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From Mises to Morgenstern.

The Austrian School of Economics during the *Ständestaat* *

1. Introduction

In the 1930s the Austrian school of economics lived through a crucial phase in its development, which led from the height of its influence at the beginning of the decade to its decline and dissolution after 1945. The rise and fall of the Austrian school and of its liberal¹ wing in general had its counterpart in the fate it experienced in its country of origin. On the one hand, Austria (and especially Vienna) had played a vital role as a center of communication for all the members of the school. And on the other hand the Austrian economists in turn had tried to use their reputation for influencing the course of Austrian economic policy, in particular during the Great Depression – and indeed many observers, contemporary and modern, trace the comparatively

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¹ The term “liberal” is always used as referring to “classical” liberalism.

weak performance of the Austrian economy back to the harmful power of the Austrian economists' ideas.

Against this background this study tries to examine the development of the Austrian school from 1934 to 1938, that is, from the end of parliamentary democracy in Austria and its replacement by the authoritarian *Ständestaat* (corporate state) regime to the eventual *Anschluss* (union) to Nazi Germany.² It starts by describing the state of the Austrian school of economics in the mid of the decade. The next section analyses the position of the school towards democracy and the corporate state. Then we turn to the change in leadership within the Austrian economics community from Mises, the liberal, to Morgenstern, the technocrat, and we discuss the divergences between the strands of thought within the Austrian school as symbolized by these two men. As a conclusion we sketch the future fate of the Austrian school after the war.

2. The outset

It is useful to distinguish two strands within the Austrian school. The first will be called that of “Austroliberalism,” whose tradition goes back to Carl Menger and Eugen Böhm-Bawerk.³ At the beginning of the 1930s Ludwig Mises, a member of the third generation of the school, was the undisputed (if only informal) leader of this group. The most prominent among the younger members were Friedrich August Hayek, Gottfried Haberler, and Fritz Machlup.⁴ The second and less coherent strand, which more closely followed the teachings of Friedrich Wieser, had a more reserved position towards liberalism, in theory as in practice; its best known representative was Hans Mayer, and among the younger economists Oskar Morgenstern, Alexander Gerschenkron, and Paul Rosenstein-Rodan.

It was these economists who dominated the economic discourse in Austria, at least if we restrict ourselves to economics in the more traditional sense.⁵ Besides the discussion in academic as well

² On the politics and economics of the *Ständestaat* see Tàlos and Neugebauer (1988), Senft (2002), and Bischof, Pelinka and Lassner (2003).

³ On the history of the Austrian school and the distinction of two strands see Streissler (1988) and similarly Hayek (1992, 42–60). The term “Austroliberalism” follows Müller (1987).

⁴ Joseph Schumpeter is not included because he is typically not considered as a member of the Austrian (or any) school.

⁵ We neglect, therefore, the activities of the Austromarxists and of the followers of the “romantic” tradition of “universalism.”

as journalistic writings, a vital part of this discourse was organised in a diversity of “circles” with members not only recruited from the economics profession but also from other social sciences, law, and business.⁶ Although his formal position was only that of a secretary of the Chamber of Commerce, Mises was a dominant figure in theory as well as in policy. It was at his initiative that in 1927 the Austrian Institute for Business Cycle Research was founded, financed mainly by funds from the Rockefeller foundation. Hayek was its first director (from 1927 to 1931), and Haberler and Machlup were members of the staff early on. Of the members of the Austrian school Mayer alone occupied a chair at the University of Vienna;⁷ however, as he spent most of his time for intrigues – his conflicts with Othmar Spann were notorious at the time, he exerted no lasting impact.⁸ Morgenstern, after a short spell under the influence of Spann in the 1920s, had turned soon to the Austrian tradition and worked as Mayer’s assistant. After returning from a three year Rockefeller Fellowship abroad, he succeeded Hayek as the director of the Institute and remained in this position until 1938.

In 1934 the state of the Austrian school and, in particular, of its liberal strand was characterised by the fact that, due to the missing career opportunities combined with an increasing hostility towards liberals and Jews, many of its most eminent members had left the country.⁹ Hayek had left already in 1931 for a professorship at the London School of Economics, from where he propagated his international reputation as a leading representative of classic liberalism. Haberler had taught as a visiting professor at Harvard University and was now at the League of Nations in Geneva, working on his study of the business cycle (Haberler 1937). Machlup spent a two-year Rockefeller Fellowship in the United States and in Great Britain. And finally, in September 1934, Mises quitted his position at the Chamber and took over a professorship at the Geneva Institute of International Studies, at first only planned for a one-year term. Of the Austro-liberals

⁶ The most important “circles” were the Mises private seminar, the so-called *Geist-Kreis* and the seminar of the Austrian Economic Society (*Nationalökonomische Gesellschaft*); see e.g. Craver, (1986a, 13–18) and Müller (1988, 59–61).

⁷ The two other chairs were held by Ferdinand Degenfeld-Schönburg (an economic historian) and Othmar Spann (the founder of “universalism”).

⁸ See Craver (1986a, 10–13). For a more favorable evaluation of Mayer see Leonard (forthcoming, ch. 1).

⁹ On the emigration of the Austrian economists see Craver (1986a), Müller (1987), Fleck (1987), and Rathkolb (1987). For biographical information see the respective entries in Hagemann and Krohn (1999).

only the lesser known stayed in Austria, for example, Richard Strigl, Martha Stephanie Braun (one of the very few female members), and Erich Schiff.

Economically, Austria had been among the countries hit most hard by the Great Depression, and in 1934 the bottom of the slump had scarcely been overcome. From the point of view of the Austrian liberals the cause of both the crisis and the depth of the depression had to be looked for in the errors of an ill-conceived economic policy: inflationism, excessive taxes and social burdens, and rigid wages, that is in short, the violation of the whole framework of economic liberalism.¹⁰ This framework of liberal rules, as symbolized by the gold standard,¹¹ required “sound” monetary and financial policies (that is, the avoidance of inflation¹² and of budget deficits), the freedom of international trade, and a minimum of government intervention into industry in general. To the liberals a sustainable recovery of the Austrian economy could only be accomplished by again subordinating economic policy to this framework of rules.

Politically, the time period in question was shaped by the transformation of parliamentary democracy into an authoritarian regime. The response of the Austrian school to this event will be inquired in the next section.

3. The Austrian economists on democracy and the *Ständestaat*

The sources from which to infer the position of the Austrian school vis-à-vis the corporate state are mainly twofold: First, we can look into what had been written on the possible conflicts between liberalism and liberal economic policy on the one hand and the different political systems on the other hand, as e.g. in Mises (1927, 1929) or in Morgenstern (1934). Secondly, there are also more detailed statements on the specific situation of Austria, in particular in unpublished notes and correspondence.¹³

¹⁰ On Austrian economic policy in the 1930s see Klausinger (2002).

¹¹ On the “gold standard mentality” see Eichengreen and Temin (2000).

¹² As contemporary terminology equated inflation with an increase in the (effective) quantity of money, this requirement was, in the case of growth, more stringent than a stable price level.

¹³ Most of the material used is from the Fritz Machlup Papers, Hoover Institution Archives, Stanford University, and the Oskar Morgenstern Papers, Special Collections Library, Duke University; for sake of brevity these will be referred to by FMP and OMP, respectively. All translations from these sources are my own.

To begin with Mises's general treatment of liberalism, he professed himself an adherent to democracy – as opposed to a corporate state or to dictatorship – as the only political system consistent with liberalism, by its virtue of permitting non-violent transitions of power and thereby safeguarding against civil war or revolution.¹⁴ However, this position became blurred as soon as he distinguished between democracy proper (that is one enlightened by the spirit of liberalism) and that kind of democracy dominated by political parties in pursuit of special interests. In particular, he was convinced that the latter kind of democracy faced the danger to be impeded in its working by the use of violence and eventually to descend into socialism. In this regard, his attitude towards democracy appears ambiguous. On the one hand, he warned that even if democracy “is on the road to destruction ... force is never a means of overcoming these difficulties” (Mises 1978a, 45 [1927, 40]). On the other hand, almost in the same breath he conceded “that Fascism and similar movements ... are full of the best intentions and that their intervention has, for the moment, saved European civilization” (Mises 1978a, 51 [1927, 45]).¹⁵ Basically, Mises identified behind the potential conflict between liberalism and (non-enlightened) democracy the more fundamental opposition of public opinion increasingly shaped by socialist ideas. As such public opinion will determine the course of events independently of the political system, whether democratic or not, in the end the mere transition to an authoritarian or corporate system will not solve the problem.¹⁶

The dilemma sketched above is to Mises paradigmatic for the Austrian situation. According to him, democracy Austrian-style had been paralyzed by the power exerted by the Social Democrats and in particular by the trade unions. For example, in one place Mises referred to the “terror apparatus ... of the Social Democratic party” (Mises 1978b, 88), and he considered wage conflicts and strikes organized by trade unions as illegitimate means of violence.¹⁷ Of the other Austrians Machlup appeared to concur with Mises's broad diagnosis. He characterized the democratic system of Austria by the fact that the left minority prevented the conservative majority – by obstruction in parliament and mainly by the power in the streets – from effectively

¹⁴ Cf. Mises (1978a, 42 [1927, 37]; 1978b, 69).

¹⁵ It should be noted that Mises finally rejected the fascist solution for reasons of principle (ibid.).

¹⁶ Cf. Mises (1978a, 173 [1927, 151]).

¹⁷ Cf. Mises (1931, 17).

realizing their objectives (Machlup 1938?).¹⁸ Moreover, Machlup (n.d.) held that if elections had been held after 1933, they would have ended with the suicide of Austrian democracy because of the majority of votes to be expected for the Austrian Nazis. Therefore, from the point of view of Mises and Machlup, probably quite typical for the Austroliberals in general, democracy Austrian style had to be considered an experiment that failed.

The Austrians also ascribed the failure of democracy to economic aspects. The most important one was the insoluble discrepancy between the economic logic of a capitalist market economy and the improvements in social legislation, as enforced by the political power of the working class immediately after the war.¹⁹ The satisfaction of these claims for social justice were seen, in the end, as causing business losses, financial weakness, and “capital consumption,”²⁰ that is, the main causes of economic stagnation. In this regard, Hayek asked: “Can capital consumption be avoided in the long run in a democratic society in which the majority of the population is anti-capitalistic?” (Hayek 1984, 155 [1932, 107]) In any case, the liberal recipes, a cutback in social policy to ease the burden of taxes and social duties, supplemented by wage cuts as a cost saving device, were considered as colliding with the power of organized interests within the democratic system. Thus, eventually the liberals apparently accepted the option of authoritarian rule as a possible way out of this dilemma.

This acceptance, at least after the fact, of the elimination of parliamentary rule does not imply a favorable view on the newly erected corporate state. For Mises it ultimately just came down to the replacement of one ruling group by another: “The cliché, a *Ständestaat*, ... merely shielded the aspiration of the Christian-Social Party and its allied homeguard for complete party rule.” (Mises 1978b, 136) Although the transition of power (to the conservatives) ensured the implementation of monetary and financial policies strictly in line with the goal of stability, conforming to the demands of the foreign creditors too, in other fields of policy the scepticism of the Austrian liberals towards the *Ständestaat* regime was imminent. They disapproved of its clerical (and somewhat disguised anti-semitic) character,²¹ they complained about intellectual

¹⁸ Just as the following piece, this is a typescript version of a speech.

¹⁹ See, for example, retrospectively Hayek (1945).

²⁰ For indeed heroic attempts at estimating a quantitative measure of capital consumption in Austria see Morgenstern, (1931) and Machlup (1935).

²¹ Cf. Max Mintz to Machlup, 9 Dec 1934. FMP, box 53, folder 25.

decay combined with progressing corruption,²² and Max Mintz, a participant of the Mises seminars, formulated the ultimate judgment: “Never in the last 80 years has political and economic liberalism been as dead as today.” (Mintz to Machlup, 9 Dec 1934. FMP, box 53, folder 25)

Another piece of evidence for the scepticism of liberal Austrian economists towards the *Ständestaat* lies in the decision of Haberler, Machlup and Mises not to return to their home country, but to make their emigration permanent. Haberler, on his way from Geneva to Harvard, stayed only for a short time in Vienna; Machlup withdrew his habilitation thesis, after the proceedings had been unduly delayed by the usual intrigues, liquidated his Austrian firm and accepted a chair at the University of Buffalo; and Mises extended his activity in Geneva up to 1940, when he emigrated to the United States too. The correspondence between Machlup and Mises is revealing in this regard. Here Machlup referred to the Nazi question and the Jewish question as the reasons for his ultimate decision not to return to Austria.²³ Mises emphasized the economic aspects: “In a country where capital is consumed the whole situation is unstable.” (Mises to Machlup, 23 Nov 1934. FMP, box 53, folder 27) Although they regarded the *Ständestaat* a last chance for Austria to survive as an independent state – whether through the support from the Italian fascists (cf. Mises 1978b, 140)²⁴ or the restoration of the Habsburg monarchy (cf. Machlup n.d.) – the future prospects for Austria were seen as dim and the eventual *Anschluss* to the German *Reich* as almost inevitable. Thus, Haberler already in 1936 noted a “cold nazification” of Austria (Haberler to Machlup, Aug 1936. FMP, box 41, folder 4).

Those members of the Austrian school critical of political and economic liberalism developed a more friendly attitude towards the *Ständestaat*. For example, Morgenstern propagated the idea of a “strong state” capable of overcoming the power of special interests, and in general he preferred authoritarian regimes to democracies for their capacity to implement the hard measures necessary in times of crisis.²⁵ By the way, this was a view widely shared by the (conservative)

²² Cf. Hayek to Machlup, 1 May 1936. FMP, box 43, folder 15.

²³ Cf. Machlup to Mises, 25 Sept 1934. FMP, box 53, folder 27. Both Machlup and Mises were of Jewish origin.

²⁴ It should be noted here that Mises’s recollections were written in 1940 (and in a very pessimistic attitude).

²⁵ Cf. Morgenstern (1934, 129–30). It is noteworthy that in the revised English version of this book (Morgenstern 1937, 141–43) this statement is considerably weakened. Furthermore, the

elites of the country.²⁶ In this vein, Morgenstern saw his task not in realizing an economic policy conforming to an ideal principle (as, e.g. that of liberalism), but in lending his technocratic advice for the evaluation of the possibly interventionist policy decided upon by the new government. Mayer adapted quickly to the new environment by giving a seminar on the “Economics of the corporate state,”²⁷ and another telling episode confirms his flexibility: Although he once had tried, by organising support from Schumpeter and other German professors, to prevent the appointment of Josef Dobretsberger, a partisan of the *Ständestaat*, to a chair at the University of Graz,²⁸ he now hailed him on the occasion of his being appointed as minister of social affairs as a great scholar, comparable to his predecessor Böhm-Bawerk (Mayer 1935) – a comparison that was ill-received among the other members of the Austrian school.²⁹

Summarizing, although the liberals’ judgment was more differentiated and critical as compared with the other Austrian economists, they accepted the end of the democratic system as unavoidable and the *Ständestaat* appeared to them as an evil only insofar as its opposition to the principles of liberalism was concerned.

4. From Mises to Morgenstern

In this section we analyse the transformation that the Austrian school experienced in these years in Austria, symbolized by the transition of the leadership role from Mises to Morgenstern. This section concentrates specifically on the developments within the economics community, the following sections examine this transformation from the point of view of theory and economic policy, respectively.

more ambivalent position of the liberals in this regard, as of 1934, is subtly expressed in the criticism by Braun (1934, 23) that Morgenstern will be “much misunderstood; for he will be reproached for favoring political fascism for the sake of sound economic policies” (my translation).

²⁶ Similar pronouncements are documented for Engelbert Dollfuß (the Federal Chancellor in 1934), Kurt Schuschnigg (his successor), Viktor Kienböck (the President of the Austrian central bank), and Rost van Tonningen (the representative of the League of Nations in Austria); cf. on this Kernbauer (1991, 389). For an analogous discussion see also the 1932 correspondence between Morgenstern and Viktor Brauneis (a director at the Austrian central bank), in OMP, box 4.

²⁷ Cf. Machlup to Mises, 8 Apr 1935.

²⁸ Cf. Haberler to Morgenstern, undated [Nov 1935?]. OMP, box 5.

²⁹ Cf. Morgenstern to Haberler, 5 Nov 1935. OMP, box 5.

As noted above, the preconditions were favorable for Morgenstern's rise to a leading position because of the vacuum left by the emigration of the most important members of the Mises group, a vacuum that could not be filled out by Mayer. Moreover, Morgenstern's position was furthered by some additional factors. The first and most important was his directorship of the Institute. The funding of the Institute by the Rockefeller Foundation³⁰ had been granted until 1935. When an attempt, undertaken jointly by Mayer, Mises and Karl Pribram, to win the Rockefeller Foundation for the financing of an alternative and more comprehensive project of social science research failed, the funding for the Institute was prolonged indefinitely. Morgenstern noted in his diary: "Mises, Mayer, etc. are not going to be asked anymore." (Morgenstern diary, 26 Dec 1934. OMP, box 13) His position, now being undisputed, allowed him to extend the Institute's research beyond the narrow fields of the business cycle to more abstract topics of pure theory. Besides this, the Institute worked as a base for Morgenstern's activities as a policy advisor, which are described in more detail below. In this regard Morgenstern also succeeded to secure for the Institute a formally independent position outside Austria's exuberant state bureaucracy. The role of the Institute was also relevant in another respect, as it provided employment opportunities, so rare at this time, for scientifically inclined economists outside the universities. Furthermore, Morgenstern through his contacts to the Foundation appears to have managed that many of his collaborators at the Institute were chosen for a Rockefeller Fellowship to be spent one year abroad. It is noteworthy that of the younger economists working at the Institute – Ernst John, Reinhard Kamitz, Josef Steindl, Gerhard Tintner, and Abraham Wald³¹ – none had a special affinity to the liberal strand of the Austrian school.

Another factor to be considered is Morgenstern's activity as an editor. As director of the Institute he was also responsible for the *Monatsberichte* (monthly bulletins) and the *Schriftenreihe* (book series), with contributions by Hayek, Machlup, Schiff, Morgenstern, Strigl, Nurkse, and Wald. Still more crucial was his position as the managing editor of the *Zeitschrift für Nationalökonomie*, after 1933 the only German-language economics journal with international reputation. There he used his discretion as an editor to move the journal towards a position rather

³⁰ On the activities of the Rockefeller Foundation see Craver (1986b) and Leonard (2002, 32–44).

³¹ Of those mentioned above Tintner, John, and Kamitz (planned for 1938/39) received stipends, but not Wald (as a stateless person of Jewish origin). By the way, the correspondence between Hayek and Machlup shows (Machlup to Hayek, 15 Feb 1934 and Hayek to Machlup, 19 Mar

critical of Austrian theory (in the tradition of Mises). Finally, Morgenstern worked regularly as a referee of projected books for the publisher Julius Springer in Vienna. All in all Morgenstern's influence on the publishing of economics literature in Austria was considerable.

The rise of Morgenstern corresponded to the decline of the Mises group. The absence of many of its former members led to the gradual decay of communication and debate within the diverse circles. The lectures given to the Austrian Economic Society were the exception to the rule, yet they too were no longer dominated by the Austrian liberals, neither among the speakers nor in the audience.³² Similarly, the journalistic activities of the Mises group evaporated. In particular, from 1932 to 1934, the liberals had attempted to educate public opinion in the insights of Austrian economics. For example, Machlup wrote up to hundred weekly columns, titled “*Zwei Minuten Volkswirtschaft*” (“Two Minutes of Economics”) for the Viennese daily, *Neues Wiener Tagblatt*,³³ and some members of the Institute (Machlup and Morgenstern among them) supplied the same newspaper with topical comments on matters of economic policy.³⁴ Yet during 1934 all these activities were stopped, on the one hand because of Machlup's emigration, and on the other hand because of the decreasing interest in lectures in liberalism combined with the interventions of censorship: “On the most important topics I must not write, and to write on unimportant topics is not worth the while.” (Machlup to Dr. Hugo Glaser [of the *Neues Wiener Tagblatt*], 6 Apr 1934. FMP, box 55, folder 18)³⁵ At last, a look at the Austrian universities confirms the above picture. Vacant chairs were filled up with adherents to the new regime, like Dobretsberger in Graz and Kerschagl at the *Hochschule für Welthandel* in Wien, Morgenstern still received the honorary title of “extraordinary professor.” In contrast, the remaining Austrian liberals had to content themselves with accompanying roles outside academia.

1934. FMP, box 42, folder 2) that Tintner was awarded the fellowship that had been refused to the more liberally-minded Schiff.

³² The loss of this center of communication might be a cause of the increasing divergence of the theoretical positions held within the Austrian school in the 1930s. For an example see Klausinger (2003, forthcoming).

³³ See Klausinger (2001).

³⁴ See *Neues Wiener Tagblatt* to Morgenstern, undated [Jan 1931?]. OMP, box 6, and Morgenstern to Grätz, 4 Apr 1932. OMP, box 5.

³⁵ On the problems with censorship see also Morgenstern to Machlup, 19 and 26 Mar 1934. FMP, box 54, folder 15.

Therefore, insofar as the Austrian school kept its influence intact even during the *Ständestaat* regime, it was now exerted no more by the members of the liberal strand but instead by the followers of Morgenstern (and to some extent Mayer). Yet, also in this period the flow of emigration of Austrian economists remained steady.³⁶

5. From apriorism to exact theory

The transition of the leading position from Mises to Morgenstern was more significant than just an exchange of persons, for it brought to light the diverging theoretical positions within the Austrian school.

In the 1930s Morgenstern attempted to formulate an independent theoretical position critical of the approach of Mises and Hayek – thereby questioning the leadership of Mises as well as the principally liberal orientation of the Austrian school. Already in 1933 he wrote: “For the Viennese it is not unimportant that it is realized in Germany that the common impression as if Mises were the leader of the local economics community and all the other economists, especially the younger ones, look up at him, does not correspond to the facts.” (Morgenstern to Vleugels, 6 May 1933. OMP, box 7) However, his endeavour for autonomy was characterized by the simultaneity of his harsh criticism of the state of contemporary economic theory and his attempts at revolutionary alternatives that were at best sketchy and often confused.³⁷

In any case, in the debates between Morgenstern and the Austrian liberals various levels of conflict can be distinguished. First, their views on the foundations of economic policy were opposed to each other. In this regard, Mises adhered to the thesis that the superiority of economic liberalism could be derived from the propositions of economic theory, based on aprioristic foundations: “[T]he science of economics proves with cold, irrefutable logic that the ideals of those who condemn making a living on the market are quite vain, that the socialist organization of society is unrealizable, that the interventionist social order is nonsensical and contrary to the ends at which it aims, and that therefore the market economy is the only feasible system of social

³⁶ Thus, in 1936 Rosenstein-Rodan took a permanent position at the University College in London, Tintner left in 1937 for the Iowa State University, and Karl Menger taught 1937/38 as a visiting professor in Notre Dame.

³⁷ Haberler, a personal friend of Morgenstern, warned: “Your *sweeping condemnations* of all possible people are very amusing. However, they put a heavy burden of responsibility on your

cooperation.” (Mises 1960, 196 [1933, 183]) Morgenstern, in contrast, considered liberalism (and socialism) as examples of “rigid systems of economic policy” that cannot be justified by the insights of economic theory.³⁸ Instead he insisted that policy advice should be purely technocratic, i.e., free of value judgments, so that in his view the economist as a policy advisor had to accept the goals as they resulted from the political process (Morgenstern 1934, 4 and 9).³⁹ Consequently, this theory of economic policy was compatible with, if not just designed for a policy of interventionism, which Mises had strictly rejected. Of course, Morgenstern’s hostility towards the Mises approach, although somewhat veiled, did not go unnoticed and caused a chilly reception among the liberals – for example, Hayek characterized Morgenstern’s book as “miserable and yet impertinent in its tone.” (Hayek to Machlup, 14 Jan 1934. FMP, box 42, folder 2)⁴⁰

The second level of dispute arose from questions of methodology. As already noted, Mises and to some extent his followers⁴¹ relied on aprioristic foundations for economics as a science of action, i.e. of “praxeology,” while Morgenstern held that economic theories should rest on an “exact” basis and their validity be determined on empirical grounds. Thereby “exactness” meant an axiomatic-mathematical foundation of economic theory⁴² free of (liberal) value judgments – whereas the anti-formalistic position of the other Austrians (from Mises to Mayer) abhorred the use of mathematical tools. Although Morgenstern in the 1930s failed in his own attempts to

forthcoming works.” (Haberler to Morgenstern, 15 Aug 1934. OMP, box 5; my translation; the italicized part is English in the original)

³⁸ Cf. Morgenstern (1934, ch. 3).

³⁹ Morgenstern (1934, 57) illustrated his position by an example where free trade is not a feasible option because policy-makers have decided to protect an important group of the population from foreign competition.

⁴⁰ In his correspondence with Morgenstern Hayek’s reaction was more diplomatic, yet still unambiguous; moreover he complained that “you ... were rather rude to some of my friends” (Hayek to Morgenstern, 2 Apr 1934. OMP, box 5). See also the critical review by Braun (1934).

⁴¹ Haberler and Hayek eventually turned away from Mises’s position. See Haberler (1933, 94) and Hayek (1937).

⁴² See Morgenstern (1936a). There can be little doubt that Morgenstern’s methodological position was shaped by his participation in two more of the Viennese circles, the Vienna circle of the philosophers around Moritz Schlick and the “Mathematical Colloquium” initiated by Karl Menger, the son of the founder of the Austrian school. On the importance of these circles for modern economic theory see Nicola Giocoli (forthcoming, ch. 4, §4) and Weintraub (1985, 62–80).

develop such an “exact” foundation for economics – a planned book on time and economic equilibrium⁴³ never went beyond a mere expression of intent –, the lack of exact thinking was an ever present argument by which he reproached all his Austrian rivals. An article by Hayek appeared to Morgenstern as “a model of confusion” (Morgenstern diary, 3 Sep 1935. OMP, box 13), on the occasion of Karl Menger’s lecture on the law of returns⁴⁴ he noted: “He [Haberler] is far from understanding the fundamentals of these exact things. Mises talked pure nonsense” (ibid., 31 Dec 1935. OMP, box 14), and his advice to Machlup was: “He should eventually start with doing *science*.” (ibid., 27 Oct 1935. OMP, box 14; emphasis in the original)

Finally, as a third level, there was also disagreement with regard to the basic tenets that constituted the liberal version of Austrian economics. This can be most easily seen by looking at the three major controversies in which Austrian economics had become involved in the 1930s, that is, the controversy on the nature of capital, on the possibility of economic calculation in socialism, and – in the debate with Keynes and his followers – on business cycle theory and policy.⁴⁵ Significantly, Morgenstern remained agnostic in the economic calculation debate, and he strictly opposed Austrian capital theory as derived from Böhm-Bawerk, with its emphasis on the time dimension of capital.⁴⁶ In his view of the business cycle Morgenstern’s position towards Austrian theory, as put forward by Mises and Hayek, appears to be most ambiguous. For he concurred with the Austrians in their strict adherence to the gold standard mentality and therefore in the rejection of Keynesian ideas designed to combat the depression by expansionist policy.⁴⁷ Yet he objected to central concepts of Austrian business cycle theory such as, for example, the “natural rate of interest”, which he considered a “mystical affair” (Morgenstern 1976a, 402 [1936a, 20]).⁴⁸ In a sense Morgenstern contented himself by justifying “sound”

⁴³ Cf. Morgenstern diary, 4 Nov 1934. OMP, box 13.

⁴⁴ Later to be published, jointly with Morgenstern (1936a), in the *Zeitschrift* as Menger (1936), on the occasion of which Hayek noted: “The Morgenstern-Menger group and thereby the *Zeitschrift* commit terrible things scientifically ...” (Hayek to Machlup, 1 May 1936. FMP, box 42, folder 2).

⁴⁵ On the Austrians’ apparent defeat in these controversies see Caldwell (1988), 517–21.

⁴⁶ See Morgenstern (1935).

⁴⁷ See on this Klausinger (2002, 15–21).

⁴⁸ For his critique of “neutral money” see Morgenstern to Knight, 12 Sep 1934. OMP, box 6.

monetary and financial policies by the eclectic proposition, supported by conventional wisdom, that the crisis is the inevitable outcome of preceding inflationary excesses.⁴⁹

In sum, it is evident that Morgenstern's rise to leadership meant a turn-away from the positions of Austrian liberalism and, with regard to the Institute, a reorientation of the fields of research. However, the revolutionary critique of current economic theory that he strived for had to wait for its formulation until the time of his cooperation with John von Neumann.⁵⁰

6. From liberalism to pragmatism

Until 1934 the impact of Austroliberalism in the Austrian economic policy debate had been considerable. Mises' position as the secretary of the Chamber of Commerce offered him the possibility to directly influence the process of policy decision-making by his proposals and programs. Moreover, as noted above, the liberals – with the then still united journalistic efforts of Mises, Machlup, and Morgenstern – tried to create a climate favorable to economic liberalism. Yet, this ended when after Morgenstern's appointment as director of the Institute and Mises's emigration to Geneva Morgenstern became one of the most important policy advisors to the authoritarian government. Looked at from this point of view, Morgenstern's 1934 monograph on the limits of economic policy might be considered a successful piece of public relations.

Morgenstern's activities as a policy advisor were manifold. He held some formal positions within Austrian bureaucracy, for example, as an advisor to the Ministry of Commerce, where he was responsible for questions of traffic infrastructure and in particular for the Austrian railroads; as a member to the price commission that regulated commodity prices, mainly of agricultural products; and he represented the Austrian government at international conferences, at the League of Nations, and at the negotiations with foreign debtors after the 1931 banking crisis. Sometimes Morgenstern's informal relations, among others to Kienböck, the President of the Austrian central bank, and to the Ministry of Finance, in particular to Ludwig Draxler, the architect of an austerity course in financial policy, were still more important. During this period Morgenstern produced a series of memoranda, some of which were also published afterwards.⁵¹

⁴⁹ Morgenstern's writings on the business cycle lacked originality. As evidence see the typescript of a lecture, the "Konjunktur-Vortrags", Jan 1936. OMP, box 26.

⁵⁰ For Morgenstern's development in the 1930s as a pre-history of game theory see Rellstab (1991) and Leonard (1995 and forthcoming).

⁵¹ See, for example, Morgenstern (1936b, 1936c).

Morgenstern also integrated his activities in policy advice with his directorship of the Institute, which once led the Rockefeller Foundation, responsible for most of the funding of the Institute, to doubt its independence from the government. In a telling episode Tintner, who had worked for the Institute and at this time had already left Austria for the United States, reported to the Foundation that Morgenstern tried to avoid any critical review of government policies (especially in the *Monatsberichte*) in exchange for having a free hand in his internal role as an advisor.⁵² Obviously, Morgenstern succeeded in dispelling this suspicion,⁵³ and the funding from the Foundation continued unabated. Yet, a glance at the *Monatsberichte* confirms that the comments on government policies were exceedingly tame and eclectic;⁵⁴ and even in 1938 Morgenstern (then already in the United States) and Kamitz were eager to censor a contribution that was too favorable towards a policy of public works.⁵⁵

For Morgenstern's role as a policy advisor 1936 became the crucial turning point. Then, after the eventual breakdown of the Gold bloc and the devaluation of the currencies of its member countries (France, Switzerland, and the Netherlands) Austria had to decide whether it should devalue the Austrian Schilling too or stabilize the current parity.⁵⁶ As the control of Austrian economic policies (by the League of Nations and the foreign creditors) had already been considerably eased, Austrian policy could decide on this issue autonomously. In conformity with Morgenstern's recommendations, the Austrian government opted for a stable currency and thereby possibly missed its last chance to stimulate the economy.

Two aspects of this decision are remarkable. On the one hand, Morgenstern's orthodox advice was not based on a specific economic theory and, in particular, not based on the Austrian view of the business cycle – he was rather astonished, as he noted in his diary, that “all the ‘foreigners’

⁵² Cf. Leonard (2002, 38–39).

⁵³ In a letter to John Morgenstern accused Tintner of a pathological hatred against anything of Austrian origin, see Morgenstern to John, 6 Jul 1937. OMP, box 5.

⁵⁴ This tameness (and Morgenstern's turning away from the Mises group) might explain the fact, emphasized by Rosner (1999, 221–222), that the business cycle analyses in the *Monatsberichte* are often in contradiction to the Mises-Hayek theory.

⁵⁵ See on this Steindl (1988, 400).

⁵⁶ For a more extensive discussion see Klausinger (2002, sec. 6).

are ever asking, why we did not devalue” (Morgenstern diary, 24 Jul 1937, OMP, box 13).⁵⁷ On the other hand, Morgenstern’s recommendation for stabilizing the currency had been conditioned on a supplementary policy of lowering prices, directly by price controls (primarily directed at agricultural products) and indirectly by opening up some industries to international competition.⁵⁸ However, this policy of lowering prices failed because they were opposed by the very special interests on whose support the government relied.

Morgenstern’s recommendations for trade and industrial policy suffered a similar fate. Although he – other than the liberals – was convinced of the necessity to regulate markets in the face of economic power, conflicts of interest, and monopolization, he found the current scheme of “market regulation” (*Marktordnung*) as highly inefficient and he pleaded for some easing of those regulations (*Auflockerung*).⁵⁹ When his hopes to influence economic policy for the better were disappointed in this regard too, he abandoned his political activities⁶⁰ and started to concentrate again on his scientific career. In January 1938 he left Austria for a three-month visit at some American universities. In retrospect and after the *Anschluss* the economic policies of the *Ständestaat* became the subject of a devastating critique – it should be relegated to the “great field ... which might appropriately be called the ‘pathology of economic policy’ ” (Morgenstern 1939, 39).

Thus, in these years thanks to Morgenstern the Austroliberals’ approach to economic policy and policy advice had been replaced by a more pragmatic (or technocratic) position. It is the more remarkable that this did not imply a policy change in the fields of monetary and financial policies, where the rule of the gold standard mentality continued more or less unquestioned. However, in other fields, like those of trade and industrial policy, where Morgenstern’s suggestions (of a cautious policy of easing regulations) collided with the organized interests of the *Ständestaat*, economic reasoning was defeated by political necessities – thus in some respect confirming the “limits of economic policy” to which Morgenstern had alluded in his book. It was

⁵⁷ One of those “foreigners” was Haberler, who argued his position in no less than four letters (see Haberler to Morgenstern, 30 Oct, 20 Nov 1936, 9 Jan 1937, and undated [1937]. OMP, box 5) and already earlier had advised to follow a devaluation of the gold currencies (17 Jul 1934. OMP, box 5).

⁵⁸ See Morgenstern (1936c, 169).

⁵⁹ See *ibid.*

these limits (and not Austria's eventual *Anschluss* to Nazi Germany) that ended Morgenstern's career as a policy advisor to the Austrian government.

7. Epilogue

The *Anschluss* marked the exodus of the Austrian school from its country of origin. Many Austrian economists desperately seized the last opportunity to escape the Nazi occupation, among them most of the Austrian liberals, and Steindl and Wald of those who worked at the Institute; Karl Schlesinger committed suicide. Henceforth the Austrian school existed only outside Austria and in a state near to dissolution – lacking the networks of communication typical of the Austrian (and Viennese) economics community and under siege from a “new economics” hostile towards classical liberalism. Up to Hayek's 1974 Nobel prize Austrian economics survived only in the diverse Mises circles, primarily in the United States, and even since then the radical-liberal Neo Austrian economics does not come up to more than a small ramification of the mainstream of economic theory.

For Morgenstern, who just spent his time as a visiting professor in the United States, the *Anschluss* meant his dismissal as the director of the Institute. The Institute came under the supervision of the German Ernst Wagemann, and of Morgenstern's co-workers only Kamitz and John stayed there, earning them the belated accusation of being “Nazis” (Morgenstern 1976b, 807), all the others were suspended or had already left Austria in time. Morgenstern was appointed to Princeton University, where his collaboration with John von Neumann marked the climax of his scientific work and his career. In the first chapter of the jointly authored work on game theory (von Neumann and Morgenstern 1944) Morgenstern finally succeeded in summing up his critique of contemporary economic theory – and it may be considered an irony that after half a century gone game theory presently finds itself as an indispensable part of mainstream economic theory. Anyway, Morgenstern's future scientific work did not show any affinity whatsoever to that of the Austrian school.

In Austria Mayer again gave proof of his flexibility by dismissing all non-Aryan members from the Austrian Economic Society.⁶¹ Thanks to his (lack of) reputation the non-liberal strand of the Austrian school soon fell into oblivion, although he possibly considered himself the last Austrian

⁶⁰ He noted: “After the appointment of Faist I have resigned from the price committee. It will come to nothing with him ...” (Morgenstern diary, 24 Jul 1937. OMP, box 13).

economists at the University of Vienna. Or as Mises put it: “He probably poses again as an Austrian economist.”⁶²

⁶¹ See Mises (1978, 99).

⁶² Mises to Hayek, 8 Dec 1945. Friedrich August Hayek Papers (Hoover Institution Archives, Stanford University), box 38.

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