard Strigl retreated into “inner emigration”. With his paper about “Wicksells Process” (“Der Wicksellsche Prozess”), Strigl made one more unequivocal stand against the predominant belief in an endless political possibility of shaping economic conditions (Strigl 1942) before he died in 1942 of a brain tumor. Hans Mayer, Alexander Mahr and Ewald Schams remained in Austria and tried to adjust to the new circumstances. All the same, only a considerably reduced *Zeitschrift für Nationalökonomie* could be maintained and even so was only published sporadically. Soon after the annexation, Nazi students defiled the Carl Menger memorial, which in 1929 had been unveiled on the inner courtyard of the university, and was subsequently removed by the university administration.

After the war, when Mayer and Mahr resumed their lectures at the University of Vienna, and Schams did the same, with some difficulty, at the *Technische Hochschule*, they did not even come close to reconnecting with the 70 year old tradition of the Viennese School, which therefore soon fell into oblivion. In an “adverse balance of emigration,” such was the essay title of Karl H. Müller (“Verlustbilanz der Emigration”, 2004), the Viennese School would appear only on a symbolic “commemorative Euro”. The essential parts of such a balance sheet, however, are its hidden assets, lying dormant.

CHAPTER 17

Ludwig von Mises: the logician of freedom

In his wife's published memoirs there is a photo showing Ludwig von Mises¹ taking a stroll through the "Prater" in Vienna (Margit v. Mises 1984 [1976], 115). It is August 1901. You can see a slim young man of medium height in imperial uniform. He is carrying an impressive sword, wearing a helmet richly adorned with gold braid and emblems, high boots, riding breeches and a close-fitting jacket, buttoned up right to the top. His lips, which are adorned by a small moustache, form a mischievous smile. Mises was only just twenty years old. Looking at later photos you have the impression that he found it increasingly more difficult to keep smiling. His face displays a melancholy, introverted expression, something austere and, at the same time, sensitive. It shows a man who seems unrelenting yet also vulnerable. For a long time, maybe too long, he lived with his mother (*ibid.*, 17f.). Only at the age of 57, shortly after his mother had died, did he venture into a late marriage with his long-standing friend Margit Sereny-Herzfeld, whom hardly anyone had known about for more than a decade. They married in Geneva. The witnesses were Gottfried von Haberler and Hans Kelsen, a former school associate who could hardly believe he was seeing his friend in front of the marriage registrar (*ibid.*, 33).

Margit von Mises, who had two children from a previous marriage, describes her "Lu" as in need of love, tender and modest, withdrawn and dejected but sometimes also as irascible and quick-tempered (*ibid.*, 36). She neglected her own professional ambitions (she was an actress, dancer and translator) in order to look after her husband and enable him to work undisturbed

¹ Regarding the biography, see in particular Hülsmann 2007a, Rothbard 1999a und Mises 2009.

and in comfort. The household remained compact and modest, but this did not impinge negatively on the affectionate way in which they got on with one another. The scholar had found his muse, and she him. She let him work as much as he wanted. Usually they went on lecture trips together, spent their vacations in the mountains and in their old age remained devoted to each other. Only once did his wife have to be firm with him and forbade him to drive a car ever again, after an act of carelessness at the wheel had caused injuries to her face and broken five of his ribs (ibid. 96f).

Ludwig von Mises, whose great-great-grandfather had received a knighthood from Emperor Franz Joseph, came from a family of assimilated Jews and was born in Lemberg, Galicia, in 1881. A few years after his birth, his father took over a senior position in the railway ministry in Vienna. At the age of ten, Ludwig witnessed how one of his two younger brothers died after a serious illness. The relationship with his brother Richard, who later became a famous mathematician, remained strained all his life. Ludwig attended the *Akademisches Gymnasium*, studied law and in 1909, then after a short time as a project supervisor in the civil service, began his career at the Viennese Chamber of Commerce. As an ordinary civil servant of the chamber administration, which he would remain—later confirmed, so that it was impossible for him to be dismissed under Austrian civil service law—for the next 35 years, he effectively became one of the leading economists of the country. In his role of economic advisor he came into regular contact with members of government, for example Otto Bauer, the leader of the social democrats, whom in the winter of 1918/19 he was able to convince, in discussions lasting many nights, to thwart a “Bolshevist experiment” in Vienna (Mises 2009, 14f). During this time, he met and became friends with Max Weber (1844–1919), who had begun to teach at the University of Vienna after the war, but who soon afterwards unexpectedly died.

Even as a young man, influenced by Carl Menger and Eugen von Böhm-Bawerk, Ludwig von Mises devoted himself to the ideas of the Viennese School and as early as 1912 he was able to achieve his *Habilitation* with his *Theorie des Geldes und der Umlaufsmittel* (*The Theory of Money and Credit*). The wide-reaching economic subjects which he subsequently dealt with “were mostly problems for which he considered the prevailing opinion false” (Hayek, in: Mises 2009, XVI). Mises did little to conceal the fact that he felt nothing but contempt for quite a few of his fellow economists. His opinions, in particular those concerning German tenured professors, were severe and ruthless. In social democratic post-war Austria he only managed to gain a post as an unsalaried lecturer. The new ruling powers resented him bitterly for his emphatic opposition to all forms of collectivist ideology.

In 1927, together with his fellow campaigner Friedrich August Hayek, and with the support of his employer, Mises succeeded in founding the indepen-

dent *Österreichisches Institut für Konjunkturforschung*, the precursor of today's *Österreichisches Institut für Wirtschaftsforschung* (Wifo). His private seminar, which he held fortnightly in the Viennese Chamber of Commerce and from which, between 1921 and 1934, the next generation of the Austrian School would emerge, helped to re-establish the Viennese School after the First World War. Apart from Hayek, Gottfried Haberler, Felix Kaufmann, Fritz Machlup, Oskar Morgenstern, Paul N. Rosenstein-Rodan, Alfred Schütz, Richard Strigl and Eric [Erich] Voegelin, among other economists, constitution lawyers and sociologists, emerged from these seminars (Mises 2009, 83). His students valued Mises as a thoughtful and inspiring teacher. After these fortnightly sessions, they used to meet regularly in a nearby bar, where the discussions continued. Even though he was undoubtedly marginalized academically, Mises regarded himself as the “economist of the land” (*ibid.*, 60).

In the spring of 1934, after the Nazis had gained power in Germany, Mises accepted the offer of a guest professorship in Geneva. As a civil servant of the Viennese Chamber of Commerce, he took advantage of the possibility of an early retirement, but until 1938 remained in contact with his employer, under whose mandate he advised the Austrian government and central bank. On the evening of the annexation, Nazis broke into his flat and seized his library and papers. His writings were a thorn in the side of all manner of collectivists: the socialists, communists, national socialists, fascists and later also the advocates of the so-called welfare economy in Europe and the US. He was never to see his library, his notes or his manuscripts again.

Apart from his teaching, Mises dedicated himself in Geneva in particular to the completion of his magnum opus, *Nationalökonomie. Theorie des Handelns und Wirtschaftens* (1940). However, as a result of the confusion caused by war and the bankruptcy of his Swiss publisher, it remained largely unnoticed. In the same year, he fled with his wife on hazardous routes from Geneva via France—the NS-henchmen on their tails—to Spain, Portugal and finally to New York. In the USA, Mises, now almost sixty years old, had to make do with savings and small scholarships. However, it was the international political events and not least being forced to leave his home country which were particularly difficult for him to stomach. The couple had to move home several times within a short period. Also, the fact that he had learnt English only by reading it, created some problems initially. He considered it a great fortune when after a few years he was offered US citizenship and accepted it gratefully. In 1945 he obtained a post as visiting professor at *New York University*, where he was able, until 1969, to school further “Austrians” such as Murray N. Rothbard (1926-1995) and Israel Kirzner (b. 1930).

In New York Ludwig von Mises soon resumed the task of publishing his work. *Omnipotent Government* (1944), *Bureaucracy* (1944) and *Planned Chaos* (1947) appeared in quick succession. *Human Action* (1949), the revised En-

glish edition of his magnum opus *Nationalökonomie* (1940), gradually brought him the success he longed for. In these, as also in earlier and later works, for example *The Anti-Capitalistic Mentality* (1956) and *Theory and History* (1957), Mises always proved to be an astute observer and a thinker who always remained true to his principles. He anticipated some developments as logically foreseeable consequences, long before they actually happened, for example the world depression at the end of the 1920s and the economic failure of fascism, of national socialism and in particular of Soviet communism. Because of his radical liberal stance, he rejected state intervention in the economic process and throughout his life wrote emphatically against the statist's claims. He explicitly distanced himself, however, from anarchism. Nevertheless, the effect of his ideas over time was that libertarian and anarcho-capitalist movements in the USA chose Ludwig von Mises, the project-managing Austrian civil servant, as one of their forefathers.

His opponents, who were always in the majority, rated Mises as obstinate, intolerant and extremist. His students emphasized the intellectual openness and broad-mindedness which prevailed in his private seminar. He always remained convinced that his theses reflected the truth and that his work was meaningful, although it brought him neither wealth nor academic glory in his lifetime. His work exhibits a rare clarity and directness and remains true independent of political circumstances and current fashions. Only at the age of 87 did he retire from teaching at the university; he died a few years later in 1973, at the age of 92, in New York. He claimed he had—very atypically for an Austrian—attempted the impossible: “I fought because there was nothing else I could do.” (Mises 2009, 76). All his life he remained loyal to the motto he had chosen early on: “*Tu ne cede malis, sed contra audentior ito!*” (“Do not give in to evil but proceed ever more boldly against it!”, Vergil, Aeneid, 6,95).

CHAPTER 18

Friedrich August von Hayek: Grand seigneur on the fence^{*}

Owing to his commercial successes, Friedrich August's great-great-grandfather Josef Hayek was knighted by Emperor Josef II in 1789, a few weeks before the French Revolution, after he had risen to estate administrator and had founded two textile factories near Brünn and Vienna. During the course of the 19th century, the family fortune was largely lost again, but, in return, the family brought forth a high school principal, an ornithologist, a botanist, a chemist, a beetle specialist and three physicians. In his free time, Friedrich August's father, who also worked as a physician, published standard works on Austria's botanical geography, which led to his being offered an unsalaried lecture post at the University of Vienna. His mother, Felicitas, whose kinship to the Wittgensteins and whose friendship with the imperial-royal finance minister, Eugen von Böhm-Bawerk, significantly contributed to the social status of the family, raised three more academics: the two younger sons, Erich and Heinrich, started careers as chemist and anatomist respectively; Friedrich August, born on May 8th, 1899, was even to make his family's name known worldwide (cf. Hennecke 2000, 27-29).

Already early on, the young Fritz accompanied his father on botanical expeditions into the region surrounding Vienna, in the course of which he received his first training in scientific methodology as photographic assistant. Through his family he became acquainted with the future Nobel Prize winners Erwin Schrödinger (1887-1961), Karl von Frisch (1886-1982) and Konrad Lorenz (1903-1982) – who even as a child was fascinated by geese –, who were to become valued dialog partners for him. His parents didn't consider

^{*}Regarding the biography see Caldwell 2004, Hennecke 2000 and Klein 1999.

religious education important, though they took him to the *Burgtheater*, where he became acquainted with the works of the great playwrights.

During Hayek's time at junior high school, he displayed "the typical signs of gifted students who are not being sufficiently challenged," attracting the teachers' attention, usually in a negative way, due to his "intelligence, laziness, lack of concentration and interest". At the same time he was reading Aristotle and, particularly in religious education lessons, read socialist pamphlets under his desk (*ibid.*, 30f). After graduating from the *Elisabethgymnasium* high school, and serving as an officer in the First World War, he enrolled to study law at the University of Vienna. In fact for most of his time here he was concerned with economics, psychology, philosophy of science and philosophy. Hayek read works by Menger and Böhm-Bawerk, began to make contact with the Austrian School and also got to know some members of the *Wiener Kreis*. Insufficient opportunities for the training and employment of psychologists finally made him decide to deepen his knowledge of economics, as part of his political science studies, particularly under his later doctoral advisor Friedrich von Wieser. The latter also supervised his *Habilitation* in political economy in 1929.

After receiving his law doctorate in 1921 Hayek founded the so-called *Geistkreis*, a private discussion group with Joseph Herbert Fürth, an old friend from his youth and time at university; Gottfried Haberler, Fritz Machlup, Felix Kaufmann, Oskar Morgenstern, Eric Voegelin and Alfred Schütz, among others, belonged to its inner circle. Like many of his generation, who returned from the battlefields of the First World War, Hayek sympathized with socialist ideas, but he was quickly otherwise persuaded by reading *Die Gemeinschaft* (1922) (*Socialism*) by Ludwig von Mises, which contained the proof that economic calculation was impossible in a socialist community. Hayek subsequently took up a professional position in the newly formed "Abrechnungsamt", an institution created to process reparation payments and to deal with the consequences of war, and in which Mises was one of his superiors. In 1923 Hayek finished a second doctoral thesis in political science, and then spent a year studying in the USA.

Quite early on Mises recognized Hayek's talent, invited him to his private seminar and with him established the *Österreichisches Institut für Konjunkturforschung*, where Hayek was able to perform "difficult pioneering work at the economic grass roots" (*ibid.*, 77). His scholarly contributions, which gradually brought him international recognition, led to *Geldtheorie und Konjunkturtheorie* (1929) (*Monetary Theory and the Trade Cycle*), a treatise which was eventually to become his *Habilitation* paper and which enabled him to take up a post as unsalaried lecturer at the University of Vienna.

In 1931 at the invitation of Lionel Robbins (1898-1984), Hayek received the chance of delivering a guest lecture at the *London School of Economics*, and

the impression it made was so good that he was promptly offered a tenured professorship. Every Thursday evening he held a seminar which was attended by prominent economists such as John Hicks (1904-1989) and Abba P. Lerner (1903-1982), but also representatives of the Viennese School such as Gottfried Haberler, Fritz Machlup and Paul Rosenstein-Rodan. Very soon Hayek, in addition to Ludwig Wittgenstein (1889-1951), the art historian Ernst Gombrich (1909-2001) and Karl Popper (1902-1994), who also attended Hayek's seminar, were enriching London's cosmopolitan community of scholars.

However, at the end of the 1930s, as he gradually became the main opponent of John Maynard Keynes (1883-1946), Hayek was more and more academically isolated. As he had spoken out, during the nadir of the Great Depression, against the policy of expansive state employment and had warned against its inflationary consequences, his recommendations hardly offered much scope politicians keen to implement policies. Keynes' suggestions, which pressed for further government intervention, on the other hand, were gladly taken up by politicians and within a short time became the guidelines for economic policy decisions. Hayek, who considered himself an Englishman at heart, and who admired Scottish Enlightenment philosophy and the English legal system, was awarded British citizenship in 1938.

"If one cannot fight against the Nazis, one ought to at least fight the ideas which produce Nazism," Hayek wrote in a letter to Fritz Machlup in 1941 (cf. Hennecke 2000, 175) after which he began preliminary work on *The Road to Serfdom*, a stern analysis of the German and Soviet varieties of socialism, but which also described democratic socialism as an insidious path to servitude. The book, which was published during the Second World War in 1944, was a resounding publishing success and made Hayek famous worldwide. In April 1945, an abridged version appeared in *The Reader's Digest*, which reached more than 600,000 readers. It was followed in 1950 by a comic strip version in *Look Magazine*. This popularized warning against the threatening totalitarian collectivism after the war –by keeping the planned war economy in peace time and the dynamics that were to be expected from any centrally planned economy—fell on fertile ground. The opponents of socialism found herein plenty of intellectual ammunition.

However, since during the Cold War Hayek's ideas were politically appropriated and put into the same category as other non-socialist schools of thought and movements, his reputation as a social scientist was soon ruined. In 1947, he nonetheless managed to gather 39 non-collectivist thinkers from all over the world in Vevey, on the shores of Lake Geneva—among them Wilhelm Röpke (1899-1966), Walter Eucken (1891-1950), Ludwig Erhard (1897-1977), Milton Friedman (1912-2006), Henry Hazlitt (1894-1983), Karl Popper, Fritz Machlup, Lionel Robbins (1898-1984) and also Ludwig von Mises—with the aim of discussing the future of liberalism on a broad basis. The Mont Pèlerin

Society, which was then founded, a kind of liberal Internationale, serves to this day as a platform for advocates of a free market economy.

After the war Hayek married his cousin Helene Warhanek, with whom he had maintained a close relationship for a long time. The matter was further hampered by the fact that, in order to get married, both had first to file for divorce. Hayek's first wife put up some strong resistance and Helene Warhanek's husband died shortly before their appointed date of divorce (cf., Hennecke 2000, 225). After a worrying time, the couple moved in 1950 to the *University of Chicago*, where Hayek took up a tenured professorship for "Moral and Social Sciences". This suited him very well, as he was able to organize all manner of different events and maintain contacts beyond the scope of his original subject matter.

In the following two decades Hayek then managed to publish those works which would secure his lasting importance as a theoretician of a liberal society: *Individualism and Economic Order* (1948), *The Sensory Order* (1952) and his magnum opus *The Constitution of Liberty* (1960). In 1962, he returned to Europe and took over Walter Eucken's chair for applied economics at the University of Freiburg. The ideas of social philosophy generated during that time were impressively presented in his *Freiburger Studien* (1969). After becoming an emeritus professor, Hayek took up a guest professorship at the University of Salzburg, although this was a move he soon regretted due to the intellectual climate in the country and petty bureaucratic quarrels. After a heart attack he returned to Freiburg, wrote the three-volume work of his later years, *Law, Legislation, and Liberty* (1973/76/79), *Denationalisation of Money* (1977) and, finally, *The Fatal Conceit. The Errors of Socialism* (1988), which compiled and reproduced for the last time the essence of his thinking. In 1992, he died at the age of 93 in Freiburg and was buried in Vienna.

In 1974, a year after Mises had died, Friedrich August von Hayek was awarded the *Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel* for his work on the theory of the business cycle; oddly enough he had to share it with the Swedish social democrat Gunnar Myrdal (1898-1987). However, the scope of Hayek's work went far beyond pure economics. Consequently, in expert circles he was considered not just an economist, but also a philosopher of law, an ethicist, a social theoretician, a historian of ideas, a legal expert, a theoretician of science, a systems theoretician and a theoretical psychologist. "It's much more the case with social sciences than with natural sciences," wrote Hayek in his *Freiburger Studien*, "that a particular problem cannot be solved by just one of the specialist subjects." Not just political science and law, but also ethnology and psychology and of course history are subjects which an economist should be much more familiar with than is possible for one human being. In particular, though, the problems of economists overlap time and again with those of philosophy. It is certainly no coincidence that

in the country that for such a long time was leading in economics, namely in England, almost all great economists were philosophers too and, at least in the past, all great philosophers were significant economists as well” (Hayek 1969a, 16).

CHAPTER 19

Other members of the younger Viennese School

In this chapter, the other members of the young Viennese School who achieved their *Habilitation* will be introduced. The order is determined by the year of their respective *Habilitation*. In addition, further students whose work was published are presented in summarized form. The account will concentrate on the time up to 1938, which marks the end of the School in Austria.

Richard Reisch (1866-1938)¹

Reisch studied law in Vienna and Innsbruck and after his PhD in 1889 went into finance administration. In 1910 he was promoted to head of department. Later he became director of the *Boden-Credit-Anstalt* and subsequently acted as undersecretary of the *Staatsamt für Finanzen* (1919-20) and as president of the *Österreichische Nationalbank* (1922-32). In the course of his work he was able to distinguish himself as a resolute advocate of rigorously balancing the budget. In 1906, Reisch received his *Habilitation* in finance law and until 1928 taught accountancy at the University of Vienna. In addition, he was co-publisher of the compilation edition *Wirtschaftstheorie der Gegenwart* (1927-1932) and of the *Zeitschrift für Nationalökonomie* (1930-1937). He himself published several articles on questions to do with payment transactions and monetary policy.

Hans Mayer (1879-1955)²

¹ Regarding the biography see ÖBL 1988, Vol. 9, 55f and DBE 1988, Vol. 8, 229.

² Regarding the biography see UA-Personalblatt Hans Mayer; Winkler 1949; Mahr 1956; Mises 2009, 77-83; DBE 1998, Vol. 7, 7.

Born and raised in Vienna, Mayer received his PhD in law in 1907 and until 1911 (interrupted by a year of studying in Heidelberg) worked in the Austrian finance administration. Mayer never achieved his *Habilitation*. His personnel file contains a short entry regarding this: "Prior to completing *Habilitation* at the university, due to unpublished manuscripts (theory of price formation), appointed untenured professor at the University of Freiburg" (cf. UA Wien, Personalblatt Mayer). After leaving Freiburg, he went in 1914 to the *Deutsche Technische Hochschule* in Prague. When the war was over he worked as director of the financial planning section in the Austrian army administration in Vienna. In 1921 he took up a position as professor in Graz and in 1923 was appointed successor of Friedrich von Wieser in Vienna.

Mayer was constantly involved in trench warfare with his opponent Othmar Spann and his relationship with Mises was also strained. Despite the small number of academic contributions—Mayer wrote hardly more than a handful of essays and some articles in the fourth edition of the *Handwörterbuch der Staatswissenschaften* ("Concise Dictionary of Political Science")—he was made dean of the faculty in 1927/28 and received offers from Frankfurt (1927), Bonn (1932) and Kiel (1933). Just middle-aged, he had already moved into the highest pay bracket (*ibid*).

Friedrich Wieser had used every opportunity to foster Hans Mayer. He was an influential mentor and developed a kind of father-son relationship with Mayer. After Wieser's death, Mayer moved into the house which Wieser had left to him, in the 19th Viennese "Gemeindebezirk" (cf. Lehmann vol. 1924, I, 1468 and vol. 1937, I, 812). However, the tall, slim, good-looking, strawberry blonde beau (cf. Winkler 1949, 39) was unable to fulfill academic expectations. He remained a maverick, noticeably keeping his distance from most of the other members of the Viennese School.

By and large judgments about Mayer are unfavorable and not free of personal resentments (cf. Craver 1986, 7-9, Mises 2009, 77-83). From the émigrés' point of view Mayer's career represented the dark side of the country they had been forced to leave: his favoritism, his cautious commitment, his smug complacency and his blatant opportunism, which made it possible for him to get away with swearing an oath of loyalty to a total of five different regimes.

Richard von Strigl (1891-1942)³

Richard von Strigl, who came from a Bohemian family with a tradition of working in the civil service, obtained his law doctorate in 1914 in Vienna. In the course of his professional work in ancillary institutions of the *Arbeiterkammer* (Chamber of Workers), he was able to achieve his *Habilitation* in 1922 with a methodological paper, which appeared in an expanded edition as

³ There is scant biographical data: see UA-Wien Personalblatt Richard von Strigl, Hayek 1944 and Klein 1992, 168-171.

Die ökonomischen Kategorien und die Organisation der Wirtschaft (1923). Apart from lecturing at the University of Vienna, he also taught at the *Hochschule für Welthandel* (College for World Trade).

As a long-term participant in the *Mises-Seminar* and as one of the few students of the Viennese School who had achieved their *Habilitation*, Strigl was held in both high personal and professional esteem in the post-war years (cf. Hayek 1968a [1944], 284). In *Kapital und Produktion* (1934) he refined the Austrian money and business cycle theory, which described how changes in the value of money inevitably lead to false allocations. Like all his writings, his textbook, *Einführung in die Grundlagen der Nationalökonomie* (1937), is characterized by its factual, clear and intelligible style. Educated in the classics, cultivated and originating from a family with liberal traditions, Strigl remained in the country after the annexation and died in 1942 of a brain tumor.

Franz Xaver Weiss (1885-?)⁴

In 1909, the native-born Viennese with Jewish roots completed a doctoral degree in law in his home town. After writing an article entitled *Die moderne Tendenz in der Lehre vom Geldwert* (1910) ("Modern Trends in the Teaching of the Value of Money") he started working in the *Wiener Kaufmannschaft* (Viennese Merchants' Society), and in his spare time worked on Böhm-Bawerk's theory of interest. Weiss wrote some articles for the third edition of the *Handwörterbuch der Staatswissenschaften*, from 1921 until 1925 he was editor of the *Zeitschrift für Volkswirtschaft und Sozialpolitik* and published shorter writings of Böhm-Bawerk, whom he admired (1924, 1926). In his *Habilitation*, he renewed and expanded the critique of David Ricardo (Weiss 1925), which led to his being offered an appointment at the *Deutsche Technische Hochschule* in Prague; in addition, he also lectured at the *Deutsche Universität Prag* (cf. Lüdtke 1931, 376). In the 1920s and 30s, he published several papers about the theory of value, ground rent (Weiss 1928) and the problem of value (Mises/Spiethoff, Vol. 2, 1933, 45-57, 91, 127-131). Weiss disputed the view held by Mises, that liberalism and the subjectivist theory of value naturally belonged together (cf. *ibid.*, 51-54, 131f.). It is impossible to determine the year of his death, but he is said to have survived Nazi rule in Bohemia by going underground (cf. Wlaschek 2003, 204).

Alexander Mahr (1896 -1972)⁵

From Poppitz near Znaim in today's Moravia, Mahr graduated in 1921 from Vienna with a PhD in German, Scandinavian studies and history, and took an additional doctoral degree, becoming a Dr. rer. pol. in 1925. Subsequently, he received a scholarship from the *Rockefeller Foundation* and was able

⁴ There is very little biographical data, see UA-Wien Personalblatt Franz Xaver Weiss.

⁵ Regarding the biography, see DBE 1997, Vol. 6, 569 and Weber 1973.

to achieve his *Habilitation* shortly after his return in 1930. However, as a student of Mayer, who had been critical of Böhm-Bawerk, Mises and Hayek in his early work on price, interest and monetary theory and also foreign exchange policy, Mahr remained an outsider. He was one of the few representatives of the Viennese School who participated neither in the *Mises-Privatseminar* nor in the *Geistkreis*. After 1938, Mahr remained in Austria and worked in the central office for statistics until he took over Mayer's chair here in 1950. After the war, Mahr attempted, as a "genuine advocate of the fundamental ideas of the Austrian or Viennese School" (Weber 1966, 3), to come to a compromise with mathematical economics and the Keynesian paradigm (cf. Mahr 1949 and 1959).

Oskar Morgenstern (1902-1977)⁶

Originating from Görlitz in Saxony, Morgenstern studied political science in Vienna, where already as a student he became Mayer's assistant and took his doctoral degree in 1925. After several years of studying abroad, he worked with Hayek in the *Österreichische Institut für Konjunkturforschung* and two years later became his successor. With *Wirtschaftsprognose: Eine Untersuchung ihrer Voraussetzungen und Möglichkeiten* ("Economic Forecasting: a Study of its Prerequisites and Possibilities") he was able to achieve his *Habilitation* in 1929 and lectured in Vienna up until 1938.

By virtue of his intellectual brilliance and his remarkable energy, Morgenstern soon belonged to the inner circle of the Viennese School. As university lecturer, director of the *Institut für Konjunkturforschung*, editor of the *Zeitschrift für Nationalökonomie*, board member of the *Nationalökonomische Gesellschaft*, advisor to the *Österreichische Nationalbank* and the ministry of trade, participant at the *Mises-Privatseminar* and initiator and author of regular columns on economic policy, he was active in almost every field.

Morgenstern distanced himself from Mises, when the latter began, from 1933 onward, to openly advocate apriorism. His turning toward mathematics further deepened the rift separating him from Mises. Probably the only reason it never escalated was that Mises soon moved to Geneva. In the course of the annexation of Austria by Nazi-Germany in 1938, Morgenstern was removed from office as director of the Institute and had his teaching license removed. He subsequently emigrated to the USA, settled in *Princeton University* and, together with the mathematician John von Neumann (1903-1957), published the ground breaking *Theory of Games and Economic Behaviour* (1944). Soon, Morgenstern ranked among the American elite of social scientists and worked for renowned think tanks, the Atomic Energy Commission and the White House. By helping to found the *Institut für Höhere Studien (IHS)* in Vienna

⁶ See Hagemann 1997, Leonard 2007 [2004] and Palgrave Vol. 3.

and by holding a scientific advisory office, he remained attached to the country of his origin until his death.

Gottfried Haberler (1900-1995)⁷

The descendant of a minor aristocratic family of civil servants (von Haberler) from Purkersdorf near Vienna, Haberler gained his doctorates in law and political science (1923 and 1925 respectively), worked subsequently in the chamber of commerce and in 1927/28 graduated from postdoctoral studies in London and Harvard. After his return he was able to achieve his *Habilitation* with *Der Sinn der Indexzahlen* ("The Object of Index Numbers") (1927). In addition to his lectures at the University of Vienna, some of which were held jointly with Hayek and Morgenstern, he regularly participated in the *Mises-Privatseminar* and now and then gave guest lectures at *Harvard University* (1931/32). He quickly gained international recognition for his research on international trade (Haberler 1930 a. 1933b). In 1934 Haberler received an offer to write a broad compilation of all the current business cycle theories, which subsequently brought him into contact with almost all the world's well-known economists, and which was later included in his main work *Prosperity and Depression* (1937). Shortly after its publication, he accepted an appointment in Harvard.

Being politically undesirable, immediately after the annexation Haberler had his teaching license removed in his absence. In the following years, he used his excellent contacts and his organizational talents to help emigrants and exiles in many ways (cf. Feichtinger 2001, 202f). Haberler gained an excellent reputation in the USA, became advisor to the *Board of Governors* of the American central banking system and was later elected to a series of honorary offices, such as president of the *American Economic Association* in 1963. He remained close to the Viennese School until his death.

Hans Bayer (1903-1965)⁸

Bayer, son of a Viennese privy councilor, gained his doctorate in 1924 in political science and became Mayer's assistant. In 1929 he gained a doctorate in law at the University of Innsbruck and was able, in the same year, to achieve his *Habilitation* in Vienna with a paper about the "Lausanne School and the Austrian School of Economics" (*Lausanner Schule und die Österreichische Schule der Nationalökonomie*). After that, he worked as an attorney in the *Niederösterreichischer Gewerbeverein* (Lower Austrian Trade Society), as general secretary of the *Hotelierversammlung* (Hoteliers' Society) and from 1934 as secretary of the *Kammer für Arbeiter und Angestellte* (Chamber of Workers and

⁷ See DBE 1996, Vol. 4, 294 and Palgrave Vol. 2, 581 with further verification.

⁸ See DBE 1997, Vol. 14, 357 and Klang 1936, 44-46.

Employees). In 1937 he became untenured professor in Innsbruck, but immediately after the annexation was given compulsory leave and transferred to the ministry. After the war he returned as professor to Innsbruck and in 1956 became director of the Sozialakademie in Dortmund.

Even in the early 1930s, Bayer distanced himself increasingly from the research program of the Viennese School, worked on questions of economic and labor policy and came to terms with the corporative state. So although he continued to show sympathy for the Viennese School, regarding content he maintained his distance and followed the Keynesian mainstream (Bayer 1949).

Further authors of the younger Viennese School⁹

If everything had gone according to plan, Fritz Machlup (Machlup-Wolf) (1902-1983) could have had a place in the above list of scholars with *Habilitation*. He grew up as the son of a Jewish businessman in Wiener Neustadt, and in addition to working in his parents' cardboard factory studied Political Science in Vienna, where he gained his doctoral degree under Mises with *Die Goldkernwährung* (1925). Apart from his business activity, he regularly participated in the *Mises-Privatseminar* and wrote reviews, essays, books and more than 150 newspaper articles. Furthermore, the dynamic workaholic was also active in the Austrian Cardboard Cartel and from 1929 to 1933 taught in the *Volkshochschule Ottakring*.

Machlup originally wanted to gain his *Habilitation* with *Börsenkredit, Industriekredit und Kapitalbildung* (1931) (*The Stock Market, Credit and Capital Formation* [1931]), a sound analysis of stock market finance in the light of the Austrian monetary theory, but professors Spann and Degenfeld-Schonburg disclosed to him that, on account of his Jewish origin, his application would not be considered. Mayer was also not prepared to support one of Mises' students (cf. Craver 1986, 23f). Subsequently, Machlup left the country in 1933 and was offered a guest professorship at *Harvard University* in 1934. One year later he sold the shares of his factory in the Lower Austrian Ybbs valley and emigrated permanently to the USA. During the war he supported many Austrians who were being persecuted, and helped them to leave the country or escape. In the US, Machlup continued with his academic career at various universities. His particular focus was international currency problems, questions regarding competition and market forms, and he laid the foundations for an economic theory of knowledge. In 1966 he was elected president of the *American Economic Association*.

⁹ Regarding the following biographies, cf. Leube 1998, 311-320 (with wrong emigration year for Braun and wrong year of death for Schams); Fischer-Brix 1997, 77-82; regarding Machlup see DBE 1997, Vol. 6, 551; regarding Rosenstein-Rodan see Palgrave, Vol. 4, 222; regarding Schams and Illy (Schönfeld) see Klein 1992, 30f., 51 a. 165-168; in particular regarding Illy (Schönfeld) see Mayer 1953; regarding Schlesinger see DBE 1998, Vol. 8, 670 each with further verification.

Fritz Machlup was always described as an extraordinary personality. He inspired with his agility, his intellectual clarity, his esprit and his great didactic abilities. One American student, obviously impressed by this ball of energy from Wiener Neustadt, went so far as to play with words, saying: “Mach 1, Mach 2, Mach 3—Machlup” (cf. Hülsmann 2007a, 478).

Like Machlup, **Paul Narcyz Rosenstein-Rodan** (1902-1985), who came from a Jewish family in Kracow, did not receive his *Habilitation* due to racial and faculty policy reasons (cf. Mayer 1952, 267). Rosenstein-Rodan gained his doctorate in law in Vienna and became Mayer’s assistant. At the age of 25 he wrote the well regarded article on the notion of marginal utility (Rosenstein-Rodan 1927) for the fourth edition of the *Handwörterbuch der Staatswissenschaften* (“Concise Dictionary of Political Science”), which was followed by an equally prominent contribution on the role of time (Rosenstein-Rodan 1930). By showing that the role of time was not as a rule taken properly into account in the economic concept of “equilibrium”, he triggered an international debate (cf. Pribram 1983, 517f.). In 1931 Rosenstein-Rodan received an appointment to teach at *University College* in London, subsequently distinguishing himself as a highly esteemed expert on developing countries, and finally he was an associate of the *Massachusetts Institute of Technology* (MIT).

Ewald Schams (1889-1949) studied in Graz under Schumpeter and worked in Vienna as *Sektionsrat* (one of the highest ranking civil servants) in the Ministry for Education. Additionally, he taught as an unsalaried lecturer at the *Technische Hochschule* in Vienna and was a regular participant in the *Mises-Privatseminar*. Schams—who according to Hayek had a “reticent, upright appearance reminiscent of an officer” (Leube 1998, 319)—was an outstanding expert of the Lausanne School of Léon Walras; he was accomplished in mathematics and worked in particular on questions of methodology and epistemology. After the annexation he remained in the country and adapted to the Nazi regime. This was also the reason why, after the war, he was not able to return to the *Technische Hochschule* until 1947.

After studying in Freiburg/Breisgau, **Stephanie Martha Braun** (1898-1990) was one of the first women to gain a doctorate in political science from the University of Vienna in 1921, after which she worked as freelance business journalist. As a participant in the *Mises-Privatseminar*, she continually wrote reviews, banking and monetary contributions and articles on questions regarding economic policy, and finally published her *Theorie der staatlichen Wirtschaftspolitik* (1929) (“Theory of National Economic Policy”), the first attempt at a theoretical rationale and limitation of economic policy in the German language. After the annexation she emigrated to the USA, where her last position was a professorship at *Brooklyn College*.

Erich Schiff (1901-1992), born in Vienna, proved in *Kapitalbildung und Kapitalaufzehrung im Konjunkturverlauf* (1933) (“Capital Formation and Cap-

ital Consumption in the Business Cycle”), that depreciation of money undermines the companies’ calculation assumptions and therefore inevitably leads to malinvestments. After a post at the *Institut für Konjunkturforschung* in 1927/28, he worked as a newspaper editor and regularly attended the *Mises-Privatseminar*. On account of his Jewish origins he fled to the USA in 1938, where he continued to work as an economist.

Karl Schlesinger (1889–1939)—one of the most outstanding personalities from the wider Viennese School circle, although he is almost forgotten as an economist today, fled from the Hungarian Soviet Republic to Vienna, pursued a career in banking and finished by working as deputy director of the *Anglo-Österreichische Bank* and as chairman of the *Bankenvereinigung* (Banking Federation). Although he was close to the Lausanne School and showed an interest in mathematical economics, he supported the Viennese School. As an expert on banking and currencies, he published papers on questions regarding monetary theory, currency policies and banking business, and from 1933/34 studied mathematics under Abraham Wald. His essay *Über die Produktionsgleichungen der ökonomischen Wertlehre* (1934) („On the Production Equations of the Economic Value Theory“) was to become a significant foundation of the neoclassical equilibrium analysis (cf. Karl Menger 1973, 47f). On the day of the annexation, Karl Schlesinger committed suicide.

Leo Illy (Schönfeld) (1888–1952), originally called Schönfeld, was a regular participant in the *Mises-Privatseminar*. After the First World War, while working as an accountant and auditor, he published some articles on economics and the monograph *Grenznutzen und Wirtschaftsrechnung* (1924) (“Marginal Utility and National Accounting”), with which he tried to rekindle the abandoned discussion on marginal utility. He remained in Austria after the annexation, gained his *Habilitation* after the war at the *Universität für Bodenkultur*, then at the *Hochschule für Welthandel* and finally at the University of Vienna under Hans Mayer. His textbook *Das Gesetz des Grenznutzens* (“The Law of Marginal Utility”), published in 1948, was an easily comprehensible condensed version of the theory of marginal utility.

About a third of the regular attendees of the *Mises-Privatseminar* or the *Geistkreis* produced publications only sporadically, for example Victor Bloch with his mathematically oriented contributions on the theory of money markets and interest and Gertrude Lovassy and Ludwig Bettelheim-Gabillon, who wrote studies on economic history. The articles by Eric Voegelin (1901–1985), Alfred Schütz (1899–1955) and Felix Kaufmann (1895–1949), on their own subjects, became in one way or another part of the economics discourse. The historians Friedrich Engel-Janosi (1893–1978) and Alexander Gerschenkron (1904–1978) were predominantly attracted by the interdisciplinary composi-

tion of the two circles and wrote nothing pertinent to economics.¹⁰

¹⁰ The following participants of the above-mentioned discussion circles did not publish anything either:

Marianne von Herzfeld, Rudolf von Klein, Walter Fröhlich, Ilse Mintz-Schüller, Rudolf Loeb, Robert Wälder, Emanuel Winternitz, Elly Offenheimer-Spiro and Adolf Redlich-Redley.

CHAPTER 20

Praxeology, a new beginning by Ludwig von Mises

Ludwig von Mises created a whole new discipline based on extensive methodological deliberations, which he called “the science of human action” or “praxeology”. He may have been inspired to a significant degree by a long since forgotten, over 1,000 page-long work, *Die wirtschaftliche Energie* (1893) (“Economic Energy”) written by the Hungarian-born journalist and Menger-student Julius Friedrich Gans von Ludassy (1858-1922). Von Ludassy suggested borrowing the cognitive foundations of economics from Immanuel Kant (1724-1804) (Gans-Ludassy 1893, 579-593). Furthermore he casually presented a “ultimate definition of economics”: “All actions have a purpose, they are therefore purposive; they are purposive even when they do not seem so to a more astute economic mind; that is to say they have been undertaken from the viewpoint of the acting individual in order to attain his objectives. Economic insights involve economic actions. Economic actions, however, are simply actions. They must adhere to laws which apply to actions in general. Economics is therefore the science of action” (ibid., 982).

Ludwig von Mises’ goal was to understand human action in general, in order to then be able to clearly think through and present economic action as well. Accordingly, such an all-encompassing “praxeology” must not be based on experiences bound by situation and time, i.e. on empirical data, but would have to be a science which, “[i]n all of its branches [...] is a priori.” Because a universally valid science of human action is derived, “[l]ike logic and mathematics, [...] not [...] from experience; it is prior to experience. It is, as it were, the logic of action and deed” (Mises 1976 [1960], 1.1.6.). Thus, the classical laws of economics were ultimately not derived from experience, but by “deduction from the fundamental category of action, which has been ex-

pressed sometimes as the economic principle (i.e., the necessity to economize), sometimes as the value principle or as the cost principle" (ibid., 1.I.6.).

Empirical research, said Mises, which gathers its knowledge a posteriori, i.e. from experience, only allows for predictions in the form of hypotheses, which result from induction, i.e. by generalizing individual observations. In order to gain empirical validity, they need to be investigated further, either by making new observations or with the help of experiments, with the goal of either discarding them as useless, or retaining them in the form of laws. Except that empirical laws never lose their hypothetical character; in order to prove them conclusively, the process of validation would have to be continued ad infinitum. For it is always possible that hitherto unobserved cases run contrary to the claims and thus falsify the original hypothesis. Thus, empirical knowledge offers no ultimate certainty. Furthermore, every observation necessarily involves theories which play a decisive role in selecting what appears to be important. In empirical research therefore, the observing subject is necessarily involved in the observation process.

The fear that empirical research would in future dominate and manipulate the theory and practice of economics was in the forefront of Mises' mind. The notion of viewing human beings as mere test objects, i.e. manipulating human action within the scope of socio-political experiments and with the aid of government force, in order to put economic hypotheses into practice and to subsequently "confirm" them, was undoubtedly anathema to Mises. Therefore economics needed a secure foundation.

In his search for the roots of scientific thinking, Mises came across Immanuel Kant, a philosopher who wanted to clearly separate the field of knowledge from that of faith and conjecture. In his reflections, which went beyond those of Kant, Mises eventually created a reasoning that would not stop "until it reaches a point beyond which it cannot go. Scientific theories are different from those of the average man only in that they attempt to build on a foundation that further reasoning cannot shake" (ibid., 1.II.2.).

In *Critique of Pure Reason* (1781), Immanuel Kant developed the notion that there are two different ways of classifying judgments: on the one hand, judgments were either analytical or synthetic, whereby the truth value of analytical judgments (for example: "Bachelors are unmarried men") can be sufficiently verified with the aid of logic, not however the truth value of synthetic judgments (for example: "Today the weather is fine"). On the other hand, judgments were either a priori or a posteriori, whereby to confirm a posteriori judgments (which are gained from experience) observations were needed, but not to confirm a priori judgments (which precede all experience). According to Kant, scientific knowledge would necessarily be valid and generic, whereby a priori by analytical judgments always fulfilled these criteria: sentences such as "Bachelors are unmarried men" are necessarily and universally valid, because

it is impossible to say “Bachelors are married too.” However, a priori analytical judgments have the drawback of not delivering any real findings. They are tautological, i.e. nothing new is added which was not already clear and given from the outset. The crucial question according to Kant would thus have to be: “Are a priori synthetic judgments possible?”. Kant himself was convinced he had found a whole series of such judgments, for example mathematical and geometrical theorems or the principle of causality (cf. Liessmann 1998, 29).

According to Kant, the truth of a priori synthetic judgments could be derived from self-evident axioms. Axioms are self-evident, when you cannot dispute their truth without contradicting yourself. Such axioms could be found to the extent that we consider ourselves as cognitive human beings and thus understand the concept of our thought processes, the way our intellect works, and ultimately how our thinking apparatus is constructed. Mises agreed with Kant in all these deliberations, which is why he has been called a Kantian (cf. Hoppe 1995, 18f.). However, what he did not agree with was Kant’s idealistic assumption that reality is merely constructed by the intellect. According to Kant, things as such cannot be known. Reality can only be recognized as it *appears* to us by virtue of our reasoning, because we quasi simulate or reconstruct it with the help of our reasoning, and no direct path to truth is available.

As a realist and logician, Mises could not accept this idealistic outlook, later adopted by constructivism, that thinking and reality are two separate worlds. Thus, in one simple, clear step, Mises went further than Kant in his thinking: true synthetic a priori judgments, which are based on self-evident axioms, are not purely cognitive constructs, and therefore conform to reality, precisely because they are not just categories of reasoning, but also categories of action. Our intellect is always *within* an acting person. It never appears in isolation, as if it were a spirit, but within an acting human being. Therefore, the categories of our reasoning, for example causality, ultimately have to be founded in the categories of our action. Action means intervening in reality, at an earlier point in time, in order to achieve results at a later point in time. Therefore every acting person must assume that a constant relationship between cause and effect does indeed exist. In this way causality is a basic prerequisite of action. As a true a priori synthetic judgment, it proves to be both a category of thinking and of acting, both in cognitive and real terms (cf., Mises 1980 [1940], 22f.). In this way the divide was bridged between thinking and reality, between the internal and external worlds, which Kant had considered an insurmountable barrier (cf. Hoppe 1995, 20f.).

“Human action,” Mises said, “is conscious behavior [...]. Conceptually it can be sharply and clearly distinguished from unconscious activity, even though in some cases it is perhaps not easy to determine whether given behavior is to be assigned to one or the other category” (Mises 1976 [1960], I.II.1). This distinguishes the general theory of action, praxeology, from psychology.

The theme of psychology “is the internal events that result or can result in a definite action. The theme of praxeology is action as such (Mises 1963 [1949], 12). Action, i.e. conscious behavior, is thus “by definition [...] always rational. One is unwarranted in calling goals of action irrational simply because they are not worth striving for from the point of view of one’s own valuations. Such a mode of expressions leads to gross misunderstandings. Instead of saying that irrationality plays a role in action, one should accustom oneself to saying merely: There are people who aim at different ends from those that I aim at, and people who employ different means from those I would employ in their situation” (Mises 1976 [1960], 1.II.4.).

It is not the task of the science of human action, Mises wrote in *Nationalökonomie* (1980 [1940]), “to tell people what ends they should aim at. It is a science of the means to be applied for the attainment of ends chosen, not, to be sure, a science of the choosing of ends. Ultimate decisions, the valuations and the choosing of ends, are beyond the scope of any science. Science never tells a man how he should act; it merely shows how a man must act if he wants to attain definite ends” (Mises 1963 [1949], 10). For “value judgments,” said Mises, could “neither be proven nor justified and substantiated, nor rejected and discarded in a way every logically thinking man needs to accept as valid. Value judgments are irrational and subjective, one can commend and condemn them, approve or disapprove them, but one cannot call them true or false” (Mises 1980 [1940], 53, cf., 59f.).

Ultimately, what is important is to be clearly separate from the “metaphysical systems of the philosophy of history”. These “presume to be able to detect behind the appearance of things their ‘true’ and ‘real’ essence, which is hidden to the profane eye. They imagine themselves capable of discovering the final purpose of all mundane activity. They want to grasp the ‘objective meaning’ of events, which, they maintain, is different from their subjective meaning, i.e., the meaning intended by the actor himself. In this respect all systems of religion and all philosophies of history proceed according to the same principles. Notwithstanding the bitterness with which they fight each other, Marxian socialism, German national socialism, and the non-German movements related to it, which have taken a variety of forms, are all in agreement on logical method; and it is worth noting that they can all be traced back to the same metaphysical foundation, namely, the Hegelian dialectic.” (Mises 1976 [1960], 1.III.6.).

It was patently clear to Mises that all those ideologies which were to turn the 20th century into a bloodbath, were ultimately based on Hegel’s philosophy of history. The philosophical counter-strategy developed by Mises, intended by him to debunk the dominating philosophy, was extreme sobriety. He didn’t allow himself any excessive enthusiasm: praxeology “is unable to give any answer to the question of the ‘meaning of the whole’. [...] It deliber-

ately abstains from intruding into the depths of metaphysics. It suffers lightly the reproach of its opponents that it stops at the 'surface' of things" (*ibid.*, I.III.6.).

If one wanted to explore and describe human action, one would have to recognize that every action is preceded by thinking, that is to say insofar as "thinking is to deliberate beforehand over one's own or someone else's future action and to reflect afterwards upon (one's own or someone else's) past action. Action is preceded by thinking. The act of thinking is always purposeful (intentional); it is, as it were, an internal action, the purpose of which is understanding" (Mises 1980 [1940], 15). When action is eventually taken, it is "not simply giving preference. [...] Thus man may prefer sunshine to rain and may wish that the sun would dispel the clouds. He who only wishes and hopes does not interfere actively with the course of events and with the shaping of his own destiny. But acting man chooses, determines, and tries to reach an end. Of two things both of which he cannot have together, he selects one and gives up the other. Action therefore always involves both taking and renunciation" (Mises 1963 [1949], 12).

Consequently, the acting human applies the means to attain his ends. The use of one's own labor is generally included, but definitely not in every case: "Under special conditions a word is all that is needed. He who gives orders or interdictions may act without any expenditure of labor. To talk or not to talk, to smile or to remain serious, may be action. To consume and to enjoy are no less action than to abstain from accessible consumption and enjoyment. [...] For to do nothing and to be idle are also action, they too determine the course of events" (*ibid.*, 13).

Goal, purpose or end of all action is result, which ultimately "is always the relief from a felt uneasiness" (*ibid.*, 92): "Acting man is eager to substitute a more satisfactory state of affairs for a less satisfactory. His mind imagines conditions which suit him better, and his action aims at bringing about this desired state. The incentive that impels a man to act is always some uneasiness. A man perfectly content with the state of his affairs would have no incentive to change things. He would not act; he would simply live free from care. But to make a man act, uneasiness and the image of a more satisfactory state alone are not sufficient. A third condition is required: the expectation that purposeful behavior has the power to remove or at least to alleviate the felt uneasiness. In the absence of this condition no action is feasible. These are the general conditions of human action. Man is the being that lives under these conditions. He is not only *homo sapiens*, but no less *homo agens*. (*ibid.*, 13f.).

"A means," wrote Mises, "is what serves to the attainment of any end, goal, or aim. Means are not in the given universe; in this universe there exist only things. A thing becomes a means when human reason plans to employ it for the attainment of some end and human action really employs it for this

purpose. Thinking man sees the serviceableness of things, i.e., their ability to minister to his ends, and acting man makes them means. [...] Means are necessarily always limited, i.e., scarce with regard to the services for which man wants to use them.” (ibid., 92f.) In *Nationalökonomie*, Mises continued this train of thought: “The term of means already includes everything this principle is meant to express. If the means with respect to an unsatisfactory state of affairs were not scarce, then no action would take place; hence there would be no reason to discern between means and ends” (Mises 1980 [1940], 66).

Step by step, Mises subsequently described a science of “rigorous universality [...] like that of logic and mathematics,” formulated sentences, which were logically derived from the basic concept of action and which revealed nothing that was not already present in the prerequisites (ibid., 18). With the concept of action, Mises said, “we simultaneously grasp the closely correlated concepts of [path and goal, means and end, cause and effect, beginning and end and thus also of] value, wealth, exchange, price, and cost. All of these are inevitably implied in the concept of action, and along with them the concepts of valuing, scale of value and importance, scarcity and abundance, advantage and disadvantage, success, profit and loss.” (Mises 1976 [1960], I.II.1.; words in square brackets missing in original translation [Transl.]). Also included is the notion of temporal sequence: “Here we have the time before gratification, we have the input of action and the period of time between the input of action and the occasion of the result, and finally we have the period of time of the gratification attained by the result. What distinguishes praxeology from logic is the reference to chronological sequence. Even though one may call it the logic of action, one must not overlook that it includes the element of temporality, which is alien to logic and mathematics.” (Mises 1980 [1940], 77) To put it simply, praxeology was thus nothing but logic plus time.

Accordingly, praxeology enables us to make predictions about future events. Admittedly, these predictions necessarily lack quantitative precision, because “there can be no universally valid praxeological prediction where subjective value judgments decide,” but this does not affect their qualitative validity (ibid., 485). Thus, economics could “say nothing about the nature of the action. Praxeological and economic insights cannot inform us about the future of society and of human culture or about the course of future events. [...] These facts may disappoint some people and make them underestimate the significance of praxeological and economic insights. However, man has to accept that there are limits to his mind’s thinking and research. We will never know what the future has in store for us. It cannot be any other way. Because if we knew in advance what the future would unalterably bring, we could no longer act. [...] That humans act and that they do not know the future are not two facts but only two different renderings of the same fact” (ibid., 75of.).

CHAPTER 21

Friedrich August von Hayek's model of society and his theory of cultural evolution

In *The Road to Serfdom* (1944), written in England during the Second World War, Friedrich August von Hayek had already outlined those fundamental ideas which were later to be so closely identified with him: he believed the development of our western civilization was only possible because people submitted to impersonal market forces. No one consciously planned and organized this development, it just came about spontaneously, in the course of increasingly more complex exchange relationships within a cultural evolution. Intending to change this structure in future and shape it with the help of ideas could thus only be the outcome of “incomplete and therefore erroneous rationalism.” No individual or government agency has anything approaching a complete overview. Nobody could be given authority over all our lives. Political planning and regulation would therefore necessarily lead to a worsening of conditions and would ultimately destroy personal freedom (cf. Hayek 1962 [1944], 152).

This fundamental notion, which became the leading idea of evolutionary economics, can be traced back directly to Carl Menger. In his *Principles of Economics*, he described the nature and origin of money as the result of human actions, but not of human design (cf. Menger 2004 [1950], 257-271). In his *Investigations into the Methods of the Social Sciences*, he expanded the application of this basic idea to a series of other “social structures,” which he understood to be law, language, the state, money, markets, prices of goods, interest rates, ground rents, wages and “a thousand other phenomena of social life in general and of economy in particular” These were “to no small extent the unintended result of social development” (Menger 1985 [1883], 147).

The Road to Serfdom, probably Hayek's most popular work, was dedicated

“To the Socialists of all Parties,” in other words to everyone who was hoping that economic planning would lead to a “new Jerusalem”. Hayek meticulously demonstrated that socialism, in whatever form it manifested itself, is incompatible with the idea of freedom and that the rise of National Socialism was not a reaction to the socialist spirit of the times, but rather had been its inevitable consequence. Whether National Socialism or soviet communism: a controlled economy will always end in despotism. By contrast, a free society does not need first to be artificially constructed through violent revolution and subsequent re-education, but is attained in an evolutionary way through consistent adherence to market economy principles. Because these principles had been gradually destroyed by socialist ideas, it was vital to restate them, so as to clearly and tangibly instill the idea of freedom in people’s consciousness.

Individualism based on traditions and conventions, which in principle affirms family values, co-operation between small communities and groups, and local self-government is the foundation of a free society. Such individualism, wrote Hayek in *Individualism and Economic Order* (1948) has the advantage of establishing “flexible but normally observed rules that make the behavior of other people predictable in a high degree” (Hayek 1949, 23). By contrast, socialist-inspired “false individualism which wants to dissolve all these smaller groups into atoms which have no cohesion other than the coercive rules imposed by the state, and which tries to make all social ties prescriptive” (ibid., 23). Genuine individualism is characterized by the fact that all forms of planning are carried out by a large number of individuals and not centrally by a government agency. Only a multitude of individuals can make the best use of the entirety of possible knowledge: “practically every individual has some advantage over all others, because he possesses unique information of which beneficial use might be made” (ibid., 80).

Thus, economic research claiming that an unequivocal solution is given *if* all facts were known to an individual, has nothing to do with reality. On the contrary, research needs to show “how a solution is produced by the interaction of people each of whom possesses only partial knowledge. To assume all the knowledge to be given to a single mind, [...] is to assume the problem away and to disregard everything that is important and significant in the real world.” (ibid., 91). That economic research could become so blind can be explained by its increasing orientation towards natural sciences. Little by little the empirical methods conventionally used in the natural sciences were formally imposed on the social sciences, which finally led to a fiasco: “To start here at the wrong end, to seek for regularities of complex phenomena which could never be observed twice under identical conditions, could not but lead to the conclusion that there were no general laws, no inherent necessities [...] and that the only task of economic science in particular was a description of historical change. It was only with this abandonment of the appropriate methods of procedure [...] that

it began to be thought that there were no laws of social life other than those made by men and that all observed phenomena were all only the product of social or legal institutions" (ibid., 127).

Just as we could often observe in biological organisms that the parts move in such a way as if their purpose were the preservation of the whole, Hayek wrote in *The Counterrevolution of Science* (1952), so we could also observe in spontaneous social structures "how the independent actions of individuals will produce an order which is no part of their intentions [...] The way in which footpaths are formed in a wild broken country is such an instance." (Hayek 1955, 40; 82f.) Therefore, social structures definitely exist which have neither been consciously planned by anyone in particular, nor the functions of which are consciously maintained by humans, but which are nevertheless very beneficial for the attainment of human goals. Many of the greatest achievements, according to Hayek, are "not the result of consciously directed thought, and still less the product of a deliberately co-ordinated effort of many individuals, but of a process in which the individual plays a part which he can never fully understand. They are greater than any individual precisely because they result from the combination of knowledge more extensive than a single mind can master." (ibid., 117).

According to Hayek, a collectivist who wants to understand social institutions objectively is thus bound to fail in his attempts to accurately define their nature and how they function. The consequence is that he will be driven to imagine these as the creation of an ingenious mind and will finally make the political demand that "all forces of society be made subject to the direction of a single mastermind", while it is "the individualist who recognizes the limitations of the powers of individual reason and consequently advocates freedom as a means for the fullest development of the powers of the inter-individual process." (ibid., 68).

Collectivist thinking is thus a recipe for despotism. Based on misunderstood rationalism, it paves the way for dangerous irrationalism. This can only be prevented to the extent that conscious reason acknowledges the limits of its own capabilities, as "as individuals we should bow to forces and obey principles which we cannot hope fully to understand, yet on which the advance and even the preservation of civilization depends. Historically this has been achieved by the influence of the various religious creeds and by traditions and superstitions which made men submit to those forces by an appeal to his emotions rather than to his reason. The most dangerous stage in the growth of civilization may well be that in which man has come to regard all these beliefs as superstitions and refuses to accept or to submit to anything which he does not rationally understand. The rationalist whose reason is not sufficient to teach him those limitations of the powers of conscious reason, and who despises all the institutions and customs which have not been consciously designed, would thus

become the destroyer of the civilization built upon them.” (ibid., 92).

There is only one alternative to control by arbitrary rule, wrote Hayek in *The Constitution of Liberty* (1960): universal submission to formal laws. This means that individuals would voluntarily comply with certain guidelines in the form of deeply rooted moral convictions. Freedom therefore requires responsibility, whereby, however, it must be clear “that the responsibility of the individual extend only to what he can be presumed to judge, that his actions take into account effects which are within his range of foresight, and particularly that he be responsible only for his own actions (or those of persons under his care)—not for those of others who are equally free.” (Hayek 1960, 73). Since responsibility cannot be expected of everybody, freedom is above all freedom under the law. However, this order must be without dictates, a universal, abstract set of rules free of arbitrariness, which is restricted to defining competing spheres of action in order to optimize the room for maneuver of each individual.

Freedom has economic significance for the simple reason that it allows “room for the unforeseeable and unpredictable” (ibid., 27). Since one cannot know which experiments with procedures, products or services will prove to be successful, maximum freedom to develop would be most expedient: “It is because every individual knows so little and, in particular, because we rarely know which of us knows best that we trust the independent and competitive efforts of many to induce the emergence of what we shall want when we see it.” (ibid.).

Coercive government measures, writes Hayek in his *Freiburger Studien* (1969a), should be limited exclusively to the enforcement of universal rules of conduct. Government should not set specific objectives. This is because a market-based system is not based on “some common objective, but instead on reciprocity, i.e. on the balance of different interests to the mutual advantage of the participants.” Therefore, in a free society, terms such as “the common good” or “public interest” could only be understood as an abstract system, which merely “offers any randomly singled out individual the best chances to successfully employ his skills for his personal objectives” (Hayek 1969a, 110f.). Government measures ostensibly serving “the common good”, such as progressive taxation for example, where a majority burdens a minority against the latter’s will, are nothing but cases of arbitrary discrimination which destroys personal freedom. Governments should therefore refrain from influencing income distribution in favor of “social equity”.

Only within the framework of a regulatory system based on law and tradition, largely removed from the grasp of the rulers, can people develop in the best way possible. The reason for this is that, because of constant competition, such a system would always favor behavior which had proved successful. It is impossible to predict where this competition, which can be characterized as a

"procedure for discovering facts", will ultimately lead (ibid., 249). Yet it is obvious that those societies which, for this purpose, draw on competition, know more and thus ultimately generate more wealth for everyone. Such a regulatory system, which one could also call "spontaneous order" and which has always, wherever it appeared, made use of the market and of private property, always leads to a "*Great or Open Society*" or an advanced civilization (ibid., 111).

The ancient Greeks had already called an order created by humans "taxis" and a spontaneous order "cosmos". According to Hayek, "cosmos" comes into being from regularity in the behavior of the elements it is made up of and thus has no particular objective or purpose. It is "an endogenous System growing from the inside or, as the cyberneticists say, a 'self-regulatory' or 'self-organizing' system." On the other hand, "taxis," as a decree or an organization, is determined by an "efficacy outside the system" and is therefore "exogenous or imposed" (ibid., 208f.). Since, in a taxis, all knowledge at the individuals' disposal has to be first channeled to a "central organizer", it will always be more limited compared to the knowledge at individuals' disposal within a cosmos (ibid., 209f.).

Rules and norms created within the framework of the cosmos are to be called "nomoi," the meaning of "nomos" being a "universal rule of just behavior [...] which applies equally to all people for an unknown number of future cases, to which the objective circumstances described in the rule pertain, regardless of the consequences induced in a specific situation by adhering to the rules. Such rules limit the protected individual spheres by letting every person or organized group know which means they may employ in pursuit of their goals, without the actions of the various people conflicting with each other." By contrast, the rules and norms created within the framework of a taxis are to be called "theseis," the meaning of "thesis" being such a rule "which is only applicable to certain persons or which serves the rulers' aims" (ibid., 211f.).

The distinction between "nomoi," the universal rules of behavior, and "theseis," the rules of organization, is comparable to the classical distinction between civil law (including penal law) and public law (constitutional and administrative law) (ibid., 213). It is instructive to remember that "the idea of law in the sense of nomos (i.e. an abstract rule independent of any concrete individual will, applicable regardless of consequences to individual cases, a law that could be 'found' and was not created for particular, foreseeable purposes), together with the ideal of personal freedom existed and continued to exist only in countries such as ancient Rome and modern England, where the advancement of civil law was based on precedent and not on written law, where it lay in the hands of judges and jurists and not in the hands of legislators" (ibid., 214).

In addition to the closely linked concepts of "cosmos/taxis" and "nomos/thesis,"

Hayek distinguished between values and goals. "Values" are what guide human action for a lifetime and which originate in cultural tradition, whereas "goals" determine human action only for certain moments in time. An open and free society is based on its members sharing common values; conversely the possibility of freedom disappears "when we insist there should be a united will issuing the orders which will direct the members towards certain goals" (ibid., 223). Those values or those rules of just behavior, which have decisively contributed to the emergence of an open and liberal society, had already, Hayek wrote in *Law, Legislation, and Liberty* (1973/76/79), been formulated by the Scottish philosopher and economist David Hume (1711-1776). Hume called them "the three fundamental laws of nature, that of stability of possession, of its transference by consent, and of the performance of promises." (Hayek 1973/76/79, Vol. II, 40). In civil law systems, these principles were later summarized as "freedom of contract, the inviolability of property, and the duty to compensate another for damage due to his fault." (Léon Duguit quoted in: Hayek, 1973/76/79, Vol.II, 40).

Historically, abstract rules and spontaneous order had developed in mutual dependency. For just as the mind can only exist as part of a system which exists independently of it, a system can likewise only develop, "only because millions of minds constantly absorb and modify parts of it." (ibid., Vol. III, 157). According to Hayek, "Man did not adopt new rules of conduct because he was intelligent. He became intelligent by submitting to new rules of conduct." (ibid., 163). What ultimately made humans "good" was "neither nature nor reason but tradition. There is not much common humanity in the biological endowment of the species" (ibid., 160). Also, human beings had not developed in the context of freedom at all. As members of small hordes, which they had to cling to if they wanted to survive, they were anything but free. Freedom thus is an "artifact of civilization," which liberated humans from the shackles of the small group. It became possible "by the gradual evolution of the discipline of civilization which is at the same time the discipline of freedom." (ibid., 163). Ultimately, we have to admit that modern civilization is possible largely only by ignoring the scandalized moralists. According to Hayek, this fact was formulated by the French historian and sociologist Jean Baechler (1905-1983) as follows: "the expansion of capitalism owes its origins and *raison d'être* to political anarchy." (ibid., 166).

CHAPTER 22

The entrepreneur

By the early 17th century there was already mention of the figure of “projector,” the brilliant creator of ideas, who was “at the same time inventor, [...] alchemist, reformer, but also fantasist and carpetbagger,” along with the figure of the entrepreneur, described by Richard Cantillon (1680-1734), an Irish-French banker, in his *Essay sur la Nature du Commerce en général* (1732), for the first time as follows: an “entrepreneur” is a person who assumes the economic risk by buying and combining factors of production in order to offer goods on the market with the intention of making a profit (Matis 2002, 31f). The achieved profit is to be understood as a kind of risk premium. This basic description was expanded thoroughly by the members of the Austrian School. Starting with Carl Menger and Victor Mataja through to Ludwig von Mises and Friedrich A. von Hayek, entrepreneurial action was given significant, even central relevance. By contrast, Schumpeter’s *Theorie der wirtschaftlichen Entwicklung* (1912) (*The Theory of Economic Development*) was more of a heroic-literary memorial in honor of the personality of the entrepreneur, for according to Schumpeter, the risk was borne not by the entrepreneur, but by the banker.

In his main work, *Grundsätze der Volkswirtschaftslehre* (1871) (Principles of Economics), Carl Menger described the work of the entrepreneur as preparing and directing processes which serve the transformation “of goods of higher order into goods of lower and first order”. Specifically this involves “(a) obtaining *information* about the economic situation; (b) economic *calculation*—all the various computations that must be made if a production process is to be efficient [...]; (c) the *act of will* by which goods of higher order [...] are assigned to a particular production process; and finally (d) *supervision* of the execution of the production plan so that it may be carried through as economically as possible” (Menger 2004 [1950], 159f.).

In the early days of entrepreneurship, according to Menger, the entrepreneur

himself would still step into the production process with his “technical labor services”. Only “with progressive division of labor and an increase in the size of enterprises,” his specific function became more clearly apparent and finally assumed the nature of an economic good. Hence “the value of entrepreneurial activity” has to be included in the value of all goods necessary for a production process (ibid., 161). There are two things about this category of activity which make it distinctive: for one, “they are by nature not commodities (not intended for exchange) and for this reason have no prices” and for another, “they have command of the services of capital as a necessary prerequisite since they cannot otherwise be performed” (ibid., 172).

Unlike other forms of income, for example labor wages or capital interest, the income of the entrepreneur is, according to Viktor Mataja in *Der Unternehmengewinn* (1884), “much more difficult to identify.” Therefore there is a need to develop a precise conceptual definition of this income. Firstly, it is incorrect to view the use of capital as a general feature of business ventures. For, “if this were the case, what would all those producers be who, solely through their own labor, place their products on the market?” (Mataja 1966 [1884], 134). Another “improper narrowing of the term” is “when one describes the intention of the entrepreneur to acquire income as part of the nature of the business venture. [...] Purely benevolent institutions, for example savings banks, societies with a business-like nature but without the purpose of acquiring income, for example co-operatives, certain state institutions etc. definitely bear the characteristics of business ventures, and may even produce an entrepreneurial profit, but are nevertheless not set up with the intention of achieving this or any other such income” (ibid., 136f.). On the other hand, what all business ventures have in common is the “production of market values (goods destined to be sold),” which is guided by the entrepreneur, and “that this production takes place on his behalf” (ibid., 142f.).

According to Mataja, entrepreneurial profit is the income which “results entirely from economic exchange and which furthermore absolutely and exclusively accrues to the owner of the business venture.” Thus, entrepreneurial *income* and entrepreneurial *profit* need to be clearly distinguished. While the former includes those incomes which befit “the individual entrepreneur as capitalist and laborer according to the capital in his ownership and his amount of work”, the latter is created only “when the earnings of the business venture (difference between costs and revenue) result in a surplus over and above these two quantities” (ibid., 142f.). Capital profit, according to Mataja, is simply “the reward for the productive involvement of capital in the creation of goods,” whereas entrepreneurial profit is a “premium for the most productive exploitation possible of already existing goods of a higher order,” effectively the “proceeds for the administration of a kind of ‘social office’ (Schäffle)” (ibid., 196f.).

Just as every human action is directed towards the future and is, as Ludwig von Mises wrote in *Nationalökonomie* (1940), “always speculation,” entrepreneurial action always involves the future use of the means of production (Mises 1963 [1949], 252). Thus, entrepreneurs are “those who are especially eager to profit from adjusting production to the expected changes in conditions, those who have more initiative, more venturesomeness, and a quicker eye than the crowd, the pushing and promoting pioneers of economic improvement.” (ibid., 254f.). According to this, “[w]hat distinguishes the successful entrepreneur [...] from other people is precisely the fact that he does not let himself be guided by what was and is, but arranges his affairs on the ground of his opinion about the future. He sees the past and the present as other people do; but he judges the future in a different way.” (ibid., 585). Ultimately however, anyone can become an entrepreneur, “if he relies upon his own ability to anticipate future market conditions better than his fellow citizens and if his attempts to act at his own peril and on his own responsibility are approved by the consumers. One enters the ranks of the promoters by spontaneously pushing forward and thus submitting to the trial to which the market subjects, without respect for persons, everybody who wants to become a promoter or to remain in this eminent position. Everybody has the opportunity to take his chance. A newcomer does not need to wait for an invitation or encouragement from anyone. He must leap forward on his own account and must himself know how to provide the means needed.” (ibid., 313).

“The capitalists, the enterprisers, and the farmers,” wrote Mises in *Bureaucracy* (1944), are ultimately nothing other than those means which serve to manage economic affairs: “They are at the helm and steer the ship. But they are not free to shape its course. They are not supreme, they are steersmen only, bound to obey unconditionally the captain’s orders. The captain is the consumer. Neither the capitalists nor the entrepreneurs nor the farmers determine what has to be produced. The consumers do that. [...] If the consumers do not buy the goods offered to them, the businessman cannot recover the outlays made. [...] If he fails to adjust his procedure to the wishes of the consumers he will very soon be removed from his eminent position at the helm. Other men who did better in satisfying the demand of the consumers replace him.” In a capitalist system the consumers are thus “[t]he real bosses. [...] They, by their buying and by their abstention from buying, decide who should own the capital and run the plants. They determine what should be produced and in what quantity and quality. Their attitudes result either in profit or in loss for the enterpriser. They make poor men rich and rich men poor. [...] Thus the capitalist system of production is an economic democracy in which every penny gives a right to vote. The consumers are the sovereign people. The capitalists, the entrepreneurs, and the farmers are the people’s mandatories. If they do not obey, if they fail to produce, at the lowest possible cost, what the

consumers are asking for, they lose their office. Their task is service to the consumer. Profit and loss are the instruments by means of which the consumers keep a tight rein on all business activities.” (Mises 1983 [1944], 23-25).

Friedrich A. von Hayek described the role of the entrepreneur, especially with regard to competition. By uncovering hitherto hidden knowledge in a systematic process of discovery, it is able to supply the entrepreneurs with information relevant to them. Wherever we employ competition, we do not know the relevant circumstances: “In sport or in exams, when awarding government contracts or awarding prizes for poems and, not least, in science,” Hayek wrote in his *Freiburger Studien* (1969a), “it would obviously be absurd to hold a competition if we knew in advance who the winner was going to be. Therefore, I would like [...] to consider competition systematically as a process for discovering facts, without which they would either remain unknown or at the very least not be utilized” (Hayek 1969a, 249). In addition, competition is “a method for breeding certain types of mind” It is always a process “in which a small number makes it necessary for larger numbers to do what they do not like, be it to work harder, to change habits, or to devote a degree of attention, continuous application, or regularity to their work which without competition would not be needed.” (Hayek 1973/76/79, Vol. III, 76f.). Thus, competition generally fosters discipline and helps motivate existing talents to achieve outstanding results.

“One revealing mark of how poorly the ordering principle of the market is understood,” Hayek wrote in *The Fatal Conceit. The Errors of Socialism* (1988), “is the common notion that ‘cooperation is better than competition’” Of course cooperation is also useful, but particularly in small, homogeneous groups, in which there is a great amount of consensus. When the issue, however, is adjustment to unknown conditions, there is hardly any merit in cooperating any more. Ultimately it was competition “that led man unwittingly to respond to novel situations; and through further competition, not through agreement, we gradually increase our efficiency.” (Hayek 1988, 19)

CHAPTER 23

The rejected legacy: Austria and the Viennese School after 1945

At the end of the 1930s, the Viennese School effectively ceased to exist on Austrian soil. Apart from a few exceptions,¹ many of its members had already left the country in the preceding years or had had to flee after the annexation of Austria by the German Reich in 1938, for racial and political reasons. Academic productivity declined dramatically and at the beginning of the war almost came to a standstill. While Hans Mayer continued to produce the *Zeitschrift für Nationalökonomie* together with Alexander Mahr as editor, he had to share the position of publisher with Walter Eucken (1891-1950), Guglielmo Masci (1889-1941), a supporter of Mussolini, and Heinrich von Stackelberg (1905-1946), the leader of the *Nationalsozialistische Dozentenschaft* (Association of National Socialist Lecturers) of the University of Cologne. Despite this concession, the following volumes appeared only at irregular intervals (1939 and 1944). Moreover, the readership had been significantly reduced due to emigration and events of war. Incidentally, there was no further mention at all of the terms *Viennese* or *Austrian School* in these volumes.

Even before the annexation, a fundamental paradigmatic shift in economics had taken place in the Anglo-American sphere. Following the brilliant success of *The General Theory of Employment, Interest and Money* (1936a) by John Maynard Keynes, interest in the Viennese School declined almost overnight. Its advocates suddenly found themselves in the position of outsiders. From now on, the Keynesian theory and its interpretations—with

¹ Hans Mayer, Alexander Mahr, Ewald Schams, Richard von Strigl and Leo Illy (Schönfeld)

mathematical equilibrium analysis as one of its centerpieces—dominated modern economics for more than three decades.

Against this backdrop, Hans Mayer continued his teaching at the University of Vienna until he became an emeritus professor in 1950. The statue of Menger, which had been removed after the annexation, was unobtrusively restored after the war to its original place in the Arkadenhof (courtyard) of the University of Vienna, but otherwise there was scarcely a sign of anyone even remotely connecting with the former greatness of the School. There was a smaller number of students enrolled at the faculty of law and political science (in 1954/55 there were 1,900) than there had been before the war (cf. Grandner 2005, 295). Alexander Mahr and Ewald Schams, two teachers of the Viennese School who worked unhindered throughout the Nazi period, were only allowed to return to teaching after some time had elapsed (cf. *ibid.*, 309). There was a general shortage of junior scholars. Thus, Mayer's first postdoctoral student was Karl Gruber (1909-1995), who, as the newly elected prime minister of Tyrol, had his *Habilitation* procedure transferred from Innsbruck to Vienna and was far from following the tradition of the School. After Leo Illy (Schönfeld), who was a mature student, the first young scholar whom Hans Mayer awarded a *Habilitation*, was Wilhelm Weber (1916-2005), in 1950, the year Mayer became an emeritus professor.

After a five-year gap, it was possible in 1949 to publish a new edition of the *Zeitschrift für Nationalökonomie* in the form of a commemorative publication on the occasion of Mayer's 70th birthday. A reviewer compared it to the opulent commemorative volume for Friedrich von Wieser (Mayer 1927-1932) and lamented on the one hand the dramatic extent of the destruction and lowering of standards in economics in German speaking countries and, on the other hand, that the emigrated members of the Viennese School had not contributed to the commemorative publication (cf. Brinkmann 1950/51, 575).

Indeed, the scholars who had remained in Austria, as well as the government agencies and politicians, had done little or nothing to improve relations with the emigrants and exiles, which past events had damaged long term. Mises, whose flat had been ransacked during his absence, wrote immediately after the war that he did not want to meet the "mob" which had "applauded the massacre of excellent men" (cf. Hülsmann 2007a, 834, FN 100). Fully in accordance with the dominating sentiment, the economists in Austria made it all too clear that they had no serious interest in a return of the emigrants and exiles (cf. Grandner 2005, 312).

In October 1945, the bestowal of an honorary doctorate upon the socialist Chancellor Karl Renner (1870-1950) by the faculty of law and political science at the University of Vienna—at the academic ceremony, the middle-class conservative principal Ludwig Adamovich (1890-1955), the Catholic-legitimistic

Ferdinand Degenfeld-Schonburg and the last tenured professor of the Viennese School in Austria, Hans Mayer together represented the faculty—became a symbol of reconciliation, but the speakers at the ceremony mainly invoked a balance between the middle-class Catholic camp and the social democratic camp and, moreover, paid an surprising tribute to public service employees (cf. Promotion 1945).

In this emerging ideological-political duopoly, which would later be criticized as “concordance democracy” (cf. Rathkolb 2005, 77) or as “moderated pluralism” (cf. Müller 1997a, 226), there was hardly room for exiles, emigrants, liberals, Jews or dissidents of any kind. Thus, invitations from Austrian faculty colleagues, for example Hans Mayer, to exiled economists to hold guest lectures and talks were often not authorized at all (cf. Seidel 1986, 227). Nevertheless, Friedrich A. von Hayek sought tirelessly to intensify contacts with Austria and took part—as did a number of other emigrants—in the academic conferences in Alpbach in Tyrol, a small mountain village which served as one of the first meeting places for intellectual exchange after the war. Unlike the students there, Hayek had only a low professional opinion of the majority of those faculty colleagues in his former home country, who in the meantime had been promoted (cf. Hennecke 2000, 201).

Among the authors of the commemorative publication for Hans Mayer, only two could be counted outright as followers of the Viennese School (Leo Illy (Schönfeld) and Ewald Schams). Some of the other authors, such as Hans Bayer and Alexander Mahr, were more selective in their support. However, the overwhelming number of contributions emphasized their authors’ critical distance to the Viennese Tradition, in some cases even demonstrating a lack of secure knowledge of the sources (for example Dobretsberger 1949 and Kerschagl 1949). To what extent this first large anthology on Viennese territory after the Second World War was already removed from international economic research was made clear, for example, by the fact that out of 25 contributions, only three were written in English and that only one discussed in detail the ubiquitous Keynesian paradigm. The commemorative publication seemed simply to want to defiantly deny that the centers, the research programs and the lingua franca of economics had in the meantime become Anglo-American and that Vienna was now on the fringes of economic research.

The first concise and objective critique (in the German speaking world) of Keynes’ theories, from the viewpoint of the Viennese School, was presented by Hans Mayer. Mayer criticized Keynes for his many imprecise definitions (cf. Mayer 1952, 41 a. 42) as well as his “completely useless all-encompassing terms”, such as “volume of labor”, “volume of employment” and “involuntary unemployment” (ibid., 45). The results thus achieved were a “setback,” because the mercantilists had already worked with all-encompassing terms (ibid., 50). Mayer considered Keynes’ psychological assumptions—a general

“propensity to consume,” a “liquidity preference” and the expectation of future earnings from capital values—to be unrealistic (*ibid.*, 46). In response to the proposition of a “comprehensive socialization of investment” under “central direction” Mayer put the question, whether there would still be room in this model for private self-interest to maneuver (*ibid.*, 49f.). Finally, Mayer criticized Keynes for not having “considered a purpose for the economy as a whole,” as the Viennese School had attempted to do with the “optimum of fulfillment of demand,” because “‘full employment’ as a goal is a misjudgment of means and ends” (*ibid.*, 51).

Mayer’s critique of Keynes came much too late and was ultimately ineffective (*cf.* Seidel 1986, 227). Even his two students Wilhelm Weber and Alexander Mahr only vouched in part for the Viennese School’s insights. On one occasion they declared themselves its supporters (*cf.* Weber 1966, 2); another time they denied even belonging to the School, although admitting being in some ways indebted to it (*cf.* Hicks/Weber 1973, Vf.). Indeed, they advocated, with some reservations, a neoclassical-Keynesian world view. Their healthy distrust of macroeconomic aggregates was the main reminder of their having originated from the Viennese tradition (*cf.* Streissler/Weber 1971, 232). Irrespective of these differences concerning the tradition of the School, Wilhelm Weber in particular made bonafide attempts to improve relations with the emigrants. Thus he was able to persuade Oskar Morgenstern and Gottfried Haberler to be co-publishers of the *Zeitschrift für Nationalökonomie*, which after 1970 appeared as the *Journal of Economics*. Weber also quietly supported the university administration preliminary talks, which were ultimately unsuccessful, with Friedrich A. von Hayek, the purpose of which was to persuade him to come to Vienna. Hayek found the idea of reviving the Viennese School in Vienna very enticing. In 1967 the Austrian government even considered him as president of the *Österreichische Nationalbank* (the central bank of Austria), after Fritz Machlup had withdrawn his candidacy (*cf.* Hennecke 2000, 305f.).

Despite these gestures of a long overdue reconciliation, post-war Austria and its duopolistic intellectual climate remained alien to many emigrants, in particular those who had retained the individualistic-liberal tradition of the Viennese School. Thus the symbolic reconciliation with Ludwig von Mises, the ancestor of the American state skeptics, amounted to nothing more than presenting him, on behalf of the socialist federal president Adolf Schärf (1890-1965), with the *Ehrenkreuz für Wissenschaft und Kunst* (Medal of Honor for Science and Art) of the Republic of Austria, in the Austrian embassy in Washington in 1962 (*cf.* Hülsmann 2007a, 1034). After becoming an emeritus professor, Friedrich A. von Hayek accepted a guest professorship at the University of Salzburg in 1969, but feeling rather isolated, both academically and intellectually, he returned to the University of Freiburg after only four years. It

was easier for the Republic to be reconciled with those who had, after their emigration or expulsion, more or less turned their backs on the Viennese School. In 1965, Oskar Morgenstern was awarded an honorary doctorate of the University of Vienna and had a leading role at the *Institut für Konjunkturforschung*. In 1971, Fritz Machlup became an honorary senator of the University of Vienna, Gottfried Haberler received an honorary PhD from the University of Innsbruck (1970) and from the Vienna University of Economics and Business (1980) and Matha Stephanie Braun an honorary PhD from the University of Vienna (1989).

In 1971 Hayek took part in a symposium organized by Wilhelm Weber and John Richards Hicks (1904-1989), which took place in Vienna on the occasion of the centenary of the first publication of Carl Menger's *Principles*. In addition to Oskar Morgenstern, Fritz Machlup and Gottfried Haberler other participants included the son of the School's founder, Karl Menger, and Kenneth J. Arrow (b. 1921) (cf. Hicks/Weber 1973, V). Never before had three future Economics Nobel Prize winners come together at a conference in Vienna (Arrow and Hicks 1972, Hayek 1974). In the presentations made in English, it was pointed out, among other things, that various strands of thought existed among the "Austrians". Two authors even preferred to talk of a "Menger Tradition" instead of a "School" (cf. Streissler/Weber 1973, 228f a. 231). Indeed, many of the theoretical achievements from Austria had found their way into the mainstream, so that over the whole span of its existence, the actual genuine characteristics of the Viennese School were no longer easy to define.

Later, in an article for an anthology celebrating the 100th birthday of Ludwig von Mises, which most of the emigrated Austrian economists contributed to, Fritz Machlup retrospectively formulated the six most important characteristics of the Viennese School as follows (cf. Machlup 1981, 9f.):

(1) *Methodological Individualism*: In the explanation of economic phenomena we have to go back to the actions (or inaction) of individuals; groups or "collectives" cannot act except through the actions of individual members.

(2) *Methodological Subjectivism*: In the explanation of economic phenomena we have to go back to judgments and choices made by individuals on the basis of whatever knowledge they have or believe to have and whatever expectations they entertain regarding external developments and especially the consequences of their own intended actions.

(3) *Tastes and Preferences*: Subjective valuations of goods and services determine the demand for them so that their prices are influenced by (actual and potential) consumers.

(4) *Opportunity Costs*: The costs with which producers and other economic actors calculate reflect the alternative opportunities that must be foregone; as productive services are employed for one purpose, all alternative uses have to be sacrificed.

(5) *Marginalism*: In all economic designs, the values, costs, revenues, productivity, etc., are determined by the significance of the last unit added to or subtracted from the total.

(6) *Time Structure of Production and Consumption*: Decisions to save reflect "time preferences" regarding consumption in the immediate, distant, or indefinite future, and investments are made in view of larger outputs expected to be obtained if more time-taking production processes are undertaken.

Finally, Machlup introduced two further characteristics, which were particularly applicable to Mises and his students:

(7) *Consumer Sovereignty*: The influence consumers have on the effective demand for goods and services and, through the prices which result in free competitive markets, on the production plans of producers and investors, is not merely a hard fact but also an important objective, attainable only by complete avoidance of governmental interference with the markets and of restrictions on the freedom of sellers and buyers to follow their own judgment regarding quantities, qualities, and prices of products and services.

(8) *Political Individualism*: Only when individuals are given full economic freedom will it be possible to secure political and moral freedom. Restrictions on economic freedom lead, sooner or later, to an extension of the coercive activities of the state into the political domain, undermining and eventually destroying the essential individual liberties which the capitalistic societies were able to attain in the nineteenth century.

Machlup's succinct and precise descriptions give us a clear indication as to why, in the political and intellectual climate of the Second Republic, it was almost inevitable that the Viennese School's research program would be met with disapproval. In many ways, the Republic epitomized, as it were, the antithesis of the individualistic-liberal credo of the Viennese School. Thus, in 1978 for example, the government share of nominal capital of the Austrian companies still amounted to 32.6 percent and the government-owned companies employed 19 percent of the entire workforce (Goldmann/Beer 1991, 35). The two major parties, with their ambivalent attitude towards the individualistic-liberal tradition, made their presence felt everywhere: with 2.4 million voters in 1979, the Socialist Party had 721,000 members (Ukacar 1997, 259), the Christian-Social People's Party at least 560,000 members (Müller 1997b, 272). For a long period of time, the voters were in favor of an economic policy which allowed the federal debt to be raised from 10 percent of GNP (1974) to 38.5 percent (1985) and finally to 68 percent (1995). Against this background it became the established view that the Viennese School was not to be seen as anything more than an interesting, but closed chapter in the history of economics.

This became particularly clear during a symposium in 1986, when the Austrian organizers indeed attempted to find common ground with the American

"Austrians" and invited Isreal M. Kirzner (b. 1930). However, the majority of speakers kept their distance from, or even expressed antagonism toward, the Viennese School (cf. Leser 1986). Apart from Kirzner (Kirzner 1986), only Hans Seidel (b. 1922), spoke tentatively, in view of the crisis of Keynesianism, about the present and future relevancy of the Viennese School (Seidel 1986, 228). Indeed, only the Innsbruck professor Karl Socher (b. 1928) was at that time systematically lecturing about the principles of the Viennese School in Austrian universities. Nevertheless, for the first time in decades, the Viennese School was once again a central subject of research, this time as a noteworthy tradition of the University of Vienna. Almost all the authors of the aforementioned symposium emphasized their distance in terms of content; however, at the same time they were pleased to use the opportunities offered to assume, based on their language skills, historic library stock, and knowledge of the intellectual environment, an internationally recognized leading role in narration and interpretation of the history of ideas behind the Viennese School.

In this context, Erich W. Streissler (g. 1933), who was the holder of Menger's former chair at the University of Vienna for the last third of the 20th century, published about two dozen papers on the history of ideas and science of the Viennese School, being one of the first to include the political, sociological and historical-intellectual aspects as well. Finally he estimated the Viennese School's relevancy to modern economics as decision theory to be very high (cf. Streissler 2000a). His assistants and faculty colleagues, such as Werner Neudeck, Gerhard O. Orosel, Peter Rosner and Karl Milford, also published articles about the history and epistemology of the School. Hans-Jörg Klausinger of the Vienna University of Economics and Business published works on the history of the School between the wars. At the University of Graz, along with Manfred Prisching, it was above all Heinz D. Kurz, director of the Graz *Schumpeter Center*, who published several articles about Joseph A. Schumpeter, but also about Böhm-Bawerk and the Austrian School as a whole (cf. Kurz 2000).

This tracing of historical roots is actively continued in the Austrian universities to this day. However, attempts to revive the Viennese School's fundamental ideas were almost entirely restricted to non-university and private initiatives. The *Carl Menger Institut*, founded 1987 in Vienna, was forced to close down after just a few years. Today, the *Friedrich August v. Hayek Institut*, founded in 1993, has taken on an acknowledged promotional role by organizing events on topics pertaining to the Viennese School, publishing books and by financing one guest professorship in Vienna each semester. Of the more recent initiatives, the *Institut für Wertewirtschaft*, founded 2007 in Vienna, deserves a particular mention. Of course, these activities cannot in any way compensate for the fact that Austria has rejected its great legacy, which was the Viennese School.

CHAPTER 24

The renaissance of the Viennese School: the Austrian School of Economics

In the 1930s it became clearer than ever before that the fundamental theoretical assumptions of the Viennese School ran decidedly counter to the dominating spirit of the age, which increasingly seemed to be dedicated to the collectivist ideologies of the left and right, which were all promising salvation. This trend could be felt even in those societies which had remained democratic, which meant that John Maynard Keynes' presumptuous claim of being able to secure the future welfare of mankind quickly found zealous supporters. After the annexation in 1938 the Viennese School finally collapsed under the strain of external forces, but it had already been on the sidelines for a long time. After the Second World War the ideas of the School seemed to sink into oblivion. Social policy in the western democracies was oriented towards the ideas of the welfare state and was bolstered by economists promising *The Affluent Society* (Galbraith 1958). One of the fundamental insights of the Viennese School, namely that the utopian societies designed by social engineers are nothing but unscientific illusions, seemed destined to perish (Salerno 2002, 115). Menger's *Principles of Economics* was first translated into English in 1950, but this made no difference to the fact that the 50s and 60s were to become "years in the wilderness" (Zijp 1993, 73).

Having emigrated, most of the exiled members of the Viennese School soon joined the neoclassical mainstream, for example Fritz Machlup, who in the USA became the pioneer of information economics. His stance on American monetary policy caused a rift between himself and his father-like friend Ludwig von Mises which lasted for many years (cf. Hülsmann 2007a, 86of). Oskar Morgenstern advised American government agencies and published works mainly on game theory, economic forecast and methodology. Paul

Rosenstein-Rodan became a highly considered expert for developing countries and Gottfried Haberler worked for the American central bank system. They all felt a lifetime devotion to the Viennese School, without, however, continuing to undertake further research for it. It was therefore possible to have the impression that the theories of the Viennese School had entered into mainstream economics (cf. Hayek 1973, 13 a. Boettke 1994a, 1).

It is to Friedrich A. von Hayek's and in particular to Ludwig von Mises' credit that it was not only possible to keep the legacy of the Viennese School alive in a new environment, but also, with some colleagues and new students, to significantly continue its development. Hayek's later most influential students from his time at the *London School of Economics* were, among others, Ludwig Lachmann (1906-1990) and George L.S. Shackle (1903-1992). Lachmann, who taught in Johannesburg (South Africa) from 1948 onwards and who developed a radical form of subjectivism, challenged altogether the information character of prices, on the grounds of constant change and therefore the unpredictability of knowledge. Shackle struck a similar path, beginning his doctoral thesis under Hayek but ultimately turning towards radical subjectivism and propelling it toward nihilism.

When Hayek was appointed to the University of Chicago in 1949, the tradition of the Viennese School came to a sudden end. Having been assigned to the "Committee of Social Thought" in Chicago, Hayek increasingly moved away from the terrain of economic research in the strict sense, which suited his interests very well. He subsequently addressed himself to the study of the legal and institutional frameworks of a free society (Hennecke 2000, 229-232). Even though his contributions to the theories of law and politics were closely connected to his economic theory and were logically cohesive (cf. Huerta de Soto 2007 [2000], 111), his faculty colleagues soon labeled him a "social and law philosopher" (cf. Boettke 1994b, 613). Yet others placed him, with a smug overtone, in the category of "conventional wisdom" (cf. Galbraith 1958, 6).

In contrast, Ludwig von Mises remained true to his original field of expertise. After his arrival in New York in 1940, with the help of Machlup's contacts he was able to have *Omnipotent Government* (1944), *Bureaucracy* (1945) and *Human Action* (1949) printed. With the help of friends and former students, von Mises, by then 64 years old, obtained a guest professorship at *New York University* in 1945, in which he was active until the grand old age of 87. The response to his first two books published in the USA was low-key. In contrast, *Human Action* became a great success (cf. Hülsmann 2007a, 883-888). The critics of the then prevalent New-Deal-statism soon recognized in Mises a welcome comrade-in-arms. Particularly impressed by Mises was the brilliant journalist Henry Hazlitt (1894-1993), who published two influential books, *Economics in One Lesson* (1946) and *The Failure of the New Economics* (1959), which contained ideas very close to those of the Viennese School. So, gradu-

ally, a heterogonous stream of freedom thinkers emerged, who—since the label “liberal” had already been taken over by the American Democrats—referred to themselves as *libertarians*. Admittedly, their critical, sometimes hostile attitude toward the state sometimes went too far for Mises, coming as he did from European liberalism (cf. Hülsmann 2007a, 857-862).

In New York, Mises managed once more to assemble a circle of students which would have a lasting effect, and from which significant economists in the tradition of the Viennese School emerged. Thus, in *Market Theory and the Price System* (1963) and in *Methodological Individualism, Market Equilibrium and Market Process* (1967), Israel M. Kirzner (b. 1930) developed a theory of markets and entrepreneurs which explained the endogenous tendency of an economy towards equilibrium with the help of entrepreneurial action. According to Kirzner, the entrepreneur is characterized by an outstanding “alertness” which enables him to detect price differences and thus deficient coordination. Subsequently, the profit motive instructs the entrepreneur to act as a co-ordinating force. Kirzner’s theory of the entrepreneur as “discoverer” is to this day considered (as) groundbreaking. Hans F. Sennholz (1922-2007), another student of German origin, who later became a professor at *Grove City College* and the president of the *Foundation for Economic Education*, translated many of Mises’ writings from German into English. With the books he published, and especially his numerous talks, he contributed to the early spreading of the Austrian position on monetary theory and monetary policy, and attempted to bridge the gap between science of economics and intellectual American-Protestant circles.

Possibly the most distinguished Mises-student in the New World was Murray N. Rothbard (1926-1995), who later became a professor at the *University of Nevada* in Las Vegas. In his extensive early work in two-volumes, *Man, Economy and State* (1962), Rothbard had already succeeded in expanding on his teacher’s approach, especially in the areas of monetary theory, theory of monopoly and theory of interest and capital. In *America’s Great Depression* (1963), using his extensive knowledge of theoretical economics and history, he demonstrated how inflation of the money supply, responsible for the artificial “boom” in the “golden 20s”, had developed and how it inevitably led to the stock market crash of 1929. This explanation of his contradicted the still currently dominant Keynesianism-biased interpretation of “Black Thursday”. With his two-volume work *An Austrian Perspective on the History of Economic Thought* (1995), Rothbard presented a comprehensive history of economic theory from the *Austrian* angle. Apart from his teaching assignments in New York and Nevada, he wrote well over a thousand articles and 25 books, which also included works on political philosophy and natural rights ethics. As a political agitator he sharply criticized the aggressive US foreign policy, the expansion of the state and the curtailment of basic freedom rights, and evolved into a

radical advocate of the libertarian movement, yet always retained his pacifist stance.

Although a succession of talented and later well-known economists emerged from Mises' New York seminar¹, prior to 1970 there was hardly any mention of a *Modern Austrian School of Economics*. Until the mid-1960s the Austrians, represented by Hayek and Mises, were considered by many of the established economists simply as historic relics, who fought aggressively and bitterly in a hopelessly quixotic manner against the mainstream and who in questions of economic policy made one mistake after another (cf. Tieben/Keizer 1997, 5). In the academic community they were merely a small minority, whose way of thinking was incompatible with the neoclassical paradigm. The three basic assumptions of neoclassical economics (optimization behavior, fixed order of preference and equilibrium) stood, then as now, in diametrical opposition to the basic positions of the Austrians – expedient action, individual preferences and dynamic processes. (cf. Boettke 1994b, 602 a. 604). Moreover, the Austrians categorically rejected a mathematical treatment of economic problems because “in the sphere of action” there is “no unit of measurement and no measuring” (cf. Mises 1953, 663). Only a few essays thus appeared in academic journals (cf. Salerno 2002, 116f), with the consequence that “Austrian Economics” was predominantly perceived as a “book science” (ibid., 602) of little consequence.

During this phase of noticeable academic isolation, the *Mont Pèlerin Society*, established in 1947 in a hotel on Mont Pèlerin near Vevey on Lake Geneva, was for both Hayek and Mises the most important bridge to their old Europe. As well as the former Italian president Luigi Einaudi (1874-1961) and the philosopher Bruno Leoni (1913-1967), the author of *Freedom and the Law* (1961), members of Hayek's society included, among others, the French expert on finance and political theoretician Jacques Rueff (1896-1978). After the First World War, Rueff successfully proved in every single case that in the countries suffering from hyperinflation (France, Italy, Germany, Poland and Austria), the money that had been handed out by central banks had in the main been used to finance budget deficits. After the Second World War he introduced currency stabilization measures under President de Gaulle and later, in *The Monetary Sin of the West* (French 1971), wrote down his insights and experiences. Other members of the *Mont Pèlerin Society* included the economics minister and later chancellor of West Germany Ludwig Erhard (1897-1977), Walter Eucken (1891-1950), Alfred Müller-Armack (1901-1978), Alexander Rüstow (1885-1963) and Wilhelm Röpke (1899-1966), who, as “ordoliberals”, attempted to find a “third way” between socialism and laissez-faire capitalism. Similarly to Hayek in his later work, Röpke also paid particular attention

¹ For example Louis Spadaro, George Reisman, Percy L. Greaves Jr. and his wife Bettina Bien Greaves, Leonard P. Liggio or Ralph Raico

to cultural factors such as morals and tradition. Moreover, he warned against the modern anti-individualistic tendencies, against the “domestication” and “convenient stable feeding” of people by the welfare state (cf. Röpke 1979 [1942], 267). Whereas Hayek maintained an ongoing close relationship with the ordoliberals, Mises categorically repudiated them.

However, the *Mont Pèlerin Society*’s part in the rebirth of the Viennese School as *Modern Austrian Economics* was hardly a direct one. What brought about a new beginning was rather the historical recollection of the central protagonists and the fundamental issues of the School. Thus in 1967, the influential English economist John Richard Hicks recalled the crucial debates between Hayek and Keynes at the beginning of the 1930s, which he called “quite a drama”, and rehabilitated Hayek’s position, which at the time had been defeated (Hicks 1967, 203). One year later, Hayek published the collected works of Carl Menger in four volumes (Hayek 1968b). The centenary of the publication of Carl Menger’s *Principles* in 1971, the eulogies of Mises’ life’s work after his death in 1973 and Hayek’s Nobel Prize for Economics in 1974 subsequently created a growing interest in the substantial legacy of the Viennese School.

This reminiscing about its origins led to a completely new evaluation of Carl Menger. That is to say, the considerable literary tradition of the Viennese School had not infrequently obscured a direct view of Menger’s original body of thought. Menger was thus simply put into the same category as Léon Walras and William Stanley Jevons: the “marginalist revolutionaries” of economics, with Menger’s distinguishing characteristic—his strict rejection of the mathematical approach – being attributed mainly to his mathematical inexperience (cf. Vaughn 1998 [1994], 12f). No other than the son of the School’s founder, the mathematician Karl Menger, was to provide the evidence that his father’s verbally formulated, logically constructed concept of marginal utility was indeed more encompassing than Walras’ mathematically formulated concept of marginal utility (cf. Karl Menger 1973, 40). Some years later, in a remarkable article, the differences between the three “revolutionaries” were made even clearer (cf. Jaffé 1976). The attempt at establishing Carl Menger’s original position within the Viennese School’s body of tradition peaked with Max Alter (1990) and Sandye Gloria-Palermo (1999), both of whom painted a very complex and sophisticated picture of Menger. Furthermore, the latter was able to point out the considerable methodological differences between Menger and Böhm-Bawerk (cf. Gloria-Palermo 1999, 39–50). That same year, Hans-Hermann Hoppe and Joseph T. Salerno, following on from Mises (cf. Mises 2009, 27f.), showed in depth, that in some fundamental methodological questions and questions of economic policy, Friedrich von Wieser had departed crucially from Menger (cf. Hoppe/Salerno 1999). The consequence of this was Wieser’s final expulsion from the Pantheon of the *Austrians*.

Whereas the symposium held 1971 in Vienna, to commemorate the centenary of the publication of Carl Menger's *Principles*, proceeded in a rather dutiful fashion, respectfully maintaining tradition, the conferences organized by the American Austrians in the 1970s were distinguished by lively, indeed sometimes vehement discussions. The contributions from Ludwig Lachmann, George L.S. Shackle, Israel M. Kirzner and Murray Rothbard appeared radical, enriching and daringly bracing, but they threatened to split the small camp of *Austrians*, which was small anyway, into "Lachmannians," "Kirznerians" and "Rothbardians". This split started to become evident even in institutions (cf. Salerno 2002, 119-123) and often appeared more confusing than appealing to outsiders. In 1981, Kirzner and Lachmann of *New York University*, along with the *George Mason University* in Fairfax (Virginia) were subsequently faced with the establishment of the *Ludwig von Mises Institute* in Auburn (Alabama) by Margit Mises, Murray N. Rothbard and the writer and author Llewellyn Rockwell, where to this day researchers and students from all over the world become acquainted with the teachings of the *Austrians*. In the 1990s a new controversy flared up which revolved around the question of whether Hayek was opposed to, or agreed with, Mises' theory (cf. Salerno 2002, 119f. a. Boettke 1994b, 613).

The fact that from the 1970s the neoclassical-Keynesian paradigm, in the light of developments in the real economy—inflation and high unemployment —, had suffered a real crisis of interpretation, and alternative models of explanation were again becoming more popular, contributed to the growing appeal of the *Austrians* and to a noticeable rise in the financial means placed at their disposal for research, teaching and publications. Since then the *Austrians* have never tired of pointing out that it is quite impossible for neoclassicism to reach a well-founded understanding of the real economy, with its model of equilibrium, neglect of dynamic market processes, negation of subjective information, knowledge and learning and its unconditional application of macroeconomic aggregates. In contrast to neoclassicism, *Austrians* had a "much more realistic, coherent and prolific paradigm" (Huerta de Soto 2007 [2000], 120f).

In recent decades the academic network of the *Austrians* has thus grown considerably, and since the 1980s has spread from the USA across the whole world. Up until Kirzner became an emeritus professor, a study program in the tradition of the Viennese School was offered at *New York University*, producing numerous economists who either considered themselves members of the School, or who were significantly inspired by it.² Notable *Austrians* have researched and lectured at the *George Mason University* in Fairfax (Virginia)

² For example Don Lavoie, Sanford Ikeda, George Selgin, Roger Garrison, Bruce Caldwell, Richard Langlois, Stephan Boehm, Uskali Maki, Frederic Sautet, David Harper and Mario J. Rizzo

up to the present, too.³ Furthermore, economists of the *Austrian* creed are currently working at the *Loyola University* in New Orleans, the *University of Missouri* in Columbia (Missouri), the *Pace University* in New York, *Florida State University* in Tallahassee (Florida), *Auburn University* in Alabama, the *University of Nevada* in Las Vegas and at *Grove City College* in Pennsylvania.⁴ The philosopher Barry Smith at the University at Buffalo (New York) should also be mentioned. Two academic journals available to the *Austrians* to this day are: *The Quarterly Journal of Austrian Economics* and *Review of Austrian Economics*.

Outside the USA economists and philosophers of *Austrian* persuasion are working today in universities in Great Britain (Stephan Littlechild, Norman B. Barry), Holland (William J. Keizer, Gerrit Meijer, Auke Leen), Italy (Raimondo Cubeddu), France (Jörg Guido Hülsmann, Pascal Salin, Jaques Garelli, Gérard Bramoullé, Philippe Nataf, Antoine Gentier, Georges Lane, Nikolay Gertchey), Portugal (José Manuel Moreira), Spain (Jesús Huerta de Soto Ballester, Rubio de Urquía, José Juan Franch, Ángel Rodríguez, Oscar Vara, Javier Aranzadi del Cerro, Gabriel Calzada) and in the Czech Republic (Josef Šima, Dan Stastny, Jan Havel). No dedicated “*Austrian chair*” exists in Germany, but a number of experts and authors identify with the research program of the *Austrians* (cf. listing in Baader 2004, 120).

Today the leading representatives of the “revitalized” Viennese School, in the form of the *Austrian School of Economics*, in Europe are Hans-Hermann Hoppe, Jörg Guido Hülsmann and Jesús Huerta de Soto.

Hans-Hermann Hoppe (b. 1949), a native German, wrote his dissertation in philosophy under Jürgen Habermas (b. 1929) and soon after went to study in the USA, eventually taking over the chair of his long-term teacher Murray N. Rothbard at the *University of Nevada*. In his *Kritik der kausalwissenschaftlichen Sozialforschung* (1983), Hoppe made a substantial contribution toward the refutation of empiricism and positivism. It is logically impossible to research causality in social science, since such research is incompatible with the statement that it is possible to learn, a statement implicitly acknowledged as valid by every scientist and which cannot be denied without contradiction. Therefore economics cannot be an empirical social science, but instead has to be understood as an aprioristic science of action. In *A Theory of Socialism and Capitalism* (1989), Hoppe defines socialism as an institutionalized system of aggression against property, a deeply immoral social system which by no means corresponds to a “natural order”. This key idea was further expanded in *Democracy: The God That Failed* (2001) and augmented by a fundamental and

³ For example Peter Boettke, Don Boudreaux und Karen I. Vaughn

⁴ For example Hans-Hermann Hoppe, Walter Block, Thomas DiLorenzo, Peter G. Klein, Joseph T. Salerno, Jeffrey Herbener, Bruce Benson, Randal Holcombe, Roger Garrison, Rodrick Long and Mark Thornton.

comprehensive critique of democracy. Hoppe has written numerous books and articles on theoretical questions of the Austrians and on natural rights ethics, but has also criticized the dominating economic fallacies, focusing on “monetary theory” and “public goods”. In 2006 he founded the *Property and Freedom Society*, a forum committed to intellectual radicalism in the tradition of Mises and Rothbard.

The German economist Jörg Guido Hülsmann (b. 1966), who teaches at the University of Angers, France pointed the interest debate in a completely new direction with the publication of *A Theory of Interest* in 2002. According to this, interest is a reflection of the difference in value between ends and means resulting from the logic of action. Unlike Böhm-Bawerk and Mises, Hülsmann therefore no longer traced interest back to the factor time. In his work on the problem of money Hülsmann emphasizes that up until now the advocates of the subjectivist theory of value have laid too much stress on the material aspect, i.e. the economic aspect in the narrow sense. Hence, in *The Ethics of Money Production* (2008; German *Die Ethik der Geldproduktion* 2007b), he defined inflation as that part of money production which arises from the violation of property rights, and classed the problem primarily as an ethical one. Quite generally, according to Hülsmann, state intervention in the monetary system always produces perverse internal dynamics, which ultimately lead either to the destruction of the currency or to total state control. In *The Last Knight of Liberalism* (2007), he presented a comprehensive biography of Ludwig von Mises, using English, French and German sources.

Jesús Huerta de Soto (b. 1956), the current vice president of the *Mont Pèlerin Society* and a leading economist in the Hayekian tradition, is a professor at the *Universidad Rey Juan Carlos* in Madrid. Under his guidance a Masters and PhD program has been set up, devoted specifically to the Viennese School. With *Money, Bank Credit, and Economic Cycles* (2006, Spanish 1998), Huerta de Soto, who majored in economics, law and actuarial mathematics, succeeded in presenting a comprehensive fundamental work on the Austrian theory of business cycles. Another focus of his work is research into creative, entrepreneurially-driven market processes. Huerta de Soto has also become well known for his theory that Spanish late scholasticism should be considered the forerunner of the Viennese School, but he has yet to provide the crucial “missing link” between the scholastic tradition and Menger.

In the last two decades the newly awakened interest in the tradition of the Viennese School and its modern form, the *Austrian School of Economics*, has led to an increased number of publications. Nowadays the main areas of research of the *Austrians* are the theory of institutional coercion, price theory, theory of monopoly and competition, theory of capital and interest, theory of money, credit and financial markets and questions of the welfare economy and its implications. Other areas of activity which are proving fruitful are

the New Institutional Economics, the branch of “law and economics” and the analysis of law and ethics (cf. de Soto 2007 [2000], 124-127 a. Boettke 1994b, 608-611). Irrespective of the multitude and diversity of these contributions, the original range of issues of the Viennese School is still strongly discernable in the current research program of the *Modern Austrians*. Nothing could be better proof of the astonishing longevity and freshness of the Viennese School, arguably the most significant contribution to modern economics to come out of Austria.

As we enter the third millennium, the *Austrians* are endeavoring, more than ever, to intensify the dialog with mainstream economics, to search for allies beyond the boundaries and also to effectively reach an audience of interested experts (cf. Boettke 1994b, 604 u. 610). In so doing, they share with Carl Menger, the founder of their tradition, the strong conviction that they indeed have the better ideas at their disposal. They want to use these ideas to actively influence economic and political discourse, and not just rely on the hope of Menger, who, in his later years once committed the following thought to paper (cf. Hayek, Hicks, Kirzner 1990, 88): “In science there is only one certain way for an idea to finally triumph: to let each and every opposing school of thought act itself out fully”.

List of Abbreviations

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| AAPS | Annals of the American Academy of Political and Social Sciences |
| DBE | Deutsche Biographische Enzyklopädie, 13 Vols., eds. Walter Killy a. Rudolf Vierhaus, KG Saur Verlag, München 1995-2003 |
| DZ | Deutsche Zeitung |
| FN | Footnote |
| HdStW. | Handwörterbuch der Staatswissenschaften, 6 Vols. a. 2 appendix volumes, eds. J. Conrads et al., Gustav Fischer, Jena 1890-1897; 3rd edition, 8 Vols., Jena 1909-1911; 4th edition, 8 Vols. a. one appendix volume, eds. von Ludwig Elster and Adolf Weber, Jena 1923-1929 |
| HOPE | History of Political Economy |
| JGVV | Jahrbuch für Gesetzgebung, Verwaltung und Volkswirtschaft im Deutschen Reich (after 1913 Schmollers year book) |
| JNS | Jahrbücher für Nationalökonomie und Statistik (also Conrads Jahrbücher) |
| LC | Literarisches Centralblatt |
| NDB | Neue Deutsche Biographie, 22 Vols., ed. Hans Günter Hockerts, Duncker & Humblot, Berlin 1953-2005 |
| NFP | Neue Freie Presse |
| ÖBL | Österreichisches Biographisches Lexikon 1815-1950, 11 Vols., edited by the Österreichische Akademie der Wissenschaften, Verlag der Österreichischen Akademie der Wissenschaften, 1957 to date |

- Palgrave The New Palgrave. A Dictionary of Economics, 4 Vols., eds. John Eatwell, Murray Milgate and Peter Newman, Macmillan-Stockton, London–New York 1987
- RGBL. Reichsgesetzblatt
- Schriften Schriften des Vereines für Socialpolitik
- SJ Schmollers Jahrbuch (before 1913 JGVV)
- UA Universitätsarchiv
- WA Wiener Abendpost (Beilage zur Wiener Zeitung)
- WZ Wiener Zeitung
- ZfGS Zeitschrift für die gesamte Staatswissenschaft
- ZfN Zeitschrift für Nationalökonomie (1930–1944), continued after the Second World War, from 1970 (to date) Journal of Economics
- ZfVS Zeitschrift für Volkswirtschaft und Sozialpolitik (1921–1925)
- ZfVSV Zeitschrift für Volkswirtschaft, Socialpolitik und Verwaltung (1892–1917; 1921–1925 as ZfVS; 1930–1944 as ZfN)

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To be done

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