

# The Historical Setting of the Austrian School of Economics

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## 1. Carl Menger and the Austrian School of Economics

### 1. *The Beginnings*

The Austrian School started in 1871 with the publication of Carl Menger's *Grundsätze der Volkswirtschaftslehre*. His theories of marginalism and subjectivism had been foreshadowed to some extent and people like Walras and Jevons at the same time developed the idea of marginal utility.

Eugen von Böhm-Bawerk and Friedrich von Wieser never studied with Menger but learned from Menger's book. Menger gave a private seminar in Vienna which resulted in an increase in the ranks of the 'Austrians'. Only with the publication of Menger's second book in 1883, *Untersuchungen über die Methode der Sozialwissenschaften und der Politischen Oekonomie insbesondere* did the label 'Austrian School of Economics' get used by its opponents.

### 2. *The Austrian School of Economics and the Austrian Universities*

At the end of the 1870s the Liberal Party that comprised the Austrian Cabinet was ousted by a coalition of nationalists, the Church and princes and counts of Czech and Polish aristocracy. But the constitution that the LP had induced the emperor to accept in 1867 remained largely in place.

This guaranteed a climate of freedom, and whereas before the second part of the 19<sup>th</sup> century nothing interesting had come from Austrians in the philosophical or historical sciences, after that Austria, in particular Vienna, became a hotbed of intellectual renewal.

Although the Austrian "Ministry of Worship and Instruction" would have wanted to do something against this intellectual climate, intellectual freedom was protected by three privileges which universities had acquired under the LP:

1. although lecturers were civil servants, their superiors were not allowed to interfere
2. the Minister was obliged to comply in appointing professors with faculty
3. a doctor who had published a scholarly book could ask faculty to admit him as free and private teacher (Privat-dozent)

At the two universities in Vienna that taught economics a body of lawyers and thus non-economists had to decide who would fill an empty spot. They had to choose between the Austrian School and the allegedly "modern" *historical* school. Since 'Austrian' was almost a curse word (because Austrian universities had been sterile for so long) they tended to choose the latter. Menger, Wieser and Böhm-Bawerk got their appointments previous to this *Methodenstreit* but so became increasingly more isolated.

### 3. *The Austrian School in the Intellectual Life of Vienna*

In Vienna like in other centers of culture (in France and Germany) there was a close association of university teachers with the cultured public of the city. This began to vanish when the old masters died or retired. The outstandingness was upheld though by Privat-Dozents. (e.g. Freud and Mises) In Mises's case almost all of the attendees at his Privat-Seminar went on to continue as scholars. But the many in the city, as everywhere, looked upon this cultured elite with disdain and distrust.

### 4. *Böhm-Bawerk and Wieser as Members of the Austrian Cabinet*

Economics is unpoplar because it exposes that privileges for the few can only come at the expense of the many. Menger, Böhm-Bawerk and Wieser were not interested in public policy and with the rejection of interventionism by Classical economics. They wanted to put economic theory on a sound basis.

Böhm-Bawerk joined staff of Austrian Ministry of Finance in 1890 and served as Minister of Finance in caretaker cabinet twice. His priorities were maintaining gold parity and balanced budget. Wieser during WWI was Minister of Commerce but had very little power.

## II. The Conflict with the German Historical School

### 1. *The German Rejection of Classical Economics*

The hostility that Classical economics encountered on European continent was primarily caused by political prepossessions, by people whose privileges were threatened by it.

But there were other grounds for rejection as well: this new branch of knowledge created epistemological and philosophical problems for which the scholars did not find a satisfactory solution. It could not be integrated into traditional *empiricist* system of epistemology and methodology. Still, only very few thought that economics could have same method as natural sciences, e.g. qua experimentation.

When Germans began to study British Classical economics they accepted idea that economic theory is derived from experience. But then they started to ask: are the experiences not very different in different times and areas and so can there be a universal economics? The Historical School said no and thereby negated the very idea of economics as a science. But this did not prevent them from saying such and such measures would have good or bad consequences in the *future*, which is odd. In any case, economics then degenerated into an unsystematic, poorly assorted collection of various scraps of knowledge borrowed from history, geography, technology, jurisprudence and party politics. Most of the professors made propaganda for the policies of the imperial Government. But this was caused, made possible by the epistemological interpretation (non-universality) of economic theory.

Moreover, the Germans were disdainful of the Classical preoccupation with wealth (creation) and utilitarianism.

### 2. *The Sterility of Germany in the Field of Economics*

German universities were owned and operated by various kingdoms and grand duchies that formed the Reich. They did not necessarily directly control research of people but started to strongly influence the hiring process. After the King party's –conservative, led by Bismarck – triumph in the Prussian war of 1866 there was no room for *laissez faire* economics. Prussia had most and profitable chairs in economics and from 1882 to 1907 Friedrich Althoff as minister of instruction controlled these departments. The result was complete sterility.

### 3. *The Methodenstreit*

After Menger's second book that attacked the epistemology underlying the Historical School the *Methodenstreit* began in full. The question essentially was not about method, but about whether there could be a science rather than mere history of human action. But Menger was too much influenced by JS Mill's empiricism to drive his point home.

What were the schools of thought that played a role?

1. Radical materialist determinism: ideas etc. are produced by physical/chemical events that one day can be explained by physics/chemistry. This is the only true scientific method. (this basically is the logical outcome of positivism)
2. Non-atheist and non-radical positivism: economics is domain of its own but in order to make it a science we need more data, more history, more material, and then apply induction. (e.g. Gustav von Schmoller)
3. Austrian School

### 4. *The Political Aspects of the Methodenstreit*

British *laissez faire* principles dominated most of Western and Central Europe in 19<sup>th</sup> century, but Bismarck started the creation of a welfare state. Classical economics would show the futility and destructive nature of such interventions, so one must deny the existence of a science of economics (and praxeology). This is what all interventionist and socialists etc. have done. They opt for the Historical School p.o.v.: different time/area- different economics. Economics as a result pretty much died in German universities and the Historical School reigned supreme with the result that the catastrophic ideas were made popular among German people which led to a lot of bad things.

Schmoller advocated state-socialism and his only critics were other socialists, i.e. Marxists who quickly got the upper hand because at least they had a theory, as crappy as it was. So Schmoller gradually became more and more Marxist himself. After the defeat in WWI the economists shifted their allegiances from the defeated princes, aristocrats and bureaucrats to various splinter groups from which the Nazi's emerged. The most gifted of Schmoller's students first praised Marxism, then attacked it for its lack of patriotism and endorsed Hitler.

#### 5. *The Liberalism of the Austrian Economists*

Plato wanted a benevolent ruler. The Enlightenment put its hope in the double faith in goodness of man and his rational mind. A great future could lie before us. Most of 19<sup>th</sup> century liberals who advocated democratic government and universal suffrage believed strongly in infallibility of common man's rational mind.

But the liberal philosophers thought differently: the rationale of representative government is not man's infallibility (in which they did not believe) but its making possible peaceful transitions of power and peace is essential for market which in turn guarantees material progress. Government eventually rests on ideas held by majority, if they want others they can achieve this, but through various means. Representative government makes this a peaceful affair.

These true liberals like Menger, Wieser and Böhm-Bawerk thought that the power of sound logical argument is irresistible and that the intellectuals could be swayed by these who in turn would be trusted by the dull masses. So they were calm in the face of fiery and passionate but incoherent Marxism. They trusted logic would win out among intellectuals and that masses would follow them. But at the same time they were not blindly optimistic, knowing full well that there was no guarantee of coming generations not regressing to bad ideas.

They regarded it as their task not to propagandize their ideas, let alone by questionable methods, but to just develop them, put them on a sound basis, as well s they could.

### **III The Place of the Austrian School of Economics in the Evolution of Economics**

#### 1. *The "Austrian School" and Austria*

Not all economists from Austria were Austrian economists (e.g. Auspits, Lieben, Amonn and Schumpeter, and a lot of economists abroad were called Austrian economists by their critics. Most *Austrian* Austrian economists were German-speaking, though some were Czech.

After Menger's death one no longer distinguished between Austrian economics and other economics because the essential ideas of the Austrian School were by and large accepted as integral parts of economic theory. Although Mises's work on the trade cycle was called specifically Austrian.

#### 2. *The Historical Significance of the Methodenstreit*

The antagonism that manifested itself in the *Methodenstreit* is of all times and places, because economics as a science threatens special privileges. The common man cannot see why coercion does to the market and how the market is essential to his well-being. So common man is susceptible to manipulation by leaders and intellectuals as happened under Bismarck and as happens everywhere all the time. But the truth persists and works.