

## Introduction

As a participant for many years in Ludwig von Mises' New York University graduate seminar in economic theory, I was distressed by the neglect of the "Austrian School of Economics" among college and university professors and in textbooks on the history of economic thought. This book attempts to fill that gap to some extent. It tells something of the step-by-step development of the Austrian school, its theories and their gradual dissemination. In recent years, the influence of the Austrian school has been increasing and its explanations of economic matters are being more seriously treated in colleges and universities. Thus the ideas of the Austrian school are beginning to have some impact on economic thinking and even on government policy in some countries.

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By the end of the 18th century, economics was recognized as a special discipline for study, apart from the natural sciences and moral philosophy. The economists of that period, later known as Classical economists, recognized a regularity in interpersonal relationships. Like scientists throughout the ages who sought the truth in their respective fields, those early economists tried to understand and explain the regularity they noted in the actions of men in relation to other men and to the world around them. They considered their special field of study to be that of production, trade, commerce, and business. In the attempt to explain as much as they could about these phenomena, they analyzed the forces which they saw as responsible for production and trade—land, labor, and capital. Among other things, they concluded that market prices arose out of the interplay of supply and demand on the market. But their explanation, depending as it did on holistic concepts, fell short of explaining specific prices. For instance, they couldn't understand why something useful like a loaf of bread or a hod of coal cost much less on the market than an ounce of gold or a piece of jewelry that filled no urgent human need. Moreover, they left out of account immaterial or "uneconomic" items and the "unproductive" services of lawyers, doctors, opera singers, musicians, etc. Thus the analyses of the Classics failed to offer a complete explanation of all interpersonal



relationships; they could not explain satisfactorily the formation of specific prices.

It was not until a century or so later that a new generation of economists pinpointed the error in the reasoning of the Classical economists. The breakthrough came when Carl Menger (1840–1921), born within the boundary of what was then the huge conglomerate of the Austro-Hungarian Empire, clearly explained the theory of subjective value and marginal utility. In doing this, Menger rejected the holism of the Classics. He dismissed land, labor, capital, supply, and demand as holistic concepts and traced market prices to the actions of individuals. Value theory, as expounded by Menger and further elaborated by two of his Austrian-born successors, Eugen von Böhm-Bawerk (1851–1914) and Friedrich von Wieser (1851–1926), proved the “Open sesame!” to understanding all economic problems. Carl Menger’s *Principles of Economics* (1871; first English translation, 1950) and Eugen Böhm-Bawerk’s chapters on “Value and Price” in his major work, *Capital and Interest* (3rd edition, 1914; English translation, 1959), have become classics. It was because of the contributions of these Austrian-born economists that the subjective, marginal utility, value theory was later labeled “Austrian.”

The new Austrian methodology, which traced market prices to the actions of individuals was known as methodological individualism. It pointed out that market prices, as well as of all other economic phenomena, rested unequivocally on the decisions, preferences, and subjective values of individuals. Thus the market price of a particular item (a loaf of bread) depends, not on the usefulness of the category of goods of which it is one specimen (food), nor on the value of a collection of such specimens (the baker’s stock of bread), but rather on the satisfaction the specific individual involved hopes to derive from that particular quantity of the good (one loaf of bread) or service (relief of hunger) at a particular time and place. That is, the market price of a particular item depends on the expected “marginal utility” of the unit concerned to a specific individual. Menger expressed it very simply: “[T]he value of each quantity of goods is equal to the importance of the satisfactions that depend on it.” (*Principles*, p. 135) In this way, by tracing market prices back to the subjective values of individuals, to their ideas, decisions, preferences, and actions, the Austrians resolved the Classics’ “paradox of value.”

The new methodology adopted by these early Austrian economists, as well as by later “Austrian” economists—all around the world, irrespective of national origin—rejected not only the holistic methodology of their Classical predecessors, but also the historical method of the



German Historical school, the dominant economic school of their day. A heated methodological controversy developed in the 1890s, a debate which gained notoriety as the *Methodenstreit*. The Austrians pointed to the sharp distinction between (1) economic history, the data and statistics describing past events which their German contemporaries—historicists, positivists, empiricists, institutionalists, collectivists—presented as economics, and (2) the logical science of economics. Economic history, economic statistics, the Austrians argued, was the study of what men had done at certain times and places in the past. The science of economics was a universal science which used reason, logic, methodological individualism, to analyze and understand the actions of men, all men, at any time, everywhere.

Ludwig von Mises (1881–1973), who became the leading spokesman of the next generation of Austrian economists, had known Menger and studied with Böhm-Bawerk. Mises carried economic reason and logic a step farther; he broadened the field of study by incorporating economics into the more general science of praxeology, the science of all human action. Economics in the narrower sense, the study of the actions of men on the market (catallactics), is a subsidiary of praxeology. Praxeological theories are developed by reasoning logically from fundamental a priori categories. Thus economics, like praxeology, is a logical science and its methodological individualism derives logically from the a priori of action.

This book brings the development of Austrian economics down through Mises. He left Austria for Switzerland in 1934 and in 1940 fled war-torn Europe and came to the United States. He brought with him to this country his indomitable spirit, courage, and determination to continue his studies and his teaching. His books and lectures became his platform.

The decades after World War II constituted the nadir of Austrian economics in this country and throughout the world. Academia was dominated by Keynesianism, historicism, positivism, and collectivism and was not particularly hospitable to Austrian ideas, or to Mises. However, some of his friends subsidized his appointment as Visiting Professor at New York University Graduate School of Business Administration and he taught there from 1945 to 1969. The university let Mises teach, but otherwise they pretty much ignored him. One student reported that NYU administration officials actively tried to discourage him from taking Mises' course; it was not economics, they said; it was a "religion." Nevertheless, Austrian methodological individualism was kept alive during these decades primarily through Mises—his NYU seminar, the Foundation for Economic Education for which he became



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economic adviser, his teachings, and his books. The Mont Pèlerin Society, composed of free market minded academicians and businessmen, which had been founded in 1947 by Mises and his fellow Austrian, Professor F. A. Hayek, helped to some extent internationally.

Most of the participants in Mises' NYU graduate seminar were not academicians. However, many of the regulars became serious students of Austrian economics and went on to contribute something, each in his or her own way, to Austrian economics. Some became college professors. Some worked for free-market think tanks. Some were journalists. Some taught. Many of them followed Mises' recommendation and wrote books. Among the regular NYU seminar participants in alphabetical order, were Bettina (Bien) Greaves, Percy L. Greaves, Jr., Henry Hazlitt, Joseph Keckeissen, Israel M. Kirzner, George Koether, Toshio Murata of Japan, William H. Peterson, George Reisman, Murray N. Rothbard, Hans F. Sennholz, Mary (Homan) Sennholz, and Louis M. Spadaro.\* Two other "Austrians" should be mentioned—Britisher W. H. Hutt and German-born Ludwig M. Lachmann—both of whom arrived in this country from South Africa.

During the post-World War II decades, Austrian economics was practically an underground movement, but it is gradually gaining some recognition. Mises died in 1973. In 1974, F. A. Hayek, Mises' close friend and associate from Vienna, was awarded the Nobel prize in economics. Also in 1974, an Institute for Humane Studies conference at South Royalton, Vermont, featuring lectures by Kirzner, Rothbard, and Lachmann, renewed interest in Austrian economics. Since then many young people have been introduced to the subject, countless discussions and debates have been held and many "Austrian" books and articles have been published. Many of this new generation of "Austrians" began studying economics as students of Mises' NYU seminar participants.

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\*Over the years quite a few other persons attended Mises' NYU Seminar as visitors or for one or two semesters. Many who went on to help keep Austrian ideas alive through their various activities and contacts should be mentioned: Beverly (Kline) Anderson, Robert G. Anderson, Manuel Ayau of Guatemala, Alberto Benegas Lynch, Sr. and Jr., both of Argentina, George W. Bishop, Walter Block, Henry M. Boettinger, Herbert Bracey, William Burkett, Roy Childs, J. Vincent Cordero, Richard Cornuelle, Mallory Cross, Rev. John F. Davis, Frank T. Dierson, Robert J. Dobson, Richard L. Fruin, Robert Guanieri, Ronald S. Hertz, Robert Hessen, Isidor Hodes, Wayne J. Holman, Hiram J. Honea, Hugh King, David L. Jarrett, J. Ranney Johnson, Leonard Liggio, Father M. Mansfield, Edwin McDowell, Father McInnis, Luis Montes de Oca of Mexico, Laurence S. Moss, Agustin Navarro of Mexico, Vincent A. Novo, Frederick C. Nymeyer, Ralph Raico, John R. Rohrs, Robert J. Smith, Allan J. Trumbull, John van Eck, Gustavo Velasco of Mexico, and Fuchow Wang of Formosa.



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The laws and principles of the physical sciences are universal, eternal, and remain the same throughout the ages. The physical sciences of astronomy, biology, chemistry, physics, physiology, geology, mathematics, etc., have not changed since the days of the Egyptian pharaohs. Moreover, they are true everywhere throughout the world. Of course, our mastery of these sciences has increased with study, exploration, and improved technology, thus expanding dramatically our knowledge of the physical world, the human body, the universe, the stars, and the planets.

The situation is the same with respect to the science of economics. The laws of human action are not limited to any particular time or to any particular place any more than are the laws of the physical sciences. They are the same in Austria as in Nigeria, Singapore, and the United States. They are the same for the rich and the poor, the Nazis, Communists, liberals or libertarians, and the Marxian proletarians as well as for members of the bourgeois "class." The laws and principles of human action apply always and everywhere, given the same conditions, wherever there are living, acting human beings.

If the laws of human action are universal and eternal, why then do we speak of Austrian economics? Out of respect for the Austrian "founding fathers" who developed the subjective, marginal utility, theory of value, basis of the logical science of economics. And also to distinguish our science from historical and statistical economic doctrines such as positivism and institutionalism.

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A number of chapters in this anthology describe the early development of Austrian economics and the 19th-century methodological struggle, the *Methodenstreit*. Others explain Austrian value theory and methodological individualism, demonstrating how all economic phenomena derive from the actions of individuals. Individuals may act alone, of course, and/or in cooperation or competition with others. The economic transactions that result may be simple or complex, time-consuming, technologically complicated, coordinated, interrelated, and/or integrated with one another. However, in the last analysis, they can always be traced back to the ideas, preferences, choices, actions, and mistakes of the various individuals participating. This is the Austrian contribution to the universal and eternal science of economics.

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The early Austrian economists and their successors, under the guidance of Mises, recognized a sharp distinction between the methodology of history, the methodology of the physical sciences, and the methodology of economics. The great contribution of the Austrians is their methodology; they use logic to develop methodological individualism. They view man as a thinking, acting person, a person with a mind, subjective values, and many wants, who is always striving to improve his or her situation. "Austrians" place *individuals* at the center of the economic system. They realize that it is only by studying the conscious, purposive actions of individuals, which reveal their decisions, choices, preferences, and values, that one may understand the relationship of acting men to the physical world and to other men. And it is only by studying the actions of acting men that one can understand and explain such economic phenomena as prices, wages, costs, production, profits, losses, money, banking, economic calculation, economic booms and busts, and so on ad infinitum, as well as the immaterial services and other values which Classical economists dismissed as "uneconomic."

Advocates of applying an empirical or statistical methodology to economics are not theoreticians; therefore, they are not economists in the Austrian sense; they are economic historians. They observe and describe economic phenomena of the past but do not *explain* them. They deal with economic averages and aggregates and, in the process, they ignore the most significant factor, that an average or aggregate is the composite outcome of the conscious, purposive acts of many individuals. They talk about "forests" and forget the "trees." Their methodology is historical, not logical.

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Many advocates of empiricism, historicism, or positivism maintain that the test of a scientific truth is whether or not it may be used as the basis for prediction. They compile massive data on recent economic phenomena in the hope that in time they will have enough statistics to enable them to discover an economic law or theory. They look for fixed and meaningful mathematical correlations among various aggregates. They consider some statistical aggregates to be "indicators," because they are supposed to give some "indication" as to future developments. However, no economic statistic nor any accumulation of many economic statistics can ever yield an economic theory or law. To be sure,



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statistical extrapolations may be made, and such extrapolations are sometimes called "predictions." But any such extrapolation is not based on statistics alone; rather it is based on a theory, and a rather unreliable theory at that, the theory that current trends will continue. No extrapolation can say anything about how long any particular current trend will continue, nor if, as, or when it will change. But one thing is certain: present trends *will* change. History is always change. No one can learn the future from the past.

Predictions *are* possible, however, in the field of logical economics, although not on the basis of history. Predictions are possible on the basis of "Austrian" theory and an understanding of the universal and eternal principles of human action. But such predictions can only be qualitative, not quantitative. For instance, we can predict that, given human nature and the world of limited resources, time, and energy in which we live, goods and services in great demand will be relatively more valuable on the market than those not so urgently demanded, although we cannot say how much more valuable. By that same token, we can predict that in a society which protects private property and allows potential producers freedom to experiment, some entrepreneurs will try to expand production of the desired goods and services. And we can predict that, other things being equal, if demand for these items falls, so will their market value, and thus also the incentive of would-be entrepreneurs to expand their production.

Another prediction we can make is that, if the quantity of money is increased while the demand for it remains the same or falls, prices generally will tend to rise, although not all prices will rise at the same time or to the same extent. The prices of some goods or services may even fall if buyers refuse to buy them.

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The methodological individualism of the Austrians has proven extremely fruitful in helping to develop and explain economic phenomena. By reasoning logically, step-by-step, on the basis of the fundamental a priori, action axiom, the "Austrians" have developed the logical science of economics. They have explained how the different values held by different individuals lead to specialization, interpersonal cooperation, and trade. They have explained the role of private property and the importance of time. They have explained money and how it originates as the most marketable commodity in a community. They have explained money's impact on prices, trade, exchange rates, as well as on patterns of production. They have explained interest rates, infla-