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From Mercantilism to the Austrian School Economics at the University of Vienna

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Foreword

We are glad to bring out this paper as the monograph of CMDR. It is quite evident that in the din of research today there are very few scholars who would be speaking on the evolution of thinking in the domain of Economics which we believe should be true for other social science disciplines in the Indian context. A good understanding of the significant contributions of various thinkers in Economics would be helpful in building a strong foundation for the NEW AGE RESEARCHERS in finding solutions to the problems that confront populations across the globe. The monograph would certainly provide rich information about how the Austrian school evolved over the period of time and in what way it helped in moulding the theoretical underpinnings in the discipline of Economics.

Prof. Peter Rosner has been on the faculty of economics at the University of Vienna, for over 35 years Being the son of the soil he would naturally have had a better understanding of the contributions of the thinkers from of Austria in a much better way. The paper is the outcome of his long experience of teaching and research at this esteemed institution.

We at CMDR sincerely thank him for visiting our Institute and delivering a talk on this theme. We hope and trust that he would continue to be associated with CMDR in the years to come.

Vinod B. Annigeri
Acting Director

To give a talk on the development of economics from the perspective of Austrian school of Thoughts at the University of Vienna in a research institute in India needs some justification. The title of my talk suggests a very parochial exercise, as if it were some kind of a regional history. But that is not the case. In the first part I will draw the attention to a type of economics dominant in the German speaking countries, showing features very different from the British tradition; however interesting from the point of view of governing a state. In the second part I will tell the story of the Austrian school before it migrated to the US. This story is part of any course in the History of Economics, because one of the three starting points for modern economics, traditionally termed neoclassic, was in Vienna. The two others were Jevons in England and Walras in Lausanne. I want to draw the attention to the achievements of this school and to its limits. Before that I want to make a few comments about my interest in history of economics.

Peter Rosner

I. Introduction

Different sort of questions are pursued in research in the history of economics. One can ask who had the original idea – who published first. Sometimes it is done for making great names appear small. For example, Joseph Schumpeter states in his thick History of Economics book, published posthumously, that there was nothing new in Adam Smith. That may be correct. But it is completely beside the point. Smith put all ideas together in a new systematic way and thereby created the subject of economics as a science. In some instances, the quest for the first one to develop an idea is used in political-cultural disputes, in many instances with some nationalist overtones. For example, people working in the History of Chemistry have shown that the first to find the formula for benzene (C_6H_6) was not the German Kekulé but the Austrian Loschmid. Such results I find rather boring unless one claims that one took it directly from the other – copy and paste. Surely this was not the case between Loschmid and Kekulé. Both were working at the same time at similar problems without having so regular a contact with each other as it is common today.

Often research in History of Economics is related to specific schools, for example Keynesian economics against neoclassical economics, or Ricardian economics against the neoclassical theory of capital. One turns to earlier authors in order to find a basis for a critique of dominant theories. Such type of research can be useful as it helps to uncover problematic aspects of a theory. Piero Sraffa found in Ricardo a fundament for the critique of the theory of capital dominant at his, Sraffa's, time – basically the concept as developed by Böhm-Bawerk.

My question for the history of economics is somehow different. I see economics as a science to discuss economic problems and to help in the governance of economies. We want to know whether qualitative easing will help to overcome the current crisis or whether it might end in an even bigger catastrophe. One wants to know what can be done to help farmers when India cannot any longer subsidise its agricultural production. For questions like these, there can be only one correct theory. Let us assume there are two. For example, a strictly monetarist theory condemning the qualitative easing and rather Keynesian one showing that it will really help. How we are going to decide which one is correct? One cannot say I believe in one of them. That would contradict the basic idea of a science. Everything has to be argued such that a participant in the discussion can agree or has to give counter arguments. To evaluate between two different theoretical approaches one needs a common theoretical framework for both. My interest in the history of economics is simply how new ideas, new concepts were brought into – perhaps – fictitious mainstream and thereby contributed to a better understanding of economic problems.

II The beginnings

In the German speaking countries topics which now belong to economics were part of the science of the state. Authors addressed in their writings the prince to tell him what he should do in order to make his state rich. This literature is called mercantilist or cameralistic. In the word cameralism there is the German word *Kammer* – chamber. In the context of economics it refers to the room where the prince discusses with his ministers and his advisors affairs of the state. It is not the room where the prince represents publicly. Economic policy was not to be discussed publicly in the German states or in Austria. This type of doing economics is completely different from the British tradition. There existed a comparatively free discussion of economic affairs since the end of the 16th century. The participants were philosophers, administrators, bankers, merchants – for example heads of the East Indian Company. It was a small elite who discussed specific economic questions by writing pamphlets, arguing for or against specific policies.[1] The authors were looking for general principles.

In the German states such a discourse did not exist. The princes ruled absolutely. The idea of a free discussion of political affairs was absent. However they were interested in economics for reforming their state to increase its wealth. Economics became the science of administration of economic affairs. Some of the princes founded chairs at their universities to teach economics long before chairs of economics were set up in British universities – Adam Smith was professor for ethics (Magnusson, 1992)[2]. The state's administrators should know about economics in order to make politics more rational and to get a more rationally working administration. German economists were pursuing questions of administration. They were not pursuing the quest for fundamental theories. Indeed, today their topics are part of development economics: what should the state do to increase production. It was then taken for granted that the state, that is the prince, can help to increase production and he should do so.

At the University of Vienna, which was amongst the first one to get such a professorship, it began 250 years ago, when in November 1763 the first professor of what later was termed economics started to teach. This was not a decision made by the university. The head of the Habsburg countries, the Empress Maria Theresia wanted to modernize the state. One aspect of the modernisation of Austria was to reform its administrative system, or rather to build up a state administration, for example separating public finance from the administration of the Habsburg estates. There was a need for the appropriate skills to be employed by the state. The court was looking for somebody to teach these skills to future public servants.

Josef von Sonnenfels, 1733-1817:

Josef von Sonnenfels, 1733-1817

The person chosen was the 30 years old Joseph Sonnenfels. He has studied law and worked as accountant in one of the court's offices. The idea was that he should teach the future civil servants and public officials not only in practical matters but to introduce the students to economics. In his inaugural lecture November 1763 he complained that economics in German literature is usually seen as an art to run an estate or a business whereas questions concerning the whole economy of the state are hardly considered at all. For that purpose one has to turn to French and English literature. He mentions Charles Davenant and William Petty, pioneers of what is now called national income accounting, David Hume whom we connect with the specie-flow mechanism, decisive for the working of the gold exchange standard, Richard Cantillon in whose book the interaction of markets, particularly of financial markets with markets of goods gets analysed and French cameralists. Note that when he started to teach Adam Smith's book was still 14 years away.

Sonnenfels has published his own book in 1769. It has been republished with amendments until 1819, two years after his death. In later editions new approaches were accepted, for example he has read Adam Smith whose Wealth of Nations was published in 1776. Today the questions he treated in the book and therefore in his lectures are dealt with in development economics, namely what makes a country rich, particularly which institutions favour economic growth and which hinder development. As he was a reformist he argued in favour of more liberal economic policies than were prevailing at that time in Austria. Of course he did not attempt to systematically delineate functions of the state in a market economy as Adam Smith had done. He argued for the removal of some of the then existing hindrances to markets, like tariffs within the state, removal of guilds, development of infrastructure, roads canals, property rights and many others; and he argued in favour of entrepreneurial activities by individuals and against organization of production by the state.

Two examples of his ideas: First, he reasoned about prices of agricultural products. He states that high prices are a hindrance for manufacturing. On the other hand, low prices restrict agricultural production and hinder the development of a market for products of manufacture. As we know this was a problem for all economies looking for a quick and often enforced industrialization. Sonnenfels did not have an answer. He simply states that a middle price is the best. But what does that mean? Clearly, one needs a theory of value.

Second example. He wrote a small book on the question what is usury and what can be done against it without using the penal code. It is well known that taking interest was considered a sin and was limited in most states by law. It was criminal offence. Be that as it may, at that time taking interest was normal and accepted unless the rate was usurious. But what is usurious? Sonnenfels developed the following idea: Money serves two functions, namely it is a medium for payments and a means to finance what we now call investment. Investment is done for profits. If the rate of interest is such that interest payments exceed profits they are usurious, meaning that they reduce investment and hinder development. He proposed a means against it, namely setting up a bank for issuing notes. For any history of economics the point is not whether this would have worked but he used arguments which still are part of the economists' discourse. Sonnenfels set the problem in the context it gets discussed today, namely the relation between the rate of interest, monetary and banking policy and its effects on real development. For the relation between the rate of profit and the rate of interest he could draw on Hume, the relation to financial intermediation was not understood by anybody at that time – and is not understood well today.

Sonnenfels remained at the University for about 20 years. His book was in use until 1848, more than 30 years after the author's death. Though it was a good book when written, it was not its quality which kept it alive. It was made mandatory material in all Austrian universities and until 1800 in some German universities as well. Professors had to read out of a book which had to be approved by the government beforehand. In some of the more liberal German states better books had been published in the 1820s and 1830s. Austria was very repressive until 1848. This clearly hindered the development of economics as science.

It cannot be claimed that Sonnenfels has furthered economics as science. But it can be claimed that the German textbook literature up to the 20th century was influenced by Sonnenfels' approach. In this literature economics is first of all a science of rational administration. The authors did not look for an abstract theory like the British classical school or like Marx. They wrote many volume textbooks about all economic aspects of government – taxes, subsidies, labour relations, quality standards and their control, schooling and teaching, public transport, environment, social problems etc. What makes it economic literature is that the authors took account of incentives created by policies and of what in many instances is termed market failures in modern economics. I think it is fair to say that this literature though quite impressive did not have much impact on economics as science. However the economic political discourse up to the present follows this line. The economics one can find in these books is a sort of sound common-sense-economics. Nothing comparable exists in the British literature of that period.[3]

III A new theory

3.1 Carl Menger


Carl Menger, 1840–1921

The rebellions during the year 1848 brought an end to the very repressive political regime in Austria – still a European empire. The universities became more open, although all appointments of professors were made by the state – ultimately by the emperor.[4] For the chair in economics at the University of Vienna a German was chosen because there was no qualified Austrian due to the former repression of free speech. The man chosen, Lorenz von Stein, had no importance for the development of economics.[5]

Things began to change when in 1871 the young Carl Menger applied at the University of Vienna for getting *Habilitation* for economics. Habilitation is the highest academic distinction in German speaking universities a person can get without having a formal position at the university. It comprises the right to teach.[6] He has published a book with the title *Grundsätze der Volkswirtschaftslehre* (Principles of Economics). It was not meant to be an introductory textbook for beginners of the study of economics like modern economic principles-books. It contained a completely new approach to economic analysis.

The problem he wanted to solve was the following: How come that water though being extremely useful is of little value in the market whereas diamonds carry a high price though it is easy to live without them. This problem has plagued economics since Adam Smith's *Wealth of Nations* in 1776. Neither he nor later British economists could solve this riddle and ascribed value merely to costs. The same is true for French economists. The Germans rejected the pure cost approach to prices and tried to find a way to integrating the concept of use value in the theory of value; however they did not succeed. Menger changed the approach to this question. In the market, we do not ask what the value in use of water is in general and compare it with the value in use of diamonds. We rather ask what the value is in the use of water in a specific situation for a specific person. If there is only little water available people may be prepared to give diamonds for satisfying extreme thirst. If more water is available people give less to get one more unit of water. And if even more water is available so that one can keep a garden with flowers the value of water is still lower. The value of a good is not determined by a general value in use but by a subjective evaluation wherein people evaluate the satisfaction of a specific need by an extra unit of that good; that is an evaluation at the margin.[7]

With this new approach went hand in hand another break with German economics. At that time the dominant approach to economics in Germany was that of the so called Historic School. The development of people as a whole was the object of analysis. Two ideas were connected. First, people developed from the stage of hunters and gatherers to sedentary agriculturists, to slaveholders, to feudal societies and finally to commercial societies. This model of development was shaped by the European history and by the then in Europe existing knowledge of societies outside Europe seen with European eyes.[8] The second idea was that people are a moral unit. Individuals see themselves as members of a society at large. Economic analysis cannot be based by an analysis of actions of self-interested persons as in Adam Smith's approach. Menger rejected this idea radically. Yes, all economic theory must be funded on an analysis of actions by individuals – methodological individualism. This was accepted in the British tradition as well as in France; however it provoked a rebuttal of Menger's approach by most German economists, particularly by the most prominent one, Gustav Schmoller who for many years served as head of the Association of German Economists.

Within a few years after having published his book Menger became full professor of economics at the most prestigious university in Austria. This is astonishing. Not only was his theory not accepted in the profession, his book only laid the groundwork for economic analysis. His theory was primarily a theory of valuation. He used it for some aspects of a price-theory. And there is an important chapter on money. That was all. There was nothing about development, nothing about social problems, nothing about infrastructure, nothing about administration or any other matter of economic policy then prominent in the German economic literature. Probably Menger was backed up by the Emperor of Austria because he had been chosen by the Empress to teach the Crown-prince economics in private lectures.

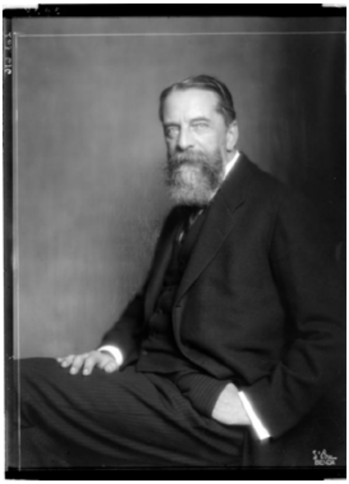
Be that as it may, in the same year as Menger has published his book, William St. Jevons published his *Principles of Political Economy* in England and three years later Léon Walras followed with his *Elements of Pure Economics*. Together they founded what was later termed the Neoclassical school of economics. One can say that economics became a science in the modern sense of science. Whereas the old books on economics – Smith, Ricardo, John St. Mill, Marx, Say, the German textbooks – were read as definite answers to all questions of economics, it was clear to all that the new books were special monographs for a foundation of economics. Others must come in and can use the instruments provided by the founding fathers.

There is a common ground and also differences between these three authors. Common ground is the encompassing marginal approach and rejection of any holistic approach. Actions by rational actors are the object of analysis, not the economy of a people. The differences are the following: (i) Whereas Menger argued with existing human needs and their satisfaction, Jevons could draw on the British utilitarian tradition and argued already with utility in the modern sense. Menger's approach was related to concepts of psychology. Indeed some people wanted to connect economics with empirical psychology. This lead later on to the search for a cardinal concept of utility, whereas Jevon's approach lead to the ordinal concept of utility (Hicks and Allen; Samuelson), dominating economics up to the present. (ii) Menger rejected the use of mathematics, while Jevons and particularly Walras used mathematics in their analysis. (iii) Walras primarily pursued the problem of market equilibrium and also for Jevons this question was important, for Menger dynamics were more important, namely how market equilibria emerge. However he could not develop such a theory.

3.2 Menger's pupils before 1914

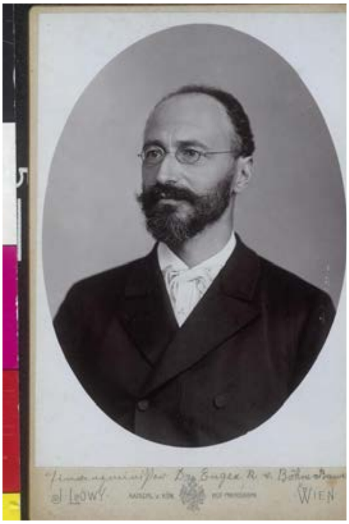
Menger taught for 30 years at the University of Vienna students of law. An economics curriculum did not exist before 1966. His research output was focused at the discussion of methods, primarily a dispute with his German opponent Gustav Schmoller. But by the instrument of *Habilitation* he gained great influence on the further development of economic theory. Students with interest in economics could participate in his private seminar and had access to his library. Those who wanted to teach at the university or strived for starting an academic career had to publish their own research. It had to be in line with Menger's approach. Indeed Menger was the most successful of the three founding fathers of the new theory in establishing a school.

Some of his pupils became high ranking government officials; others became professors at other Austrian universities.[9] Two of them returned to the Vienna University, namely Friedrich Wieser from the University of Prague (now Czech Republic) followed Menger after his retirement and Eugen von Böhm-Bawerk from the University of Innsbruck after having stepped down from the position of minister of finance in the Austrian government. They had a great impact on the further development of economics. Both served for some time as ministers in Austrian governments, Böhm-Bawerk three times as minister of finance and Wieser as minister of trade and social affairs.



Friedrich Wieser, 1851–1926

One cannot claim that they had a common research programme; however their research was centred on political questions then very important, namely the question of socialism and capitalism. Note that in final decades of the 19th century the strictly Marxist Social democratic Party in Austria



Eugen von Böhm-Bawerk, 1841-1915

became very strong. Wieser and Böhm-Bawerk were not arguing for or against one or the other system. But by using Menger's theory they developed concepts to understand the issues raised by Marx. What is capital? What is the difference of value in a capitalist society and a socialist one? How come there are profits? At that time there was no economic theory to answer these and similar questions outside the Ricardo-Marx framework of value. The new theory as worked out by Menger, Jevons and Walras left no space for the classical theory and its Marxian reinterpretation.[10] A new theory was in need!

Wieser asked what the value might be in a socialist society. As such a society aims at satisfying the needs of its members as good as possible, it faces the same problem as an individual person in Menger's theory or any of the other approaches. In this context Wieser coined the expression marginal utility (*Grenznutzen*) and developed the concept of opportunity costs. Whereas in a market society everybody has to equate marginal benefits with marginal costs according to his or her private preferences and available options, in a socialist economy it is the society which has to evaluate the value of satisfying preferences of the society and the costs for doing it. The important point of Wieser was that there is no principle difference between a socialist society and a market society when deciding about production and consumption. In both societies value according to a needs-satisfaction (Menger) resp. utility maximisation (Jevons) should govern all decision concerning production. How a society can find valuation for goods and whether that can be done at all, Wieser did not ask. This question was picked up by the next generation of Austrian economists, namely by Mises and Hayek (see below). Today the problem of finding a collective valuation out of individual preferences is dealt with in social choice theory (Sen, 1970).

Another question Wieser raised was the following. How come that value is attached not only to consumer goods – that was the realm of Menger's theory – but on capital goods as well. With the knowledge of modern economics his answer is not surprising, but they were news when Wieser put it down. It is the marginal contribution of a factor of production for a good. As the value of a good is the value of the marginal satisfaction of a specific need or desire the value of a unit of capital or any other factor of production is the value of the marginal contribution to the marginal value of the satisfaction provided by that good. That is the idea of the marginal product.

Böhm-Bawerk pursued these questions a bit further by asking: what is capital? Namely is there a metric for capital such that one can say more capital or less capital. Note that Ricardo had the idea that machines are capital and more of machines are tantamount to more of capital. The same is true for Marx. Capitalists want to accumulate capital; that is they do not consume their profits and invest them into more and bigger machines.[11] A further theoretical problem with capital was how to see consumption goods as long as they are in the hands of consumers, particularly workers. It seemed clear to all that goods for consumption in the hands of consumers are not part of capital. But how to regard them when they are still in the hand of producers or merchants? Actually when Ricardo spoke of more capital he meant also more wheat to feed more workers. And how is capital related to profits?

Böhm-Bawerk developed a framework for a new theory of capital. People produce consumption goods. Each production takes time. It may turn out that in order to increase the output it is necessary to produce first an intermediate good – Menger introduced the notion of goods of higher order – and then use this good to produce the desired consumption good. The intermediate good is a capital good. To give an example from a famous novel first published in 1719, namely Robinson Crusoe: The shipwrecked hero has to collect fruits, wild cereals and to hunt wildlife for nourishment. One day he discovers a place better suited for survival than the original one. For going to this place he needs a boat. However building one takes time. That implies that he has to accumulate food in order to be freed from search for food while building the boat - savings. Building the boat would now be called investment. The boat itself is a capital good.

Böhm-Bawerk's point was that it takes time to produce capital goods. This only will be accepted if the longer production period results in a final product sufficiently large to make people postpone consumption. This is in line with Menger's approach, namely to base all economic decisions on subjective evaluation. The decision between today's consumption and future consumption is analysed in the same way as how to decide between different uses of a given wealth within a period. Not only do individuals decide according to marginal evaluations within a period, they do it also across periods. Böhm-Bawerk builds on this idea a theory of the rate of interest. It was a purely psychological theory insofar as it looked for psychological arguments why individuals disregard consumption in the future compared with consumption today. That he thought was the reasons why the rate of interest has to be positive.

The psychological foundation of the theory of interest never had great influence on the further development of economics. It rather conformed to the overall psychological approach of the Austrian school and got lost in the ordinal revolution of theory of value by John Hicks and Paul Samuelson. They succeeded in establishing a subjective theory of value without any reference to psychology. Instead they put forward the theory of *rational choice*, later becoming the standard instrument for all microeconomics. But the theory of capital as developed by Böhm-Bawerk had great influence for the further development of economics. Within a few years his book got translated into English and French. It was held in high esteem by other pioneers of economic theory, for example by Irving Fisher in the USA and by Knut Wicksell in Sweden. After all he had developed a concept of capital which provided a metric, so that one could speak more capital or less capital – the period between the first application of labour for producing raw materials until the final goods for consumption. He used the term *roundaboutness*. It can be regarded being an expression for what now is called capital intensity. Furthermore he opened the way to conceptualise economic equilibria in an intertemporal context. That aspect became prominent in the theory of business cycles.

It is justified to say that Böhm-Bawerk had laid the fundament for the neoclassical theory of capital. Its basic flaw was discovered much later. It consists of the following: in order to determine the average roundaboutness – somehow a measure of capital intensity – one needs already the rate of interest. Therefore one cannot use the marginal product of capital as determinant of the rate of interest. To put it into other words: The rate of interest and the prices of capital goods must be determined in one step – a theory general equilibrium. It took decades and many Nobel-prize winning economists until this point was cleared.

3.3 The next generation – the interwar years.

After WW1 a new generation of economists continued the Austrian research programme.[12] Some of them continued to work on theory of value. Due to their insistence on a cardinal theory and of a rejection of mathematics being a means for economics, they had lost any influence on the international development of economic theory. They pursued an approach which would now be called behavioural economics; but they were unable to work out an interesting research programme. They are justly forgotten or at best relegated to footnotes.

More interesting and still well-known is another group. If one speaks in a broader context about Austrian economics of neo-Austrian economics, this group is the object of interest.[13]


Ludwig von Mises, 1881–1973

The two most important men were Ludwig von Mises and Friedrich von Hayek. Neither had a position at the University of Vienna, but as *Dozent* they could teach. They worked in two fields, one being the old question of socialism versus capitalism. This was not any more the question of profits and private property of means of production. Now the question was allocation via markets versus allocation by central planning; particularly what are the functions of prices in an economy with division of labour. After all after WW1 economists in the Soviet-union started to develop ideas for central planning. In Austria as well as in other parts of Central Europe socialist groups striving for abolishing the market system were strong. Be that as it may, Mises and later Hayek stressed the function of prices as provider of information about scarcities. A central planning office can never have the information necessary to allocate resources. It is clear that this question remained a hot topic in economics.

The other field Mises, Hayek and their colleagues and pupils worked was monetary theory and monetary policy. To understand their research question one has to keep in mind that Austria and Germany experienced in the aftermath of WW1 a hyperinflation. In Austria prices rose between October 1921 and Septeber1922 by 1460%, with a peak during August 1922 of 142%. In Germany at the end of the high inflation prices doubled each second day. The cause of these inflations was the increasing supply of money. To finance their war expenditures all European powers stopped binding their currency to gold at the beginning of WW1. Austria having lost the war seized to be a European power. It became a small state in its current borders.[14] The industrial heartland of Bohemia was lost, as well as the fertile lands of Hungary. To keep the remaining Austria together and to ward off a revolution and civil war the government resorted to printing money to finance state expenditure. The result was a drastic reduction of all financial wealth. On the other hand the government got rid of all outstanding debt accumulated during the war.[15]

In the theoretical discussions triggered by that development Mises and Hayek became stout defenders of a strict monetary policy; that is changing the supply of money should never be an instrument for economic policy.[16] However their fame does not rest on this political position but on the theory developed to argue it.

Using the ideas developed by Knut Wicksell in Sweden, who in turn was the first to use Böhm-Bawerk's theory of capital to understand swings of economic activity around a macroeconomic equilibrium Mises sketched and Hayek worked out a theory of business cycles and what can be done about it. This research fitted into the British discussion of monetary disturbances which was started by R. Hawtrey, D. Robertson and J. M. Keynes around 1910. Two questions were pursued. How do banks influence the stability of equilibrium? Namely, the claim was that in an upswing the banks receive more deposits and therefore can grant more loans, thereby enabling the banks to increase the volume of loans. Doesn't that imply an inherent instability for the economy? (Hayek, 1929) The other problem concerned economic policy. If in case of an economic depression the supply of money is increased in order to facilitate investment or state expenditure is increased via public sector borrowing as demanded by great parts of the general public and as the emerging theory of Keynes suggested, will this really help? Hayek's answer in 1931 : no. His argument can be sketched in the following way: In equilibrium the time structure of production according to Böhm-Bawerk's concept of capital, namely the production of primary goods far away from consumer goods via goods of secondary order and so on to finally consumption goods must correspond to the plans of the households for consumption in different periods. The mechanism to bring about such equilibrium is the price mechanism, particularly the rate of interest in an inter-temporal equilibrium. If in case of an insufficient demand for consumer goods the state furthers demand by reflationary policy this attempt will be frustrated as the structure of the existing stock of capital does not allow an increased production of consumer goods. Inflationary pressure will build up.

Equipped with modern macroeconomics it is not difficult to reject this argument. Furthermore, as mentioned above, the underlying theory of capital turned out to lack consistency. But when published Hayek's book was highly esteemed by opponents of reflationary policy and economists in favour of such a policy had difficulties rejecting this theory.[17] Indeed, Hayek who was head of the Institute for Business Cycle Research in Vienna was made professor at the London School of Economics and became the most important opponent to the emerging Keynesian approach.

Be that as it may, Hayek was only the first of the economist to leave Vienna. Austria was at that time a very poor country, politically divided between a Marxist socialist party and a conservative catholic one. There was no liberal group of influence. Furthermore a strong anti- Semitism dominated all cultural and scientific discourse in Austria at that time. Although there were not many Jews amongst the economists, some of them had Jewish ancestors. That contributed to the hostilities in Austria against the Austrian school. By and by all left: Mises first to Geneva at the International Labour Organisation and then to New York University; Fritz Machlup first to the University at Buffalo and then Princeton; Oskar Morgenstern, first New York University, then Princeton; Gottfried

Haberler, first to London School of Economics and then to Harvard (Schumpeter was already there); Paul Rosenstein-Rodan University College London, London School of Economics, Massachusetts Institute of Technology; Gerhard Tintner University of Aimes Iowa, then University of Southern California. Nobody of importance remained in Austria, nor did anybody return to Austria after WW2. The distinct Austrian approach to economics has come to an end at the University of Vienna.

Those who emigrated furthered in the host countries the development of economics with their research and teaching. But they seized to remain a distinctive school. They worked in different fields and contributed to the modern main stream approach of economics. Three of them became head of the American Economic Association (Joseph Schumpeter, Gottfried Haberler and Fritz Machlup). Some of them worked for international organisation – World Bank, GATT, United Nations. Hayek got the Nobel-Price in 1974.


Friedrich August von Hayek, 1899 - 1992

Today an Austrian School of Economics has no impact in the development of current economic theory. Different from academic research an Austrian school, often called neo- Austrian, has influence in the political field. Think-tanks and applied research institutions on the liberal-conservative side of the political spectrum are proud of this heritage. Often they refer to Ludwig von Mises and Friedrich Hayek when arguing for or against a specific policy. But modern economics builds on the achievements of the Austrians – Game Theory heralded by Oskar Morgenstern (together with John von Neumann); development economics – Paul Rosenstein-Rodan; monetary aspects of international economics – Fritz Machlup; the dynamic aspects of behavioural economics, to mention a few. But nowhere in the important journals for research in economics can one find articles whose authors explicitly claim to follow an Austrian approach. It has become a chapter in the history of economics – an important one.


Oskar Morgenstern, 1902–1977

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[1] The most important question related to topics which today belong to monetary macroeconomics – the relation between the amount of money, the rate of interest, the price level, the trade balance, investment etc.

[2] Actually the East Indian College was among the first having a chair for economics. Robert Malthus was made professor there in 1805.

[3] The most important authors were Karl Heinrich Rau, three volumes, 1826 – 1837; Wilhelm Roscher, five volumes, 1854 – 1894; Albert Schäffle, 4 volumes, 1874 – 1978; Adolph Wagner, public finance; Eugen Phillipovic, 3 volumes, 1893 – 1897.

[4] Actually until 2003 the state appointed all professors.

[5] There is an interesting point: The first book by Stein on French socialist and communist ideas argued that in modern societies only two classes will remain; namely the bourgeoisie and the proletariat. This idea is usually connected with the name of Karl Marx. However, Marx (together with Engels) published this idea in 1848 in the *Communist Manifesto*. Stein published this idea already in 1842, six years earlier. Stein's book was read and discussed in Germany. Surely Marx has read it. There are two important differences between Stein and Marx ideas. Unlike the other Stein was conservative. He saw the split of the society into two classes being a threat to civilisation. He considered it an important task for the state to overcome this split, or at least to ameliorate it. This topic remained prominent with the German academic economists. Indeed the German association of economists working at universities was founded already in 1873 and carries the programmatic name, *Verein für Socialpolitik* until today (Association for Social Policy). Second, Stein did not grasp the importance of the bourgeoisie for the development of productive forces, an important topic for Marx.

[6] In many instances it was and still is a precondition for becoming professor.

[7] Actually there was one author who much earlier used the marginal analyses in a more general way, namely Hermann Heinrich Gossen. His book which was published in 1854 made ample use of mathematics and the idea of utility. He remained completely unknown and had no contact with the academic world. He was later rediscovered as an unknown precursor of the new theory.

[8] This idea became prominent in Marxism as well.

[9] These universities are not necessarily situated in Austria in its present borders. For example, Joseph Schumpeter got his first position of professor at the University of Chernivtsi, today Ukraine.

[10] Before WW1 the Russian Nicolai Bukharin who later became one of the leading

men in the Bolshevik revolution wrote during a stay in Vienna a book on the Austrian school claiming that this theory is shaped by the interest of renters. It became a Marxist classic.

[11] Actually, when arguing the tendency of the rate of profit to fall (Capital, vol. 3) Marx does not distinguish between more voluminous capital goods and capital goods of bigger value. He also does not distinguish between capital as a stock and the use of capital as a flow, though in Capital vol. 2 he is very clear on this point.

[12] Menger retired in 1903, Wieser in 1919, Böhm-Bawerk died in 1914.

[13] I have left out Joseph Schumpeter, 1883 – 1950. Unlike the other Austrians he accepted the concept of equilibrium in the sense of Walras and was not interested in a cardinal theory of value. But he himself did not attempt to work out mathematical concepts for economics. Instead he wrote thick books about dynamic aspects –on economic development, on business cycles.

[14] Before WW1 the following countries were within the Habsburg Empire: Austria, Hungary, Slovakia, Slovenia, Croatia, Czech Republic, Bosnia-Herzegovina, parts of Italy, Romania, Poland, Bulgaria and Ukraine.

[15] Joseph Schumpeter who served as minister of finance in the Austrian government for a short period after WW1 suggested taxing all financial wealth, thereby liquidating the public debt. The leader of the Social democratic Party rejected this plan. He wanted to tax all wealth. Schumpeter resigned.

[16] Actually Mises published his book on money already in 1913 when Austria still converted the Austrian currency (Crowns) at a fixed rate into gold.

[17] In a review by Keynes one can read the following about Hayek's 1931 book "The book, as it stands, seems to me to be one of the most frightful muddles I have ever read, with scarcely a sound proposition in it … and yet it remains a book of some interest, which is likely to leave its mark on the reader. It is an extraordinary example of how, starting with a mistake, a remorseless logician can end up in bedlam." (Keynes, 1931, p. 394)