

**AUSTRIAN THEORIES OF CAPITAL,  
INTEREST, AND THE TRADE-CYCLE**

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THE TRADE-CYCLE

By

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## PREFACE

**W**ITH the exception of the published translations of the works of Böhm-Bawerk and Wieser, the theories of the Austrian Schools of economics are not well known in England. However, for an adequate understanding of this school the contributions of Mises and Schumpeter are of equal importance and a knowledge of Menger's principles of economics is essential, not only because Menger was himself the founder of this school, and thus greatly influenced Böhm-Bawerk, but also because his investigation of monetary phenomena (and its successful continuation by others such as v. Wieser, v. Mises, and Schumpeter) is so characteristic of the methods of Austrian research.

Attention to the teaching of the Austrian School was recently drawn by Hayek whose examination of the trade-cycle has stirred so much interest and controversy in England. Hayek's main objection to the modern English School of Economics was that these authors have over-estimated the significance of monetary phenomena and undervalued the importance of the events in the world of goods. Although we find a general neglect of monetary phenomena in the works of most of the earlier Austrian authors, attempts were later made to combine the purely economic factors with purely monetary factors into a successful theory of the trade-cycle. The object of this thesis will be to study these various attempts and to examine how far they have been successful. We shall find that all these authors have had different conceptions of the role which money plays in the trade-cycle, some authors attributing to money a more active, some a more passive, role. The

problem with which all authors are concerned is whether changes from one equilibrium to another are merely brought about by monetary factors or whether a steady development can be ensured by excluding the somewhat unwholesome influences of money. The earlier teaching of the Austrian School becomes most important for those authors who advocate a policy of neutralizing money. These authors visualize an economic system where the development towards an optimal equilibrium runs smoothly without the disturbing influences of money. But it seems clear that even if one does not adhere to a policy of neutralizing money the study of the events occurring in the world of goods is equally important for any theorist who attempts to solve the problems of the trade-cycle. The problem which any theory of the trade-cycle attempts to solve is the always recurring disproportion between the increase in physical output and the increase in value. The inadequate solution of this phenomenon is the reason for the failure of so many theories. Another common error was the mixing up of two questions ; that of the existence and that of the determination of interest. Böhm-Bawerk for example has solved the question of the existence of interest, but he has not solved the problem of the payment of interest. The question of the payment of interest must be the main subject of any theory of the trade-cycle, i.e. the theory should be an attempt to solve the problem of the temporarily existing disproportion between the increase in physical output and the increase in value or (according to Böhm-Bawerk) the disproportion between physical productivity and value-productivity.\* The question is whether the profitability of new investments will cover the rate of interest and allow gains to be made. In other words can we regulate our credit-policy so that new investments will always cover interest and allow gains to be made and does a credit-supply by voluntary saving fulfil these purposes under all circumstances.

Such are the problems with which we are concerned in dealing with Austrian theories of capital, interest, and the trade-cycle. The difficulty, however, has been in the first place to select those theories of the Austrian school which were most significant for further investigation, and secondly to put them into some systematic order. In this thesis the material has been arranged after the following scheme. The trade-cycle is characterized by an upward movement which conditions later a downward movement. Thus the unwholesome effects of the downward movement necessitate an examination of their causes which lie in the upward movement. The thesis has accordingly been divided into two parts. The first part deals with the upward movement and the theories of credit and capital by which this movement has been analysed. The second part discusses how Austrian authors attempted a solution of the problems which arise in the upward movement. Those authors have been selected whose names have become significant in the world of economists and whose theories are most characteristic of the development of the Austrian line of thought.

The first part of this thesis is divided into three chapters. The first chapter gives an account of the terminological confusion which prevailed for so long in the Austrian School, and which made it impossible to find an adequate theory of capital and credit. Great emphasis is laid on Böhm-Bawerk's theory of the productive process and his explanation of the function of the fund of subsistence, which are the basis of all further investigations, especially those of Wicksell, Mises, Hayek, and Engländer who have further advanced Böhm-Bawerk's ideas. The second chapter deals with the attempts of Austrian theorists to fuse monetary and economic phenomena into an explanation of the trade-cycle. Thus it deals with Menger's theory of the popular notion of capital and Wieser's attempted solution of changes in equilibria which prepared the ground for Schumpeter's later



discoveries. The third chapter deals with Austrian theories of credit from Menger to Schumpeter.

It points out the fundamental difference between a static and a dynamic stage of the economic system and examines the possibility of a completion of Schumpeter's theory.

The second part is also subdivided in three chapters. The first chapter deals with Böhm-Bawerk's theory of interest and explains why we may consider this to be a non-monetary theory of the trade cycle, for although Böhm-Bawerk explains why interest exists he does not solve the problem of the payment of interest, his non-monetary conception of interest therefore leading to circular reasoning. The second chapter examines the monetary form which Schumpeter has given Böhm-Bawerk's theory and its attempt to consider interest as a dynamic problem. The third chapter deals with Mises's, Hayek's, and Engländer's theories of the trade-cycle. It shows that Mises has realized the significance of the movements of the relative prices of commodities from explanation of the trade-cycle, and that his theory of forced saving and refutation of the old quantity-theory is the outstanding achievement of Austrian economists. Mises nevertheless is aware that too great a readiness on the part of the banking system to grant credits can lead to crisis and his examination of changes in the structure of production has influenced Hayek who, although advocating a policy of neutralizing money, bases his propositions on Wicksell's theory of the divergence between the equilibrium-rate and the money-rate of interest. Money-loans according to Hayek will be neutral towards the relative values of goods provided that the money-loans granted to the producer are restricted to actual saving deposits and provided that the quantity of money has remained unchanged. Engländer's theory is contrary to Hayek with regard to changes in the money-supply and with regard to Hayek's theory of saving.

PREFACE

II

No serious student of English economic theory can afford to ignore contemporary continental research. Not only should it receive consideration in the formation of English theory, but its neglect has even caused a neglect on the part of the English School of proper consideration of purely economic factors and too great an emphasis on purely monetary problems.

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<sup>1</sup> Special references are given in the context of this thesis.

<sup>2</sup> *E.J.* = abbreviation for *Quarterly Economic Journal* or the *Economic Journal*.

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