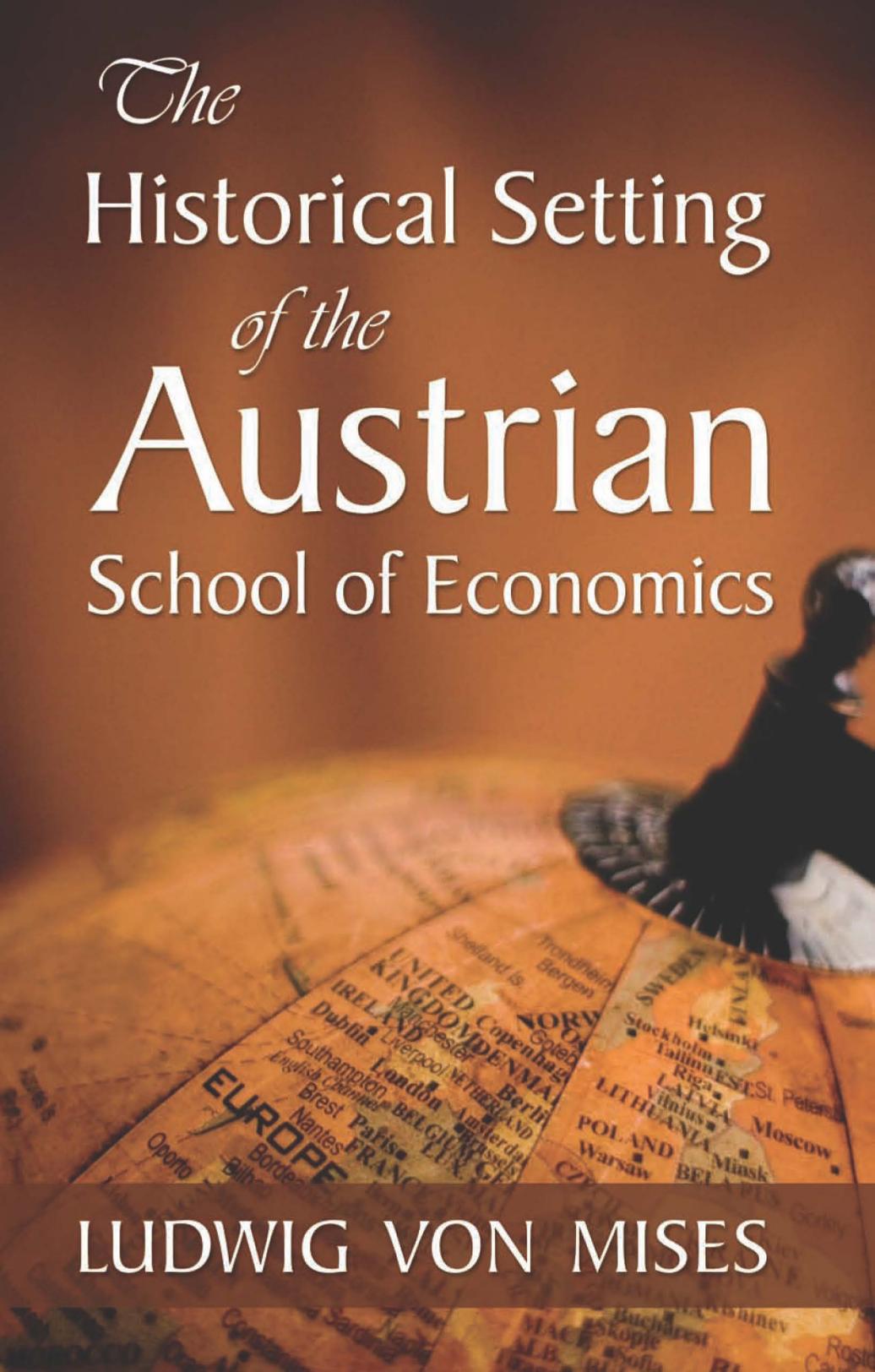


*The*  
Historical Setting  
*of the*  
**Austrian**  
School of Economics

A vintage, sepia-toned map of Europe is the background. A hand in a dark coat is visible on the right side, pointing towards the map. The map shows various countries and cities, including London, Paris, Berlin, and Moscow. The text 'EUROPE' is visible on the map.

LUDWIG VON MISES

# The Historical Setting of the Austrian School of Economics

**Ludwig von Mises**

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## The Historical Setting of the Austrian School of Economics

### Ludwig von Mises

#### I. *Carl Menger and the Austrian School of Economics*

##### 1. The Beginnings

What is known as the Austrian School of Economics started in 1871 when Carl Menger published a slender volume under the title *Grundsätze der Volkswirtschaftslehre*.

It is customary to trace the influence that the milieu exerted upon the achievements of genius. People like to ascribe the exploits of a man of genius, at least to some extent, to the operation of his environment and to the climate of opinion of his age and his country. Whatever this method may accomplish in some cases, there is no doubt that it is inapplicable with regard to those Austrians whose thoughts, ideas and doctrines matter for mankind. Bernard Bolzano, Gregor Mendel and Sigmund Freud were not stimulated by their relatives, teachers, colleagues or friends. Their exertions did not meet with sympathy on the part of their contemporary countrymen and the government of their country. Bolzano and Mendel carried on their main work in surroundings which, as far as their special fields are concerned, could be called an intellectual desert, and they died long before people began to divine the worth of their contributions. Freud was laughed at when he first made public his doctrines in the Vienna Medical Association.

One may say that the theory of subjectivism and marginalism that Carl Menger developed was in the air. It had been foreshadowed by several forerunners. Besides, about the same time Menger wrote and published his book, William Stanley Jevons and Léon Walras also wrote and published books which expounded the concept of marginal utility. However this may be, it is certain that none of his teachers, friends, or colleagues took any interest in the problems that excited Menger. When, some time before the outbreak of the first World War, I told him about the informal, but regular meetings in which we younger Vienna economists used to discuss problems of economic theory, he pensively observed: "When I was your age, nobody in Vienna cared about these things." Until the end of the Seventies there was no "Austrian School." There was only Carl Menger.

Eugen von Böhm-Bawerk and Friedrich von Wieser never studied with Menger. They had finished their studies at the University of Vienna before Menger began to lecture as a *Privat-Dozent*. What they learned from Menger, they got from studying the *Grundsätze*. When they returned to Austria after some time spent at German universities, especially in the seminar of Karl Knies in Heidelberg, and published their first books, they were appointed to teach economics at the Universities of Innsbruck and Prague respectively. Very soon some younger men who had gone through Menger's seminar, and had been exposed to his personal influence, enlarged the number of authors who contributed to economic inquiry. People abroad began to refer to these authors as "the Austrians." But the designation "Austrian School of Economics" was used only later, when their antagonism to the German Historical School came into the open after the publication, in 1883, of Menger's second book, *Untersuchungen über die Methode der Sozialwissenschaften und der Politischen Oekonomie insbesondere*.

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

The Austrian Cabinet in whose journalistic department Menger served in the early Seventies—before his appointment in 1873 as assistant professor at the University of Vienna—was composed of members of the Liberal Party that stood for civil liberties, representative government, equality of all citizens under the law, sound money, and free trade. At the end of the Seventies the Liberal Party was evicted by an alliance of the Church, the princes and counts of the Czech and Polish aristocracy, and the nationalist parties of the various Slavonic nationalities. This coalition was opposed to all the ideals which the Liberals had supported. However, until the disintegration of the Habsburg Empire in 1918, the Constitution which the Liberals had induced the Emperor to accept in 1867 and the fundamental laws that complemented it remained by and large valid.

In the climate of freedom that these statutes warranted, Vienna became a center of the harbingers of new ways of thinking. From the middle of the sixteenth to the end of the eighteenth century Austria was foreign to the intellectual effort of Europe. Nobody in Vienna—and still less in other parts of the Austrian Dominions—cared for the philosophy, literature, and science of Western Europe. When Leibniz and later David Hume visited Vienna, no indigenes were to be found there who would have been interested in their work.<sup>1</sup> With the exception of Bolzano, no Austrian before the second part of the nineteenth century contributed anything of importance to the philosophical or the historical sciences.

But when the Liberals had removed the fetters that had prevented any intellectual effort, when they had abolished censorship and had denounced the concordat, eminent minds began to converge toward Vienna. Some came from Germany—like the philosopher Franz Brentano and the lawyers and philosophers Lorenz von Stein and Rudolf von Jhering—but most of them came from the Austrian provinces; a few were born Viennese. There was no conformity among these leaders, nor among their followers. Brentano, the ex-Dominican, inaugurated a line of thought that finally led to Husserl's phenomenology. Mach was the exponent of a philosophy that resulted in the logical positivism of Schlick, Carnap, and their "Vienna Circle." Breuer, Freud, and Adler interpreted neurotic phenomena in a way radically different from the methods of Krafft-Ebing and Wagner-Jauregg.

The Austrian "Ministry of Worship and Instruction" looked askance upon all these endeavors. Since the early Eighties the Cabinet Minister and the personnel of this department had been chosen from the most reliable conservatives and foes of all modern ideas and political institutions. They had nothing but contempt for what in their eyes were outlandish fads." They would have liked to bar the universities from access to all this innovation.

But the power of the administration was seriously restricted by three "privileges" which the universities had acquired under the impact of the Liberal ideas. The professors were civil servants and, like all other civil servants, bound to obey the orders issued by their superiors, i.e., the Cabinet Minister and his aides. However, these superiors did not have the right to interfere with the content of the doctrines taught in the classes and seminars; in this regard the professors enjoyed the much talked about "academic freedom." Furthermore, the Minister was obliged—although this obligation had never been unambiguously stated—to comply in appointing professors (or, to speak more precisely, in suggesting to the Emperor the appointment of a professor) with the suggestions made

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<sup>1</sup> The only contemporary Viennese who appreciated the philosophic work of Leibniz was Prince Eugene of Savoy, scion of a French family, born and educated in France.

by the faculty concerned. Finally there was the institution of the *Privat-Dozent*. A doctor who had published a scholarly book could ask the faculty to admit him as a free and private teacher of his discipline; if the faculty decided in favor of the petitioner, the consent of the Minister was still required; in practice this consent was, before the days of the Schuschnigg regime, always given. The duly admitted *Privat-Dozent* was not, in this capacity, a civil servant. Even if the title of professor was accorded to him, he did not receive any compensation from the government. A few *Privat-Dozents* could live from their own funds. Most of them worked for their living. Their right to collect the fees paid by the students who attended their courses was in most cases practically valueless.

The effect of this arrangement of academic affairs was that the councils of the professors enjoyed almost unlimited autonomy in the management of their schools. Economics was taught at the Schools of Law and Social Sciences (*Rechts und staatswissenschaftliche Fakultäten*) of the universities. At most of these universities there were two chairs of economics. If one of these chairs became vacant, a body of lawyers had—with the cooperation, at most, of one economist—to choose the future incumbent. Thus the decision rested with non-economists. It may be fairly assumed that these professors of law were guided by the best intentions. But they were not economists. They had to choose between two opposed schools of thought, the "Austrian School" on the one hand, and the allegedly "modern" historical school as taught at the universities of the German Reich on the other hand. Even if no political and nationalistic prepossessions had disturbed their judgment, they could not help becoming somewhat suspicious of a line of thought which the professors of the universities of the German Reich dubbed specifically Austrian. Never before had any new mode of thinking originated in Austria. The Austrian universities had been sterile until—after the revolution of 1848—they had been reorganized according to the model of the German universities. For people who were not familiar with economics, the predicate "Austrian" as applied to a doctrine carried strong overtones of the dark days of the Counter-Reformation and of Metternich. To an Austrian intellectual, nothing could appear more disastrous than a relapse of his country into the spiritual inanity of the good old days.

Carl Menger, Wieser, and Böhm-Bawerk had obtained their chairs in Vienna, Prague, and Innsbruck before the *Methodenstreit* had begun to appear in the opinion of the Austrian laymen as a conflict between "modern" science and Austrian "backwardness." Their colleagues had no personal grudge against them. But whenever possible they tried to bring followers of the historical school from Germany to the Austrian universities. Those whom the world called the "Austrian Economists" were, in the Austrian universities, somewhat reluctantly tolerated outsiders.

## 3. The Austrian School in the Intellectual Life of Austria

The more distinguished among the French and German universities were, in the great age of liberalism, not merely institutions of learning that provided the rising generations of professional people with the instruction required for the satisfactory practice of their professions. They were centers of culture. Some of their teachers were known and admired all over the world. Their courses were attended not only by the regular students who planned to take academic degrees but by many mature men and women who were active in the professions, in business, or in politics and expected from the lectures nothing but intellectual gratification. Such outsiders, who were not students in a technical sense, thronged, for instance, in Paris the courses of Renan, Fustel de Coulanges, and Bergson, and in Berlin those of Hegel, Helmholtz, Mommsen, and Treitschke. The educated public was seriously interested in the work of the academic circles. The elite read the books and the magazines published by the professors, joined their scholastic societies and eagerly followed the discussions of the meetings.

Some of these amateurs who devoted only leisure hours to their studies rose high above the level of dilettantism. The history of modern science records the names of many such glorious "outsiders." It is, for instance, a characteristic fact that the only remarkable, although not epoch-making, contribution to economics that originated in the Germany of the second Reich came from a busy corporation counsel, Heinrich Oswald from Frankfurt, a city that at the time his book was written had no university.<sup>2</sup>

In Vienna, also, close association of the university teachers with the cultured public of the city prevailed in the last decades of the nineteenth century and in the beginning of our century. It began to vanish when the old masters died or retired and men of smaller stature got their chairs. This was the period in which the rank of the Vienna University, as well as the cultural eminence of the city, was upheld and enlarged by a few of the *Privat-Dozents*. The outstanding case is that of psychoanalysis. It never got any encouragement from any official institution; it grew and thrived outside the university and its only connection with the bureaucratic hierarchy of learning was the fact that Freud was a *Privat-Dozent* with the meaningless title of professor.

There was in Vienna, as a heritage of the years in which the founders of the Austrian school had finally earned recognition, a lively interest in problems of economics. This interest enabled the present writer to organize a *PrivatSeminar* in the Twenties, to start the Economic Association, and to set up the Austrian Institute for Trade Cycle Research, that later changed its name to the Austrian Institute for Economic Research.

The Privat-Seminar had no connection whatever with the University or any other institution. Twice a month a croup of scholars, among them several *Privat-Dozents*, met in the present writer's office in the Austrian Chamber of Commerce. Most of the participants belonged to the age group that had begun academic studies after the end of the first World War. Some were older. They were united by a burning interest in the whole field of the sciences of human action. In the debates problems of philosophy, of epistemology, of economic theory, and of the various branches of historical research were treated. The *Privat-Seminar* was discontinued when, in 1934, the present writer was appointed to the chair of international economic relations at the Graduate Institute of International Studies in Geneva, Switzerland.

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<sup>2</sup> Cf. H. Oswald, *Vorträge über wirtschaftliche Grundbegriffe*, 3rd ed. (Jena, 1920).

With the exception of Richard von Strigl, whose early death put an untimely end to a brilliant scientific career, and Ludwig Bettelheim-Gabillon, about whom we will have more to say, all the members of the *Privat-Seminar* found a proper field for the continuation of their work as scholars, authors, and teachers outside of Austria.

In the realm of the spirit, Vienna played an eminent role in the years between the establishment of the Parliament in the early Sixties and the invasion of the Nazis in 1938. The flowering came suddenly after centuries of sterility and apathy. The decay had already begun many years before the Nazis intruded.

In all nations and in all periods of history, intellectual exploits were the work of a few men and were appreciated only by a small elite. The many looked upon these feats with hatred and disdain; at best with indifference. In Austria and in Vienna the elite was especially small; and the hatred of the masses and their leaders especially vitriolic.

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

The unpopularity of economics is the result of its analysis of the effects of privileges. It is impossible to invalidate the economists' demonstration that all privileges hurt the interests of the rest of the nation or at least of a great part of it, that those victimized will tolerate the existence of such privileges only if privileges are granted to them too, and that then, when everybody is privileged, nobody wins but everybody loses on account of the resulting general drop in the productivity of labor.<sup>3</sup> However, the warnings of the economists are disregarded by the covetousness of people who are fully aware of their inability to succeed in a competitive market without the aid of special privileges. They are confident that they will get more valuable privileges than other groups or that they will be in a position to prevent, at least for some time, any granting of compensatory privileges to other groups. In their eyes the economist is simply a mischief-maker who wants to upset their plans.

When Menger, Böhm-Bawerk, and Wieser began their scientific careers, they were not concerned with the problems of economic policies and with the rejection of interventionism by Classical economics. They considered it as their vocation to put economic theory on a sound basis and they were ready to dedicate themselves entirely to this cause. Menger heartily disapproved of the interventionist policies that the Austrian Government—like almost all governments of the epoch—had adopted. But he did not believe that he could contribute to a return to good policies in any other way than by expounding good economics in his books and articles as well as in his university teaching.

Böhm-Bawerk joined the staff of the Austrian Ministry of Finance in 1890. Twice he served for a short time as Minister of Finance in a caretaker cabinet. From 1900 to 1904 he was Minister of Finance in the cabinet headed by Ernest von Körber. Böhm's principles in the conduct of this office were: strict maintenance of the legally fixed gold parity of the currency, and a budget balanced without any aid from the central bank. An eminent scholar, Ludwig Bettelheim-Gabillon, planned to publish a comprehensive work analyzing Böhm-Bawerk's activity in the Ministry of Finance. Unfortunately the Nazis killed the author and destroyed his manuscript.<sup>4</sup>

Wieser was for some time during the first World War Minister of Commerce in the Austrian Cabinet. However, his activity was rather impeded by the far-reaching powers—already given before Wieser took office—to a functionary of the ministry, Richard Riedl. Virtually only matters of secondary importance were left to the jurisdiction of Wieser himself.

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<sup>3</sup> Cf. Mises, *Human Action*, 3rd Edition (1966), pp. 716–861.

<sup>4</sup> Only two chapters, which the author had published before the Anschluss, are preserved: "Böhm-Bawerk und die Brüsseler Zuckerkonvention" and "Böhm-Bawerk und die Konvertierung von Obligationen der einheitlichen Staatsschuld" in *Zeitschrift für Nationalökonomie*, Vol. VII and VIII (1936 and 1937).

## II. *The Conflict with the German Historical School*

### 1. The German Rejection of Classical Economics

The hostility that the teachings of Classical economic theory encountered on the European continent was primarily caused by political prepossessions. Political economy as developed by several generations of English thinkers, brilliantly expounded by Hume and Adam Smith and perfected by Ricardo, was the most exquisite outcome of the philosophy of the Enlightenment. It was the gist of the liberal doctrine that aimed at the establishment of representative government and equality of all individuals under the law. It was not surprising that it was rejected by all those whose privileges it attacked. This propensity to spurn economics was considerably strengthened in Germany by the rising spirit of nationalism. The narrow-minded repudiation of Western civilization—philosophy, science, political doctrine and institutions, art and literature—which finally resulted in Nazism, originated in a passionate detraction of British political economy.

However, one must not forget that there were also other grounds for this revolt against political economy. This new branch of knowledge raised epistemological and philosophical problems for which the scholars did not find a satisfactory solution. It could not be integrated into the traditional system of epistemology and methodology. The empiricist tendency that dominates Western philosophy suggested considering economics as an experimental science like physics and biology. The very idea that a discipline dealing with "practical" problems like prices and wages could have an epistemological character different from that of other disciplines dealing with practical matters, was beyond the comprehension of the age. But on the other hand, only the most bigoted positivists failed to realize that experiments could not be performed in the field about which economics tries to provide knowledge.

We do not have to deal here with the state of affairs as it developed in the age of the neo-positivism or hyperpositivism of the twentieth century. Today, all over the world, but first of all in the United States, hosts of statisticians are busy in institutes devoted to what people believe is "economic research." They collect figures provided by governments and various business units, rearrange, readjust, and reprint them, compute averages and draw charts. They surmise that they are thereby "measuring" mankind's "behavior" and that there is no difference worth mentioning between their methods of investigation and those applied in the laboratories of physical, chemical, and biological research. They look with pity and contempt upon those economists who, as they say, like the botanists of "antiquity," rely upon "much speculative thinking" instead of upon "experiments."<sup>1</sup> And they are fully convinced that out of their restless exertion there will one day emerge final and complete knowledge that will enable the planning authority of the future to make all people perfectly happy.

But with the economists of the first part of the nineteenth century, the misconstruction of the fundamentals of the sciences of human action did not yet go so far. Their attempts to deal with the epistemological problems of economics resulted, of course, in complete failure. Yet, in retrospect, we may say that this frustration was a necessary step on the way that led toward a more satisfactory solution of the problem. It was John Stuart Mill's abortive treatment of the methods of the moral sciences that unwittingly exposed the futility of all arguments advanced in favor of the empiricist interpretation of the nature of economics.

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<sup>1</sup> Cf. Arthur F. Burns, *The Frontiers of Economic Knowledge* (Princeton University Press, 1954), p. 189.

When Germans began to study the works of British Classical economics, they accepted without any qualms the assumption that economic theory is derived from experience. But this simple explanation could not satisfy those who disagreed with the conclusions which, from the Classical doctrine, had to be inferred for political action. They very soon raised questions: Is not the experience from which the British authors derived their theorems different from the experience which would have faced a German author? Is not British economics defective on account of the fact that the material of experience from which it is distilled was only Great Britain and only Great Britain of the Hanoverian Georges? Is there, after all, such a thing as an economic science valid for all countries, nations, and ages?

It is obvious how these three questions were answered by those who considered economics as an experimental discipline. But such an answer was tantamount to the apodictic negation of economics as such. The Historical School would have been consistent if it had rejected the very idea that such a thing as a science of economics is possible, and if it had scrupulously abstained from making any statements other than reports about what had happened at a definite moment of the past in a definite part of the earth. An anticipation of the effects to be expected from a definite event can be made only on the basis of a theory that claims general validity and not merely validity for what happened in the past in a definite country. The Historical School emphatically denied that there are economic theorems of such a universal validity. But this did not prevent them from recommending or rejecting—in the name of science—various opinions or measures necessarily designed to affect future conditions.

There was, e.g., the Classical doctrine concerning the effects of free trade and protection. The critics did not embark upon the (hopeless) task of discovering some false syllogisms in the chain of Ricardo's reasoning. They merely asserted that "absolute" solutions are not conceivable in such matters. There are historical situations, they said, in which the effects brought about by free trade or protection differ from those described by the "abstract" theory of "armchair" authors. To support their view they referred to various historical precedents. In doing this, they blithely neglected to consider that historical facts, being always the joint result of the operation of a multitude of factors, cannot prove or disprove any theorem.

Thus economics in the second German Reich, as represented by the Government-appointed university professors, degenerated into an unsystematic, poorly assorted collection of various scraps of knowledge borrowed from history, geography, technology, jurisprudence, and party politics, larded with deprecatory remarks about the errors in the "abstractions" of the Classical school. Most of the professors more or less eagerly made propaganda in their writings and in their courses for the policies of the Imperial Government: authoritarian conservatism, *Sozialpolitik*, protectionism, huge armaments, and aggressive nationalism. It would be unfair to consider this intrusion of politics into the treatment of economics as a specifically German phenomenon. It was ultimately caused by the viciousness of the epistemological interpretation of economic theory, a failing that was not limited to Germany.

A second factor that made nineteenth-century Germany in general and especially the German universities look askance upon British political economy was its preoccupation with wealth and its relation to the utilitarian philosophy.

The then prevalent definitions of political economy described it as the science dealing with the production and distribution of wealth. Such a discipline could be nothing but despicable in the eyes of German professors. The professors thought of themselves as people self-denyingly engaged in the pursuit of pure knowledge and not, like the hosts of banalistic money-makers, caring for earthly possessions. The mere mention of such base things as wealth and money was taboo among people

boasting of their high culture (*Bildung*). The professors of economics could preserve their standing in the circles of their colleagues only by pointing out that the topic of their studies was not the mean concerns of profit-seeking business but historical research, e.g., about the lofty exploits of the Electors of Brandenburg and Kings of Prussia.

No less serious was the matter of utilitarianism. The utilitarian philosophy was not tolerated at German universities. Of the two outstanding German utilitarians, Ludwig Feuerbach never got any teaching job, while Rudolf von Jhering was a teacher of Roman Law. All the misunderstandings that for more than two thousand years have been advanced against Hedonism and Eudaemonism were rehashed by the professors of *Staatswissenschaften* in their criticism of the British economists.<sup>2</sup> If nothing else had roused the suspicions of the German scholars, they would have condemned economics for the sole reason that Bentham and the Mills had contributed to it.

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<sup>2</sup> Later similar arguments were employed to discredit pragmatism. William James's dictum according to which the pragmatic method aims at bringing out of each word "its practical cash-value" (*Pragmatism*, 1907, p. 53) was quoted to characterize the meanness of the "dollar-philosophy."

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

The German universities were owned and operated by the various kingdoms and grand duchies that formed the Reich.<sup>3</sup> The professors were civil servants and, as such, had to obey strictly the orders and regulations issued by their superiors, the bureaucrats of the ministries of public instruction. This total and unconditional subordination of the universities and their teachings to the supremacy of the governments was challenged—in vain—by German liberal public opinion, when in 1837 the King of Hanover fired seven professors of the University of Göttingen who protested against the King's breach of the constitution. The governments did not heed the public's reaction. They went on discharging professors with whose political or religious doctrines they did not agree. But after some time they resorted to more subtle and more efficacious methods to make the professors loyal supporters of the official policy. They scrupulously sifted the candidates before appointing them. Only reliable men got the chairs. Thus the question of academic freedom receded into the background. The professors of their own accord taught only what the government permitted them to teach.

The war of 1866 had ended the Prussian constitutional conflict. The King's party—the Conservative party of the Junkers, led by Bismarck—triumphed over the Prussian Progressive party that stood for parliamentary government, and likewise over the democratic groups of Southern Germany. In the new political setting, first of the *Norddeutscher Bund* and, after 1871, of the *Deutsches Reich*, there was no room left for the "alien" doctrines of Manchesterism and laissez faire. The victors of Königgrätz and Sedan thought they had nothing to learn from the "nation of shopkeepers"—the British—or from the defeated French.

At the outbreak of the war of 1870, one of the most eminent German scientists, Emil du Bois-Reymond, boasted that the University of Berlin was "the intellectual bodyguard of the House of Hohenzollern." This did not mean very much for the natural sciences. But it had a very clear and precise meaning for the sciences of human action. The incumbents of the chairs of history and of *Staatswissenschaften* (i.e., political science, including all things referring to economics and finance) knew what their sovereign expected of them. And they delivered the goods.

From 1882 to 1907 Friedrich Althoff was in the Prussian ministry of instruction in charge of university affairs. He ruled the Prussian universities as a dictator. As Prussia had the greatest number of lucrative professorships, and therefore offered the most favorable field for ambitious scholars, the professors in the other German states, nay, even those of Austria and Switzerland, aspired to secure positions in Prussia. Thus Althoff could as a rule make them, too, virtually accept his principles and opinions. In all matters pertaining to the social sciences and the historical disciplines, Althoff entirely relied upon the advice of his friend Gustav von Schmoller. Schmoller had an unerring flair for separating the sheep from the goats.

In the second and third quarter of the nineteenth century some German professors wrote valuable contributions to economic theory. It is true that the most remarkable contributions of this period, those of Thünen and of Gossen, were not the work of professors but of men who did not hold teaching jobs. However, the books of Professors Hermann, Mangoldt, and Knies will be remembered in the history of economic thought. But after 1866, the men who came into the academic career had only contempt for "bloodless abstractions." They published historical studies, preferably such as dealt with labor conditions of the recent past. Many of them were firmly

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<sup>3</sup> The Reich itself owned and operated only the University of Strassburg. The three German city-republics did not at that period have any university.

convinced that the foremost task of economists was to aid the "people" in the war of liberation they were waging against the "exploiters," and that the Godgiven leaders of the people were the dynasties, especially the Hohenzollern.

### 3. The *Methodenstreit*

In the *Untersuchungen* Menger rejected the epistemological ideas that underlay the writings of the Historical School. Schmoller published a rather contemptuous review of this book. Menger reacted, in 1884, with a pamphlet, *Die Irrtümer des Historismus in der Deutschen Nationalökonomie*. The various publications that this controversy engendered are known under the name of the *Methodenstreit*, the clash over methods.

The *Methodenstreit* contributed but little to the clarification of the problems involved. Menger was too much under the sway of John Stuart Mill's empiricism to carry his own point of view to its full logical consequences. Schmoller and his disciples, committed to defend an untenable position, did not even realize what the controversy was about.

The term *Methodenstreit* is, of course, misleading. For the issue was not to discover the most appropriate procedure for the treatment of the problems commonly considered as economic problems. The matter in dispute was essentially whether there could be such a thing as a science, other than history, dealing with aspects of human action.

There was, first of all, radical materialist determinism, a philosophy almost universally accepted in Germany at that time by physicists, chemists, and biologists, although it has never been expressly and clearly formulated. As these people saw it, human ideas, volitions, and actions are produced by physical and chemical events that the natural sciences will one day describe in the same way in which today they describe the emergence of a chemical compound out of the combination of several ingredients. As the only road that could lead to this final scientific accomplishment they advocated experimentation in physiological and biological laboratories.

Schmoller and his disciples passionately rejected this philosophy, not because they were aware of its deficiencies, but because it was incompatible with the religious tenets of the Prussian Government. They virtually preferred to it a doctrine that was but little different from Comte's positivism (which, of course, they publicly disparaged on account of its atheism and its French origin). In fact, positivism, sensibly interpreted, must result in materialist determinism. But most of Comte's followers were not outspoken in this regard. Their discussions did not always preclude the conclusion that the laws of social physics (sociology), the establishment of which was in their opinion the highest goal of science, could be discovered by what they called a more "scientific" method of dealing with the material assembled by the traditional procedures of the historians. This was the position Schmoller embraced with regard to economics. Again and again he blamed the economists for having prematurely made inferences from quantitatively insufficient material. What, in his opinion, was needed in order to substitute a realistic science of economics for the hasty generalizations of the British "armchair" economists was more statistics, more history, and more collection of "material." Out of the results of such research the economists of the future, he maintained, would one day develop new insights by "induction."

Schmoller was so confused that he failed to see the incompatibility of his own epistemological doctrine and the rejection of positivism's attack upon history. He did not realize the gulf that separated his views from those of the German philosophers who demolished positivism's ideas about the use and the treatment of history—first Dilthey, and later Windelband, Rickert, and Max Weber. In the same article in which he censured Menger's *Grundsätze*, he reviewed also the first important book of Dilthey, his *Einleitung in die Geisteswissenschaften*. But he did not grasp the fact that the tenor of Dilthey's doctrine was the annihilation of the fundamental thesis of his own epistemology, viz., that some laws of social development could be distilled from historical experience.

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

The British free trade philosophy triumphed in the nineteenth century in the countries of Western and Central Europe. It demolished the shaky ideology of the authoritarian welfare state (*landesfürstlicher Wohlfahrtsstaat*) that had guided the policies of the German principalities in the eighteenth century. Even Prussia turned temporarily toward liberalism. The culmination points of its free trade period were the *Zollverein's* customs tariff of 1865 and the 1869 Trade Code (*Gewerbeordnung*) for the territory of the *Norddeutscher Bund* (later the *Deutsches Reich*). But very soon the government of Bismarck began to inaugurate its *Sozialpolitik*, the system of interventionist measures such as labor legislation, social security, pro-union attitudes, progressive taxation, protective tariffs, cartels, and dumping.<sup>4</sup>

If one tries to refute the devastating criticism leveled by economics against the suitability of all these interventionist schemes, one is forced to deny the very existence—not to mention the epistemological claims—of a science of economics, and of praxeology as well. This is what all the champions of authoritarianism, government omnipotence, and "welfare" policies have always done. They blame economics for being "abstract" and advocate a "visualizing" (*anschaulich*) mode of dealing with the problems involved. They emphasize that matters in this field are too complicated to be described in formulas and theorems. They assert that the various nations and races are so different from one another that their actions cannot be comprehended by a uniform theory; there are as many economic theories required as there are nations and races. Others add that even within the same nation or race, economic action is different in various epochs of history. These and similar objections, often incompatible with one another, are advanced in order to discredit economics as such.

In fact, economics disappeared entirely from the universities of the German Empire. There was a lone epigone of Classical economics left at the University of Bonn, Heinrich Dietzel, who, however, never understood what the theory of subjective value meant. At all other universities the teachers were anxious to ridicule economics and the economists. It is not worthwhile to dwell upon the stuff that was handed down as a substitute for economics at Berlin, Munich, and other universities of the Reich. Nobody cares today about all that Gustav von Schmoller, Adolf Wagner, Lujo Brentano, and their numerous adepts wrote in their voluminous books and magazines.

The political significance of the work of the Historical School consisted in the fact that it rendered Germany safe for the ideas, the acceptance of which made popular with the German people all those disastrous policies that resulted in the great catastrophes. The aggressive imperialism that twice ended in war and defeat, the limitless inflation of the early Twenties, the *Zwangswirtschaft* and all the horrors of the Nazi regime were achievements of politicians who acted as they had been taught by the champions of the Historical School.

Schmoller and his friends and disciples advocated what has been called state socialism; i.e., a system of socialism—planning—in which the top management would be in the hands of the Junker aristocracy. It was this brand of socialism at which Bismarck and his successors were aiming. The timid opposition which they encountered on the part of a small group of businessmen was negligible, not so much on account of the fact that these opponents were not numerous, but because their endeavors lacked any ideological backing. There were no longer any liberal thinkers left in Germany. The only resistance that was offered to the party of state socialism came from the Marxian party of the Social-Democrats. Like the Schmoller socialists—the socialists of the chair (*Kathedersozialisten*)—the Marxists advocated socialism. The only difference between the two

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<sup>4</sup> Cf. Mises, *Omnipotent Government* (Yale University Press, 1944), pp. 149 ff.

groups was in the choice of the people who should operate the supreme planning board: the Junkers, the professors and the bureaucracy of Hohenzollern Prussia, or the officers of the Social-Democratic party and their affiliated labor unions.

Thus the only serious adversaries whom the Schmoller School had to fight in Germany were the Marxists. In this controversy the latter very soon got the upper hand. For they at least had a body of doctrine, however faulty and contradictory it was, while the teachings of the Historical School were rather the denial of any theory. In search of a modicum of theoretical support, the Schmoller School step by step began to borrow from the spiritual fund of the Marxists. Finally, Schmoller himself largely endorsed the Marxian doctrine of class conflict and of the "ideological" impregnation of thought by the thinker's class membership. One of his friends and fellow professors, Wilhelm Lexis, developed a theory of interest that Engels characterized as a paraphrase of the Marxian theory of exploitation.<sup>5</sup> It was an effect of the writings of the champions of the *Sozialpolitik* that the epithet "bourgeois" (*bürgerlich*) acquired in the German language an opprobrious connotation.

The crushing defeat in the first World War shattered the prestige of the German princes, aristocrats, and bureaucrats. The adepts of the Historical School and *Sozialpolitik* transferred their loyalty to various splinter-groups, out of which the German Nationalist-Socialist Workers' Party, the Nazis, eventually emerged.

The straight line that leads from the work of the Historical School to Nazism cannot be shown in sketching the evolution of one of the founders of the School. For the protagonists of the *Methodenstreit* era had finished the course of their lives before the defeat of 1918 and the rise of Hitler. But the life of the outstanding man among the School's second generation illustrates all the phases of German university economics in the period from Bismarck to Hitler.

Werner Sombart was by far the most gifted of Schmoller's students. He was only twenty-five when his master, at the height of the *Methodenstreit*, entrusted him with the job of reviewing and annihilating Wieser's book, *Der natürliche Wert*. The faithful disciple condemned the book as "entirely unsound."<sup>6</sup> Twenty years later Sombart boasted that he had dedicated a good part of his life to fighting for Marx.<sup>7</sup> When the War broke out in 1914, Sombart published a book, *Händler und Helden* (*Hucksters and Heroes*).<sup>8</sup> There, in uncouth and foul language, he rejected everything British or Anglo-Saxon, but above all British philosophy and economics, as a manifestation of a mean jobber mentality. After the war, Sombart revised his book on socialism. Before the war it had been published in nine editions.<sup>9</sup> While the pre-war editions had praised Marxism, the tenth edition fanatically attacked it, especially on account of its "proletarian" character and its lack of patriotism and nationalism. A few years later Sombart tried to revive the *Methodenstreit* by a volume full of invectives against economists whose thought he was unable to understand.<sup>10</sup> Then, when the Nazis seized power, he crowned a literary career of forty-five years by a book on German Socialism. The guiding idea of this work was that the *Führer* gets his orders from God, the supreme *Führer* of the universe, and that *Führertum* is a permanent revelation.<sup>11</sup>

<sup>5</sup> Cf. the more detailed analysis in Mises, *Kritik des interventionismus*, (Jena, 1929), pp. 92 ff.

<sup>6</sup> Cf. Schmoller's *Jahrbuch*, Vol. 13 (1889), pp. 1488-1490.

<sup>7</sup> Cf. Sombart, *Das Lebenswerk von Karl Marx* (Jena, 1909), p. 3.

<sup>8</sup> Cf. Sombart, *Händler und Helden* (Munich, 1915).

<sup>9</sup> Cf. Sombart, *Der proletarische Sozialismus*, 10th ed. (Jena, 1924), 2 vol.

<sup>10</sup> Cf. Sombart, *Die drei Nationalökonomien* (Munich, 1930).

<sup>11</sup> Cf. Sombart, *Deutscher Sozialismus* (Charlottenburg, 1934), p. 213. (In the American edition: *A New Social Philosophy*, translated and edited by K. F. Geiser, Princeton, 1937, p. 149.) Sombart's achievements were appreciated abroad. Thus, e.g., in 1929 he was elected to honorary membership in the American Economic Association.

Such was the progress of German academic economics from Schmoller's Glorification of the Hohenzollern Electors and Kings to Sombart's canonization of Adolf Hitler.

## 5. The Liberalism of the Austrian Economists

Plato dreamed of the benevolent tyrant who would entrust the wise philosopher with the power to establish the perfect social system. The Enlightenment did not put its hopes upon the more or less accidental emergence of well-intentioned rulers and provident sages. Its optimism concerning mankind's future was founded upon the double faith in the goodness of man and in his rational mind. In the past a minority of villains—crooked kings, sacrilegious priests, corrupt noblemen—were able to make mischief. But now—according to Enlightenment doctrine—as man has become aware of the power of his reason, a relapse into the darkness and failings of ages gone by is no longer to be feared. Every new generation will add something to the good accomplished by its ancestors. Thus mankind is on the eve of a continuous advance toward more satisfactory conditions. To progress steadily is the nature of man. It is vain to complain about the alleged lost bliss of a fabulous golden age. The ideal state of society is before us, not behind us.

Most of the nineteenth-century liberal, progressive, and democratic politicians who advocated representative government and universal suffrage were guided by a firm confidence in the infallibility of the common man's rational mind. In their eyes majorities could not err. Ideas that originated from the people and were approved by the voters could not but be beneficial to the commonweal.

It is important to realize that the arguments brought forward in favor of representative government by the small group of liberal philosophers were quite different and did not imply any reference to an alleged infallibility of majorities. Hume had pointed out that government is always founded upon opinion. In the long run the opinion of the many always wins out. A government that is not supported by the opinion of the majority must sooner or later lose its power; if it does not abdicate, it is violently overthrown by the many. Peoples have the power eventually to put those men at the helm who are prepared to rule according to the principles that the majority considers adequate. There is, in the long run, no such thing as an unpopular government maintaining a system that the multitude condemns as unfair. The rationale of representative government is not that majorities are God-like and infallible. It is the intent to bring about by peaceful methods the ultimately unavoidable adjustment of the political system and the men operating its steering mechanism to the ideology of the majority. The horrors of revolution and civil war can be avoided if a disliked government can be smoothly dislodged at the next election.

The true liberals firmly held that the market economy, the only economic system that warrants a steadily progressing improvement of mankind's material welfare, can work only in an atmosphere of undisturbed peace. They advocated government by the people's elected representatives because they took it for granted that only this system will lastingly preserve peace both in domestic and in foreign affairs.

What separated these true liberals from the blind majority-worship of the self-styled radicals was that they based their optimism concerning mankind's future not upon the mystic confidence in the infallibility of majorities but upon the belief that the power of sound logical argument is irresistible. They did not fail to see that the immense majority of common men are both too dull and too indolent to follow and to absorb long chains of reasoning. But they hoped that these masses, precisely on account of their dullness and indolence, could not help endorsing the ideas that the intellectuals brought to them. From the sound judgment of the cultured minority and from their ability to persuade the majority, the great leaders of the nineteenth-century liberal movement expected the steady improvement of human affairs.

In this regard there was full agreement between Carl Menger and his two earliest followers, Wieser and Böhm-Bawerk. Among the unpublished papers of Menger, Professor Hayek discovered a note that reads: "There is no better means to disclose the absurdity of a mode of reasoning than to let it pursue its full course to the end." All three of them liked to refer to Spinoza's argumentation in the first book of his *Ethics* that ends in the famous dictum, "*Sane sicut lux se ipsam et tenebras manifestat, sic veritas norma sui et falsi.*" They looked calmly upon the passionate propaganda of both the Historical School and Marxism. They were fully convinced that the logically indefensible dogmas of these factions would eventually be rejected by all reasonable men precisely on account of their absurdity and that the masses of common men would necessarily follow the lead of the intellectuals.<sup>12</sup>

The wisdom of this mode of arguing is to be seen in the avoidance of the popular practice of playing off an alleged psychology against logical reasoning. It is true that often errors in reasoning are caused by the individual's disposition to prefer an erroneous conclusion to the correct one. There are even hosts of people whose affections simply prevent them from straight thinking. But it is a far cry from the establishment of these facts to the doctrines that in the last generation were taught under the label "sociology of knowledge." Human thinking and reasoning, human science and technology are the product of a social process insofar as the individual thinker faces both the achievements and the errors of his predecessors and enters into a virtual discussion with them either in assenting or dissenting. It is possible for the history of ideas to make understandable a man's failings as well as his exploits by analyzing the conditions under which he lived and worked. In this sense only is it permissible to refer to what is called the spirit of an age, of a nation, of a milieu. But it is circular reasoning if one tries to explain the emergence of an idea, still less to justify it, by referring to its author's environment. Ideas always spring from the mind of an individual, and history cannot say anything more about them than that they were generated at a definite instant of time by a definite individual. There is no other excuse for a man's erroneous thinking than what an Austrian Government once declared with regard to the case of a defeated general—that nobody is answerable for not being a genius. Psychology may help us to explain why a man failed in his thinking. But no such explanation can convert what is false into truth.

The Austrian economists unconditionally rejected the logical relativism implied in the teachings of the Prussian Historical School. As against the declarations of Schmoller and his followers, they maintained that there is a body of economic theorems that are valid for all human action irrespective of time and place, the national and racial characteristics of the actors, and their religious, philosophical, and ethical ideologies.

The greatness of the service these three Austrian economists have rendered by maintaining the cause of economics against the vain critique of Historicism cannot be overrated. They did not infer from their epistemological convictions any optimism concerning mankind's future evolution. Whatever is to be said in favor of correct logical thinking does not prove that the coming generations of men will surpass their ancestors in intellectual effort and achievements. History shows that again and again periods of marvelous mental accomplishments were followed by periods of decay and retrogression. We do not know whether the next generation will beget people who are able to continue along the lines of the geniuses who made the last centuries so glorious. We do not know anything about the biological conditions that enable a man to make one step forward in the march of intellectual advancement. We cannot preclude the assumption that there may be limits to man's further intellectual ascent. And certainly we do not know whether in this

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<sup>12</sup> There is need to add that Menger, Böhm-Bawerk, and Wieser looked with the utmost pessimism upon the political future of the Austrian Empire. But this problem cannot be dealt with in this essay.

ascent there is not a point beyond which the intellectual leaders can no longer succeed in convincing the masses and making them follow their lead.

The inference drawn from these premises by the Austrian economists was, that while it is the duty of a pioneering mind to do all that his faculties enable him to perform, it is not incumbent upon him to propagandize for his ideas, still less to use questionable methods in order to make his thoughts palatable to people. They were not concerned about the circulation of their writings. Menger did not publish a second edition of his famous *Grundsätze*, although the book was long since out of print, second-hand copies sold at high prices, and the publisher urged him again and again to consent.

The main and only concern of the Austrian economists was to contribute to the advancement of economics. They never tried to win the support of anybody by other means than by the convincing power developed in their books and articles. They looked with indifference upon the fact that the universities of the German-speaking countries, even many of the Austrian universities, were hostile to economics as such and still more so to the new economic doctrines of subjectivism.

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

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

When the German professors attached the epithet "Austrian" to the theories of Menger and his two earliest followers and continuators, they meant it in a pejorative sense. After the battle of Königgrätz, the qualification of a thing as Austrian always had such a coloration in Berlin, that "headquarters of *Geist*," as Herbert Spencer sneeringly called it.<sup>1</sup> But the intended smear boomeranged. Very soon the designation "the Austrian School" was famous all over the world.

Of course, the practice of attaching a national label to a line of thought is necessarily misleading. Only very few Austrians—and for that matter, non-Austrians—knew anything about economics, and still smaller was the number of those Austrians whom one could call economists, however generous one might be in conferring this appellation. Besides, there were among the Austrian economists some who did not work along the lines which were called the "Austrian School"; best known among them were the mathematicians Rudolf Auspitz and Richard Lieben, and later Alfred Amonn and Josef Schumpeter. On the other hand, the number of foreign economists who applied themselves to the continuation of the work inaugurated by the "Austrians" was steadily increasing. At the beginning it sometimes happened that the endeavors of these British, American, and other non-Austrian economists met with opposition in their own countries and that they were ironically called "Austrians" by their critics. But after some years all the essential ideas of the Austrian School were by and large accepted as an integral part of economic theory. About the time of Menger's demise (1921), one no longer distinguished between an Austrian School and other economics. The appellation "Austrian School" became the name given to an important chapter of the history of economic thought; it was no longer the name of a specific sect with doctrines different from those held by other economists.

There was, of course, one exception. The interpretation of the causes and the course of the trade cycle which the present writer provided, first in his *Theory of Money and Credit*<sup>2</sup> and finally in his treatise *Human Action*,<sup>3</sup> under the name of the Monetary or Circulation Credit Theory of the trade cycle, was called by some authors the Austrian Theory of the trade cycle. Like all such national labels, this too is objectionable. The Circulation Credit Theory is a continuation, enlargement, and generalization of ideas first developed by the British Currency School and of some additions to them made by later economists, among them also the Swede, Knut Wicksell.

As it has been unavoidable to refer to the national label, "the Austrian School," one may add a few words about the linguistic group to which the Austrian economists belonged. Menger, Böhm-Bawerk, and Wieser were German Austrians; their language was German and they wrote their books in German. The same is true of their most eminent students Johann von Komorzynski, Hans Mayer, Robert Meyer, Richard Schiffler, Richard von Strigl, and Robert Zuckerkandl. In this sense the work of the "Austrian School" is an accomplishment of German philosophy and science. But among the students of Menger, Böhm-Bawerk, and Wieser there were also non-German Austrians. Two of them have distinguished themselves by eminent contributions, the Czechs Franz Cuhel and Karel Englis.

<sup>1</sup> Cf. Herbert Spencer, *The Study of Sociology*, 9th edition (London, 1880), p. 217.

<sup>2</sup> First German-language edition 1912, second German-language edition 1924. English-language editions 1934 and 1953.

<sup>3</sup> Yale University Press, 1949.

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

The peculiar state of German ideological and political conditions in the last quarter of the nineteenth century generated the conflict between two schools of thought out of which the *Methodenstreit* and the appellation "Austrian School" emerged. But the antagonism that manifested itself in this debate is not confined to a definite period or country. It is perennial. As human nature is, it is unavoidable in any society where the division of labor and its corollary, market exchange, have reached such an intensity that everybody's subsistence depends on other people's conduct. In such a society everybody is served by his fellow men, and in turn, he serves them. The services are rendered voluntarily: in order to make a fellow do something for me, I have to offer him something which he prefers to abstention from doing that something. The whole system is built upon this voluntariness of the services exchanged. Inexorable natural conditions prevent man from indulging in a carefree enjoyment of his existence. But his integration into the community of the market economy is spontaneous, the result of the insight that there is no better or, for that matter, no other method of survival open to him.

However, the meaning and bearing of this spontaneousness are only grasped by economists. All those not familiar with economics, i.e., the immense majority, do not see any reason why they should not by means of force coerce other people to do what these people are not prepared to do of their own accord. Whether the apparatus of physical compulsion resorted to in such endeavors is that of the government's police power or an illegal "picket" force whose violence the government tolerates, does not make any difference. What matters is the substitution of compulsion for voluntary action.

Due to a definite constellation of political conditions that could be called accidental, the rejection of the philosophy of peaceful cooperation was, in modern times, first developed into a comprehensive doctrine by subjects of the Prussian State. The victories in the three Bismarck wars had intoxicated the German scholars, most of whom were servants of the government. Some people considered it a characteristic fact that the adoption of the ideas of the Schmoller school was slowest in the countries whose armies had been defeated in 1866 and 1870. It is, of course, preposterous to search for any connection between the rise of the Austrian Economic Theory and the defeats, failures, and frustrations of the Habsburg regime. Yet, the fact that the French state universities kept out of the way of historicism and *Sozialpolitik* longer than those of other nations was certainly, at least to some extent, caused by the Prussian label attached to these doctrines. But this delay had little practical importance. France, like all other countries, became a stronghold of interventionism and proscribed economics.

The philosophical consummation of the ideas glorifying the government's interference, i.e., the action of the armed constables, was achieved by Nietzsche and by Georges Sorel. They coined most of the slogans that guided the butcheries of Bolshevism, Fascism, and Nazism. Intellectuals extolling the delights of murder, writers advocating censorship, philosophers judging the merits of thinkers and authors, not according to the value of their contributions but according to their achievements on battlefields,<sup>4</sup> are the spiritual leaders of our age of perpetual strife. What a spectacle was offered by those American authors and professors who ascribed the origin of their own nation's political independence and constitution to a clever trick of the "interests" and were casting longing glances at the Soviet paradise of Russia!

The greatness of the nineteenth century consisted in the fact that to some extent the ideas of Classical economics became the dominant philosophy of state and society. They transformed the

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<sup>4</sup> Cf. the passages quoted by Julien Benda, *La trahison des clercs* (Paris, 1927), Note 0, pp. 192–295.

traditional status society into nations of free citizens, royal absolutism into representative government, and above all, the poverty of the masses under the ancien regie into the well-being of the many under capitalistic laissez faire. Today the reaction of statism and socialism is sapping the foundations of Western civilization and well-being,. Perhaps those are right who assert that it is too late to prevent the final triumph of barbarism and destruction. However this may be, one thing is certain. Society, i.e., peaceful cooperation of men under the principle of the division of labor, can exist and work only if it adopts policies that economic analysis declares as fit for attaining the ends sought. The worst illusion of our age is the superstitious confidence placed in panaceas which—as the economists have irrefutably demonstrated—are contrary to purpose.

Governments, political parties, pressure groups, and the bureaucrats of the educational hierarchy think they can avoid the inevitable consequences of unsuitable measures by boycotting and silencing the independent economists. But truth persists and works, even if nobody is left to utter it.

The peculiar state of German ideological and political conditions in the last quarter of the nineteenth century generated the conflict between two schools of thought out of which the *Methodenstreit* and the appellation “Austrian School” emerged. But the antagonism that manifested itself in this debate is not confined to a definite period or country. It is perennial.

Ludwig von Mises



Ludwig von Mises Institute  
518 West Magnolia Avenue  
Auburn, Alabama 36832-4528  
Mises.org