

ICONS *of* AUSTRIAN ECONOMICS

Your instant guide to the **Austrian**
School of Economics -- visionaries
who shaped the modern world



A modern vision...

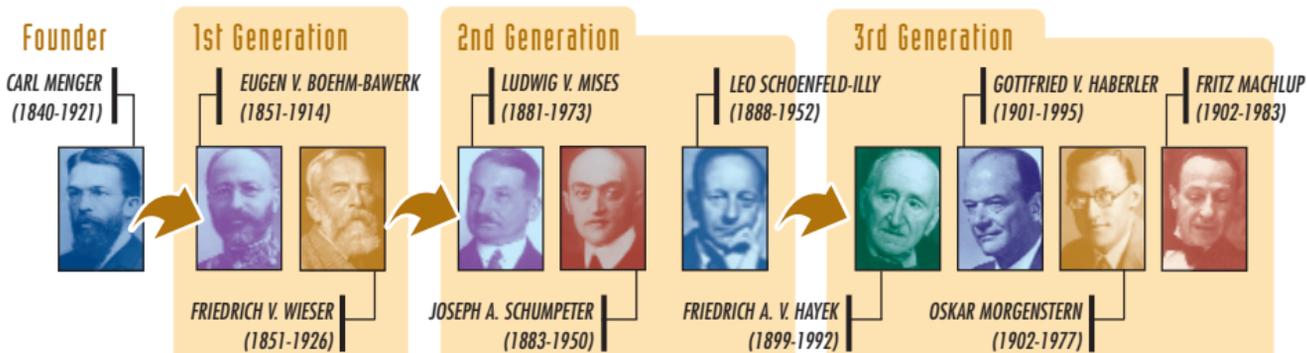
A group of brilliant thinkers based in Vienna in the late 1800s helped create our modern economy. This is your guide to the Austrian School -- it's the secret history of 20th century economics.

TURN-OF-THE-CENTURY VIENNA WAS A SITE OF incredible intellectual activity, producing an array of memorable figures whose work defined our current view of the world. Great advances in the fields of psychology (Sigmund Freud), art (Gustav Klimt), music (Arnold Schoenberg, Gustav Mahler), medicine (Theodor Billroth) and philosophy (Ludwig Wittgenstein) were all

made in this one place. But did you know that Vienna was also the site of our modern view of economics?

While Freud was revolutionizing psychology, a group of vanguard economists, led by Carl Menger, Eugen von Boehm-Bawerk and Friedrich von Wieser, were using similar principles to reinvent economics. Eventually called "The Austrian School," these men rejected the mechanical and deterministic approach of their colleagues, advocating instead a "pure" economics that accounted for the role of individuals and their desires.

The Austrian School reflected the recognition of risk and uncertainty in their models... and have done more for global wealth creation than possibly any other group.



Know your terms...

Many of the hot topics in today's economic discussions center around ideas first popularized by the Austrian School. You're thinking like an Austrian if you consider any of these economic factors important...



Individual choice

The Austrian School was the first tradition to portray individuals and their choices as active participants in the economic process. In fact, according to the Austrians, markets are *determined* by these choices. After all, what value can be given to an object outside of the desire for it?



Entrepreneurship

The Austrians didn't pretend that the role of the economist was to predict the outcome of economic processes. Too much of that process was uncertain and couldn't be predicted by one so "out of the loop." The only one with the proper knowledge to predict outcomes and minimize risk was the *entrepreneur*, perhaps the most important role in any economy.

Free and competitive markets



With the Austrian School's belief in a "free and competitive markets" approach to macroeconomics came their equally strong belief in a minimal role for government in our everyday lives. Free markets should be just that: without the intervention of central institutions.

Private property



Individual property ownership is the bedrock of a healthy economy according to the Austrian School. Without it, there's no basis for capital, no basis for trade, no basis for value... and there is no basis for a free market.

A price system



In the Austrian School model, a realistic price system emerges when free markets are allowed to do their work. It's only through competitive markets that we can find the optimal price for resource distribution, the one that reflects the best situation for both producers and consumers.

The beginning...

THE ECONOMIC tradition known as the Austrian School began in 1871 with the publication of Carl Menger's *Principles of Economics*, although it would be years before the term "Austrian School" was coined. The Austrians were at the forefront of a "neoclassical revolution" in economics, a movement that built on the work of "classical" economists like Adam Smith (theories of demand, specifically) to place human action at the center of the economic world. This pit them

According to Ludwig von Mises, "until the end of the [1870s] there was no Austrian School. There was only Carl Menger." Yet Menger's *Principles of Economics*, the manifesto of the Austrian School, was little read when first published -- the situation for many works ahead of their time.

Many dismissed Menger's theories as "subjectivist" and unscientific. But where others saw subjectivity, Menger saw the heart and soul of economics: individuals acting to satisfy their wants. It was this wholly natural impulse, according to the *Principles*, that dictated all economic activity, from trade to consumption to price systems.

Gustav von
Schmoller



HIS NOTORIOUS REVIEWS OF MENGER'S WORK LED TO THE FAMOUS *METHODENSTREIT*.

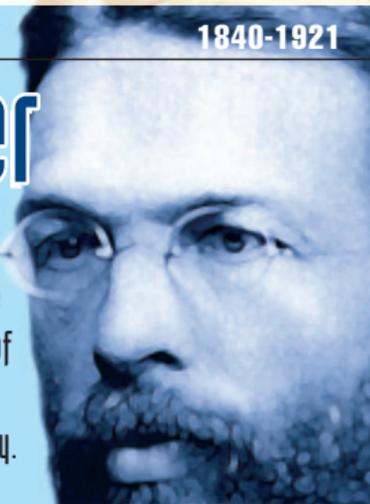
against the Younger German Historical School, which considered history the only science qualified to explain human action. The resulting intellectual battle, dubbed the *Methodenstreit* ("debate on method"), lasted for several years and had lasting effects. Ironically, history would prove the Austrian School right.

Carl

Menger

1840-1921

He tutored Austria's Crown Prince before being named chair of Political Economy in Vienna's Law Faculty.



Time and value...



THE AUSTRIANS offered a viable alternative to the reigning Classical School of economics popularized by Adam Smith's *The Wealth of Nations*. In the classical view, value was an objective figure expressed through mathematical formulas. To the Austrians, however, value was determined by people and affected by time and place, and could never be objective.

Menger laid the groundwork for this theory in his *Principles*, but it was the next generation, figures like

A lawyer by training, Eugen von Boehm-Bawerk began studying economics after reading Carl Menger's writings. His major work, *Capital and Interest*, explored in more detail the relation of time and value put forth by Menger.

According to Menger, time played a crucial role in economic processes, as market conditions at the beginning of production are usually not the same as at the end. This idea led directly to Boehm-Bawerk's Time-Preference Theory, which claimed that the uncertainty of market conditions affected the value of goods produced. In fact, the longer production takes, the less value those goods will have.

Friedrich
von Wieser



BOEHM-BAWERK'S ASSOCIATE AND BROTHER IN LAW, HIS WORKS INCLUDE THE LANDMARK *SOCIAL ECONOMICS* (1914).

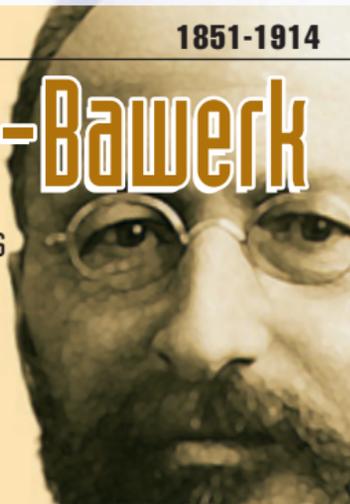
Eugen von Boehm-Bawerk and Friedrich von Wieser, that brought it to a wider audience. In explaining Menger's theory of value -- that only *individual objects* with a need or use by a specific person have value, versus *goods* in the general sense, which are valueless -- Wieser first applied the now-famous term "marginal utility."

Eugen von

1851-1914

Boehm-Bawerk

His work in economics earned him a position as Austria's Finance Minister, a post he held three times.





Money and credit...

WITH THE END OF the Austro-Hungarian empire in 1918, Austrian School economists found themselves battling a more pronounced socialist influence in European politics and society. Ludwig von Mises and Joseph Schumpeter remained two of the most prominent champions of free-market policies through the 1920s, with Schumpeter being the first to proclaim the entrepreneur as the central actor of economic change.

When Mises began his famous *Privatseminar* in Vienna,

Although Ludwig von Mises was part of the Austrian School's third generation, studying under Eugen von Boehm-Bawerk, he was also the first of the greats to study with Carl Menger himself. His groundbreaking work on money and credit helped Austria avoid the inflation in the 1920s that Germany suffered. He showed that supply and demand dictated not only the price of goods, but also purchasing power, or the "price" of money.

In 1927, Mises and his student, Friedrich A. von Hayek, founded the Austrian Institute for Business Cycle Research, an institution devoted to fostering entrepreneurial activity throughout Austria.

Joseph A.
Schumpeter



HE DESCRIBED THE PERIODIC ACTION OF ECONOMIC CHANGE AS "CREATIVE DESTRUCTION"

he laid the intellectual groundwork for an entire new generation of Austrian School thinkers. Men like Friedrich A. von Hayek, Oskar Morgenstern, Fritz Machlup and Gottfried von Haberler all studied with Mises. The work of this next generation would again bring the theories of the Austrian School to the world stage.

Ludwig

1881-1973

VON MISES

His classic critique of socialism, published in 1922, anticipated the fall of the Berlin Wall by almost 70 years.



The Great Debates...

The Austrian School's unorthodox theories led to many famous intellectual battles. The three presented here are considered the "Great Debates" of the School's history.

German Historical School (1870-1885)

Gustav von Schmoller's scathing review of Carl Menger's work led to a heated debate on the very role of economics. Menger "retired" from the *Methodenstreit* in the late 1880s to focus on other work.

Menger:

- Economics can help us understand human action
- Economic theories are needed to help us interpret history

von Schmoller:

- History is the only science suited to study human action
- Economic theories are formed through the study of history

Socialism (1884-1922)

The first Austrian School criticisms of Karl Marx came from Eugen von Boehm-Bawerk, but the debate ended in 1922 with Ludwig von Mises' book, *Socialism*, which proved Marx's economic model fundamentally impossible.

Mises:

- Income distribution is an economic issue
- A price system is necessary for any proper distribution of resources

Marx:

- Income distribution is a political issue
- Centrally run governments can distribute resources effectively and properly

Keynesian School (1932-1940)

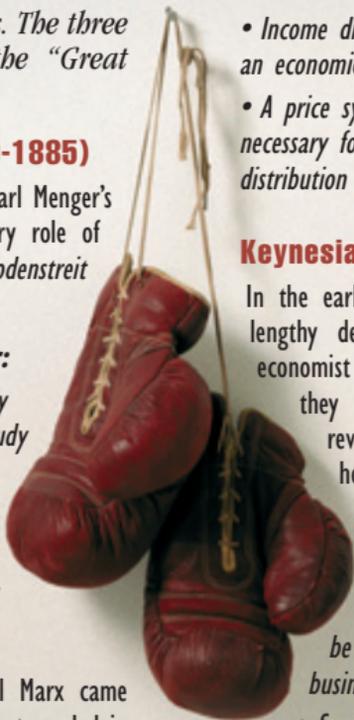
In the early 1930s, Friedrich A. von Hayek entered a lengthy debate on macroeconomics with Cambridge economist John Maynard Keynes through the journals they each edited. By 1940, the "Keynesian revolution" had won the battle; by the 1970s, however, Hayek's theories would win the war.

Hayek:

- Free markets can and should be allowed to dictate business cycles
- Supply and demand are determined by individual economic actors

Keynes:

- Central banks and other institutions should manage business cycles
- Supply and demand are analyzed by use of aggregate data



Business and capital...



THE GREAT DEPRESSION was an important time for the Austrian School; with worldwide unemployment at all-time highs, the need for economic solutions was critical. The work of Mises and Hayek on business cycles in the 1920s and 1930s was nothing short of prophetic: they were two of the very few who predicted the stock market crash in 1929. But their answer to the ills of the world economy -- that the depression was due to interference in free markets, and

Friedrich A. von Hayek is well-known outside of economic circles -- *The Road to Serfdom* is a classic of political philosophy. In economics, however, he is a legend. His theory of the business cycle defended free-market economic systems and showed how economic crises were historically the product of manipulation: lowering interest rates to an unnatural level, central banks would induce “overinvestment” and create false booms.

Hayek’s theories sparked a famous debate in the 1930s with John Maynard Keynes, whose work advocated the role of government intervention and regulation in business cycles.

Leo
Schoenfeld-Illly



THE AUTHOR OF INFLUENTIAL WORK ON MARGINAL UTILITY, HE IS ALSO KNOWN FOR HIS THEORY OF “MARKET PROCESS”.

that it would take the free markets to recover -- couldn’t compete with Keynesian ideas of public investment.

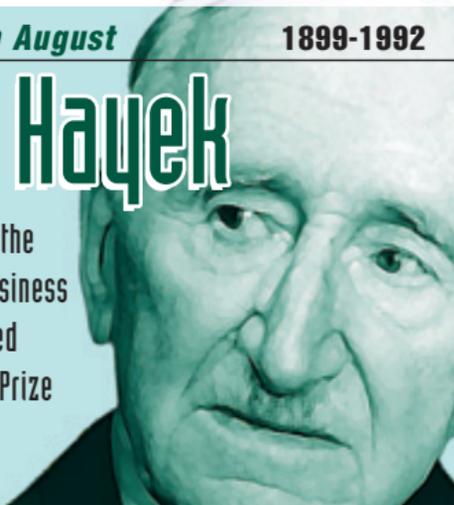
As the “Keynesian revolution” took hold, men like Mises, Hayek and Leo Schoenfeld-Illly continued to champion free markets with their economic theories. It would take 30 years for the world to come around.

Friedrich August

1899-1992

von Hayek

His work on the theory of business cycles earned him a Nobel Prize in 1974.



Action and knowledge...



BY THE 1970s, the shortcomings of the Keynesian economic model forced many to reconsider the theories of the Austrian School. According to Keynesian and other neoclassical views, it was possible for economic actors (read: the government) to have knowledge of the end of economic processes. But the crushing stagflation of that decade and Hayek's 1974 Nobel Prize brought the Austrian School's theories on the essential *uncertainty* of economic

Free and competitive international trade found one of its most outspoken advocates in Gottfried von Haberler. As Professor of Economics at Harvard University from 1936 until his retirement in 1971, Haberler argued tirelessly against the restrictive economic policies advocated by many of his colleagues -- arguments that were influenced by his study in the 1920s and 1930s with Ludwig von Mises in Austria.

His published books show a life-long interest in trade and business cycles -- *The Theory of International Trade, Prosperity and Depression*, and *Economic Growth and Stability* among them.

Fritz Machlup
KNOWLEDGE
THEORY PIONEER



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Oskar Morgenstern
CREATOR OF
GAME THEORY

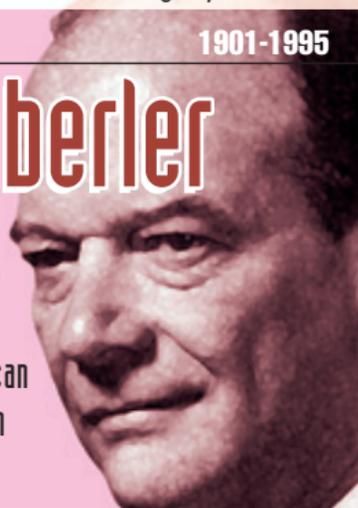
processes to the forefront. The work of Mises and Hayek — as well as Fritz Machlup's on “knowledge industries” and “knowledge economics” (terms he invented) and Oskar Morgenstern's on game theory — gained new audiences. The resurgence of free-market policies led to the prosperity of the Thatcher and Reagan years.

Gottfried

1901-1995

von Haberler

After retiring from Harvard University he became a Resident Scholar at the American Enterprise Institute in Washington, D.C.



The current scene...

The renewed interest in the Austrian School tradition that began in the 1970s continues today. With the fall of Communism in 1989, its theories have become even more relevant.

In Europe...

While Ludwig von Mises' work found powerful allies in Italy (Luigi Einaudi, Bruno Leoni) and France (Jacques Rueff), Friedrich von Hayek's professorship at the London School of Economics introduced the Austrian School's theories to men like Lionel Robbins and J.R. Hicks. The Austrians' influence can also be seen clearly in the work of Ludwig Erhard and Wilhelm Roepke and Germany's *Ordo* Liberalism movement. Austrian School theories are now taught in universities from Aix en Provence to Buckingham and Turin.

In the Americas...

Mises' work at New York University and Hayek's at the University of Chicago influenced an entire generation of American economists, including Israel Kirzner, Murray Rothbard, and James M. Buchanan,

as well as scholars from Europe and the Americas. The founding of the Ludwig von Mises Institute at Auburn University and the Austrian School program at NYU are further indications that Austrian theories are still considered viable alternatives to mainstream economics. The latest generation of Austrian School economists is already taking up major academic positions.

Find out more...

In addition to the original work of Menger, Mises, Hayek and others mentioned in this guide, there are new books, journals, and essays about or in the tradition of the Austrian School published every year. Austrian ideas are studied in classrooms not only throughout the U.S., Latin America and Europe, but also the former Soviet Union, Africa and Asia.

Visit these websites...

- The Mises Institute -- www.mises.org
- Hayek Institute -- www.hayek-institut.at
- NYU -- www.econ.nyu.edu/dept/austrian/
- Buchanan Center -- www.gmu.edu/jbc



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OSKAR MORGENSTERN
GOTTFRIED VON HABERLER
FRITZ MACHLUP



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