

EUGEN VON BOEHM-BAWERK



CAPITAL AND INTEREST

Capital and Interest

A Critical History of
Economic Theory

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Translator's Preface

My only reasons for writing a preface to a work so exhaustive, and in itself so lucid, as Professor Böhm-Bawerk's *Kapital und Kapitalzins*, are that I think it may be advisable to put the problem with which it deals in a way more familiar to English readers, and to show that the various theories stated and criticised in it are based on interpretations implicitly given by practical men to common phenomena.

First, to state the problem. A manufacturer who starts business with a capital of £20,000 takes stock at the end of a year, and finds that he is richer by £2000—that is to say, if he sold plant, stock, and debts at a fair valuation, he would obtain for them £22,000. The increment of £2000 he will probably call his "profit." If asked to explain what is the origin of profit in general, and of this amount of profit in particular, and, further, why this profit should fall to him, his first answer will probably be that the goods he manufactures meet a want felt by a certain section of the public, and that, to obtain the goods, buyers are willing to pay a price high enough to allow him, over the whole field of his production for one year, to obtain the profit of £2000.

This, however, immediately suggests the question why a public which, as a rule, is not willing to pay more than it can help for anything, should pay prices such as allow of this profit. The manufacturer's answer probably would be, that it would not be worth his while to put forth his energies in manufacturing for less than this amount of profit, as he could, with at least equal safety and without personal exertion, obtain, say £1000 by lending his capital to any ordinary productive undertaking.

In this answer two statements are involved: first, that of the £2000 one part is wage for personal exertion, and,

second, that the remainder is the "usual return to capital" without personal exertion. Thus is drawn a rough dividing line between what is usually called "undertaker's profit" and interest. Interest seems to be defined as that annual return to capital which may be obtained, as a rule, without personal exertion. Accepting this answer we should expect to find the phenomenon of interest most easily studied in the case of a Limited Liability Company, where the personal exertion of the shareholders is limited to choosing the investment, subscribing the capital, and receiving the dividends. The portion of total "profit" obtained by the private employer or undertaker, as such, is here eliminated; or, rather, it is made definite and measurable in being divided among the managing director, the ordinary directors, and the secretary, who are paid a fixed fee, salary, or, accurately and simply, a wage.

A careful consideration of the balance sheet of any such company will guard us against a common misunderstanding. Such a balance sheet will generally show two funds—a Depreciation Fund and an Insurance Fund. The former, sometimes called Sinking, Wear and Tear, Repairs, or Replacement of Capital Fund, secures that fixed capital, or its value, is replaced in the proportion in which it is worn out, and thus provides a guarantee that the value of the parent capital is not encroached upon, or inadvertently paid away in dividend. The latter, sometimes called Equalisation of Dividend Fund, is a provision for averaging the losses that are sure to occur over a series of years, and are really a portion of the current expenses. It is only after these funds are provided for that the dividend is paid over to the shareholders, and this accentuates two important facts: (1) that interest properly so called is something distinct from any portion of parent capital, and (2) that it is not accounted for by insurance against risks.

The question now is, Is such a dividend pure interest? Here we have to reckon with the familiar fact that limited

companies, under similar conditions, pay the most various rates of dividend. If then we accept "dividend" as the equivalent of "interest" we shall have to conclude that varying rates of interest are obtainable on equal amounts of capital. ^{Ref. 001} On looking closer, however, we find the dividing line again reasserting itself. If a sound industrial company is known to be paying a dividend higher than a certain definite percentage on its capital, the value of the stock, or parent capital, will rise to the point where dividend corresponds to an interest no greater than this definite percentage—e.g. the £100 stock of a great railway paying 5 per cent will rise to something like £125, at which price the 5 per cent dividend on the original capital shows a return of 4 per cent on the new value of the capital.

There is, in short, in every country, although varying from country to country, a certain annual return which can be obtained by capital with a minimum of risk, without personal exertion of the owner. Its level is usually determined by the market price of the national security. We count the $2\frac{3}{4}$ per cent interest of Consols an absolutely safe return, because the British Constitution is pledged for the annual payment of this amount of interest on its debt—on the capital borrowed by the nation from its members in past years. This we should probably consider the proper economic interest for capital invested in Great Britain. Any return above this level we should consider, either as due to the insecurity of the capital as invested (i.e. as a premium for insurance), or as that still vague quantity called "profit." Thus we should probably consider the 4 per cent of our railway stocks as consisting of, say $2\frac{3}{4}$ per cent for interest proper, and $1\frac{1}{4}$ per cent insurance or equalisation of dividend.

Now it is this interest proper, obtainable by the owner of capital without risk and without personal effort, that is the object of our problem.

In which of the many forms that interest takes can we best study its nature? It might seem that the 2¾ per cent of Consols was the most appropriate subject for examination, but a glance will show that this form of interest is secondary and derivative. The nation as a whole cannot pay interest on its debts unless the citizens as individuals produce the wealth wherewith this interest is paid, otherwise the nation will be paying away its capital. To study interest as expressed in the annual payments on the Consolidated National Debt would be to make the common mistake of explaining Natural Interest by Contract Interest, which is very much the same as explaining why people pay interest by showing that they do pay it. The phenomenon, then, must, primarily, be studied as it appears in some or other of the forms of production of wealth. Let us take the case of a manufacturing company.

The essential features here, as regards our problem, are that, over a year's time, the products manufactured are sold at a price which not only covers the value of raw materials, reimburses the various wages of manual and intellectual labour, and replaces the fixed capital as worn out, but leaves over that amount of value which is divided out among the capitalist shareholders as interest. In normal capitalist production, that is to say, not only is the value of capital consumed in the production process replaced, but a surplus of value appears. It has not always been perceived by economists that this surplus value is the essential phenomenon of what we call interest,—that interest on capital consists of this very surplus value and nothing else,—but whenever it is perceived the question almost suggests itself, What does this surplus value represent? Is it merely a surplus, or is it of the nature of a wage? In other words, is it something obtained either by chance or force, and corresponding to no service rendered by anybody or anything; or is it something connected with

capital or the capitalist that, economically speaking, deserves a return or a wage?

A little consideration will show that the idea of a "mere surplus" is untenable. When a manufacturer engages his capital in production he, as it were, throws it into solution, and risks it all on the chance of the consuming public paying a certain price for the products into which his capital is transformed. If they will not pay any price at all the capital never reappears; even the labour, which bound up its fortunes with the materials and machinery of manufacture, loses its wage, or would do so except for the wage contract which pays labour in advance. If the consumers, again, will only pay a price equal to the value of the capital consumed, the various workers, including the employer proper, will get their wage, and the value of the capital itself will be unimpaired, but there will be no interest. It is only if the consumers are willing to pay a higher price that capital can get its interest.

The surplus then, which we call interest, appears primarily in the value or price of products—that is to say, interest is, in the first instance, paid over by the consumer of goods in the price of the products he buys.

Now it seems intelligible, although it is not really so intelligible as is usually assumed, that the public will always pay a price for products sufficient to reimburse the wages paid in producing them. The labourer, theoretically, is paid by what he makes—although this proposition requires more careful statement and limitation than can be given it here—and wages are supposed, *prima facie*, to represent an equivalent in value contributed to the product by the worker. But that the consuming world, over and above this wage, will pay a surplus which does not represent any equivalent value given to the product, is only conceivable on the supposition that the public is unconscious that it is paying such a surplus. This supposition, however, is incredible in a community where

most of the consumers are also producers. To lose as consumer what one gains as producer is a game of Beggar my Neighbour which would scarcely commend itself to business men.

The surplus then may be assumed to represent something contributed by capital to the value of products. This view is supported by the common consciousness of practical men, who certainly believe that capital plays a distinct and beneficent rôle in production.

If, now, we appeal to the common consciousness to say what it is that capital does, or, forbears to do, that it should receive interest, we shall probably get two answers. One will be that the owner of capital contributes a valuable element to production; the other, that he abstains from using his wealth in his own immediate consumption. On one or other of these grounds, the capitalist is said to deserve a remuneration, and this remuneration is obtained by him in the shape of interest.

Now it might possibly be the case that both answers point to elements indispensable in the explanation of interest, but a slight consideration will show that the two answers are very different from one another. The one is positive—that capital does something; the other negative—that the capitalist abstains from doing something. In the one case interest is a payment for a tool; in the other, a recompense for a sacrifice. In the one case the capitalist is paid because the capital he lends produces, or helps to produce, new wealth; in the other he is paid because he abstains from diminishing wealth already produced.

It will become evident as we go on that, on these two answers, which spring to the lips of any business man asked to account for interest, are based the most important of the theories criticised in the present book. The first answer is the basis of the Productivity theories and of the Use theories; the second is the basis of the Abstinence theory.

The argument of the Productivity theory may be put thus. Human labour, employing itself on the materials given free by nature, and making use of no powers beyond the natural forces which manifest themselves alike in the labourer and in his environment, can always produce a certain amount of wealth. But when wealth is put into the active forms of capital—of which machinery may be taken as instance and type—and capital becomes intermediary between man and his environment of nature, the result is that the production of wealth is indefinitely increased. The difference between the results of labour unassisted and labour assisted by capital is, therefore, due to capital, and its owner is paid for this service by interest.

The simpler forms of this theory (where capital is credited with a direct power of creating value, or where surplus of products is tacitly assumed to be the same thing as surplus of value) our author has called the Naïve theory. The more complex formulations of it—where, for instance, emphasis is laid on the displacement of labour by capital, and interest is assumed to be the value formerly obtained as wage, or where prominence is given to the work of natural powers which, though in themselves gratuitous, are made available only in the forms of capitalist production—he has called the Indirect theories.

How slight a claim this explanation has to the dignity of a scientific theory appears in its practical definition of interest as the whole return to capitalist production which is not accounted for by labour. Yet the statement just given is elaborate and logical in comparison with that of many of the economists who profess the Productivity theory. Their usual treatment of the interest problem is to co-ordinate capital with the other factors of production, land and labour, and assume that interest is the payment for the services of capital, as wage is for the services of labour, give ample illustration of the triumphs of capitalist

production, and pass on to discuss the rise and fall of its rate.

If, however, we demand an answer to what we have formulated as the true problem of interest, we shall make the discovery that the Productivity theory has not even put that problem before itself. The amount of truth in the theory is that capital is a most powerful factor in the production of wealth, and that capital, accordingly, is highly valued. But to say that capital is "productive" does not explain interest, for capital would still be productive although it produced no interest; e.g. if it increased the supply of commodities the value of which fell in inverse ratio, or if its products were, both as regards quantity and value, greater than the products of unassisted labour. The theory, that is to say, explains why the manufacturer has to pay a high price for raw materials, for the factory buildings, and for the machinery—the concrete forms of capital generally. It does not explain why he is able to sell the manufactured commodity, which is simply these materials and machines transformed by labour into products, at a higher price than the capital expended. It may explain why a machine doing the work of two labourers is valued at £100, but it does not explain why capital of the value of £100 now should rise to the value of £105 twelve months hence; in other words, why capital employed in production regularly increases to a value greater than itself.

It must be admitted that there is something very plausible in this theory, particularly in apparently simple illustrations of it. A poor widow owns a chest of tools valued at £50. An unemployed carpenter borrows them. The fifty shillings interest he pays seems almost an inadequate return for the added productiveness given to his labour over the year. Is not the interest made possible by the qualities of the tools? The facts here are as stated: without production there would be no interest. So without

land there would be no turnips, but the existence of land is scarcely the sufficient cause of the turnips. Suppose the widow sold the chest of tools to another carpenter for £50. His labour also would be rendered productive; and in the same degree, but he would pay no interest. Or suppose she sold the tools for £50, but did not get payment for a year; the reason she would give for asking fifty shillings extra would be, not that the tools were productive, but that the payment was deferred. The important circumstance forgotten in this theory is that the productiveness of concrete capital is already discounted in its price. The chest of tools would be of no value but for the natural forces embodied in them or made available by them. To ascribe interest to the productive power of capital is to make a double charge for natural forces—in the price and in the interest. Meanwhile we may note one significant circumstance in all these transactions,—that the emergence of interest is dependent on a certain lapse of time between the borrowing and the paying.

It cannot be too often reiterated that the theory which explains interest must explain surplus value—not a surplus of products which may obtain value and may not; not a surplus of value over the amount of value produced by labour unassisted by capital; but a surplus of value in the product of capital over the value of the capital consumed in producing it. The insufficiency of the present theory to meet these requirements may be shown in another way. It is often assumed that, if a labouring man during his week's work consumes the value of, say 20s. in food, tools, etc., and during that week turns 20s. worth of raw material into finished commodities, these commodities, together, will sell in the market for something over 40s. But the ordinary life of many a peasant proprietor who lives by continual toil, and never "gets out of the bit,"—that is, never does more than reproduce his bare living—might show that the assumption is not universally valid, and that labour by no

means always produces more value than it consumes. But the plausibility of the Productivity theory is the parallelism it assumes between labour and capital—the suggestion that interest is wage for capital's work. If, however, the emergence of surplus value in the case of simple labour needs explanation, much more does it in the case of capitalist production. What is a product or commodity but raw material plus labour? Labour and capital co-operate in making it, and the individual form and share of each is lost in the joint product. But, of the two, labour is the living factor, and if surplus value does emerge in capitalist production as a regularly recurring phenomenon, it is more likely that it comes from the living agent than from the dead tool. Thus the Productivity theory ends in suggesting that other and hostile theory according to which surplus value comes from labour, and is only snatched away by capital.

But the fact is that, in all this, we have an entire misconception of the origin of value. Value cannot come from production. ^{Ref. 002} Neither capital nor labour can produce it. What labour does is to produce a quantity of commodities, and what capital co-operating with labour usually does is to increase that quantity. These commodities, under certain known conditions, will usually possess value, though their value is little proportioned to their amount; indeed, is often in inverse ratio. But the value does not arise in the production, nor is it proportional to the efforts and sacrifices of that production. The causal relation runs exactly the opposite way. To put it in terms of Menger's law, the means of production do not account for nor measure the value of products; on the contrary, the value of products determines and measures the value of means of production. Value only arises in the relation between human wants and human satisfactions, and, if men do not "value" commodities when made, all the labour and

capital expended in the making cannot confer on them the value of the smallest coin. But if neither capital nor labour can create value, how can it be maintained that capital employed in production not only reproduces its own value, but produces a value greater than itself?

I confess I find some difficulty in stating the economic argument of what our author has called the Use theory of interest, and I am almost inclined to think that he has done too much honour to some economists in ascribing to them this theory, or, indeed, any definite theory at all.

It is of course a familiar expression of everyday life that interest is the price paid for the "use of capital," but most writers seem to have accepted this formula without translating it. If the formula, however, is considered to contain a scientific description of interest, we must take the word "use" in something like its ordinary signification, and consider the "use of capital" as something distinct from the capital itself which affords the use. The loan then will be a transfer and sale of this "use," and it becomes intelligible how, at the end of the loan period, the capital lent is returned undeteriorated in value; it was not the capital that was lent, but the use of the capital. To put it in terms of Bastiat's classical illustration: James, who lends a plane to William, demands at the year's end a new plane in place of the one worn out, and asks in addition a plank, on the ostensible ground that over a year William had the advantage, the use of the plane.

If, however, we look carefully into this illustration, we shall see that William not only had the use of the plane but the plane, itself, as appears from the fact that the plane was worn out during the year. Here then the using of the plane is the same thing as the consumption of the plane; payment for a year's "use" is payment for the whole capital value of the plane. Yet the payment demanded at the year's end is not the capital value of the plane, the sum lent, but also a surplus, a plank, under the name of interest. To put it

another way. If William on the 1st of January had bought the plane outright from James, he would have paid him on that date a value equivalent, say, to a precisely similar plane; he would have had the "use" of the plane over 365 days; and by 31st December the plane would have been consumed. As things are, he pays nothing on 1st January; he has the use of the plane over the year; by 31st December the plane is consumed; and next day he has to pay over to James a precisely similar plane plus a plank. The essential difference between the two transactions is that, on 1st January the price of the plane is another similar plane; on the 31st December it is a plane plus a plank.

This again suggests a very different source of interest, viz. that it is to be found in the difference of time between the two payments.

Thus the Use theory, as put in this illustration, has only to be clearly stated to show that it involves a confusion of thought as regards the word "use." It is not difficult to find the origin of the confusion, and the fallacy of the theory may be most easily shown thereby. It has arisen in too exclusively studying the loan under the form properly called Hire—that is, where a durable good is lent and is returned at the year's end, deteriorated indeed but not destroyed. If we lend out a horse and cart, a tool, a house, we are apt to conclude that the interest paid us is a price for the "use" of these; because we get the goods themselves back in a year's time, somewhat deteriorated in value, but visibly the same goods; and probably most of us would fall into the common error of supposing the interest to be the equivalent of the wear and tear, i.e. a portion of the parent capital. This is rendered more plausible by the fact that most loans of capital are made in money; we unconsciously assume the gold or notes we receive to be the same gold or notes we lent. But if we take the case of coals, or grain, or perishable goods generally, and ask how it is possible to conceive of these goods giving off a use and being returned

to us substantially the same as before, less wear and tear, we must perceive that interest, in this case at least, cannot be a payment for the "use" of goods, but for the consumption of them, for the goods themselves. Are we to conclude then that durable goods admit of an independent use possessing independent value, and that perishable goods do not? If so, interest cannot be the price of the "use" of capital, as interest is paid for all capital, whether durable or perishable.

This theory, in fact, affords a striking instance of how our science has revenged itself for our unscientific treatment of it. It was almost a misfortune that Adam Smith put its first great treatise in such an attractive form that "the wayfaring men, though fools, might not err therein." The result, in a good many cases, has been an emulation among economists to keep their work at the same level of clearness and attractiveness, and this was more easily effected by discussion on the great social and industrial problems than by severe attention to scientific method. In no other way can I account for the fact that, a hundred years after the appearance of *Wealth of Nations*, the great American and German economists should be devoting so much of their time to elementary and neglected conceptions. One of these neglected conceptions is that of the "Use of goods," and one of the most important contributions to economic theory is the section devoted by Dr. Böhm-Bawerk to that subject. Briefly it amounts to this, that all material "goods," the objects of economical attention as distinct from mere "things," are economic only in virtue of their use, real or imaginary. Every good is nothing but the sum of its uses, and the value of a good is the value of all the uses contained in it. If a good, such as gunpowder, can only serve its purpose or afford its use all at one time, we employ the word "consumption" for the act by which the good gives forth its use. If, on the contrary, it is so constituted that its life-work extends over a period of

time, then each individual use diminishes the sum of uses which constitutes the essential nature of the good. But Consumption is only a single exhaustive use, and Use is only a prolonged consumption.

This at once enables us to estimate the Use theory of interest. The "use of capital" is not something apart from the using of the goods which constitute the capital; it is their consumption, fast or slow as the case may be; and a payment for the use of capital is nothing but a payment for the consumption of capital. The true nature of the loan transaction is, not that in it we get the use of capital and return it deteriorated, but that we get the capital itself, consume it, and pay for it by a new sum of value which somehow includes interest. If, however, we admit this, we are landed in the old problem once more—how do goods, when used as capital in production, increase in value to a sum greater than their own original value? and the Use theory ends in raising all the difficulties of the Productivity theories.

We have seen that the previous theories were founded on some positive work supposed to be done by capital. The Abstinence theory, on the other hand, is founded on the negative part played by the capitalist. Wealth once produced can be used either in immediate consumption—that is, for the purposes to which, in the last resort, all wealth is intended; or it can be used as capital—that is, to produce more wealth, and so increase the possibilities of future consumption. The owner of wealth who devotes it to this latter purpose deserves a compensation for his abstinence from using it in the former, and interest is this compensation. It must be carefully noted that the abstinence here spoken of is not abstinence from personal employment of capital in production—that would simply throw us back on the previous question, viz. how the owner could make interest (as distinct from wage) by the use of

his capital—but abstinence from immediate consumption in the many forms of personal enjoyment or gratification.

At the back of this theory of interest is that theory of value which makes it depend upon costs of production. Senior, the first and principal apostle of the Abstinence theory, saw very clearly that the inclusion of interest or profit among costs was an abuse of language. The word "Cost" implies sacrifice, not surplus. But in production, as it seemed to him, there was another sacrifice besides the prominent one of labour, that of abstinence, and interest in his view was the compensation for this sacrifice.

It must be confessed that to those who are in the habit of looking upon all work as sacrifice, and all wage as compensation, there is something a little ridiculous in the statement of this theory. The "abstinence" of a rich man from what he probably cannot consume, the capitalist's "compensation" for allowing others to preserve his wealth from moth and rust by using it, the millionaire's "sacrifice" measured by his £100,000 a year—these are the familiar weapons of those who consider the evils of interest aggravated by its claim. Yet if we ask whether the amount of capital in the world would have been what it is if it had not been for the "abstinence" of those who had the command over wealth, to accumulate or dissipate it, we can see that such jibes are more catching than convincing. The strength of the Abstinence theory is that the facts it rests on really give the explanation how capital comes into being in primitive conditions and in new countries. The first efforts to accumulate capital must be attended by sacrifice; a temporary sacrifice, of course, to secure a permanent gain, but, in the first instance at least, a material sacrifice. It is with the beginnings of national capital as it is with the beginnings of individual capital; there is need of foresight, effort, perhaps even curtailment in necessities.

But to account for the origin of capital by abstinence from consumptive use is one thing; to account for interest is

another. In all production labour sacrifices life, and capital sacrifices immediate enjoyment. It seems natural to say that one part of the product pays wage and another pays interest, as compensation for the respective sacrifices. But labour is not paid because it makes a sacrifice, but because it makes products which obtain value from human wants; and capital does not deserve to be paid because it make sacrifices—which is a matter of no concern to any one but the capitalist—but because of some useful effect produced by its co-operation. Thus we come back to the old question, What service does capital render that the abstinence which preserves and accumulates it should get a perpetual payment? And if, as we saw, productivity cannot account for interest, no more can abstinence.

Dr. Böhm-Bawerk's chief criticism, however, is directed to a more fundamental mistake in Senior's famous theory. Senior included abstinence among the costs of production as a second and independent sacrifice. In a singularly subtle analysis Böhm-Bawerk shows that abstinence is not an independent sacrifice but an alternative one. The analysis may be more easily understood from the following concrete example. An owner of capital embarks it in a productive undertaking. In doing so he decides to undergo the sacrifice of labour (in personally employing his capital), and that labour is made productive and remunerative by the aid of the capital. If, in calculating the remuneration due him, he claims one sum as wage for labour, and another as reward for abstaining from the immediate enjoyment of his own wealth, he really makes the double calculation familiarly known as eating one's cake and having it. His labour would not have yielded the profitable result which returns him the (undertaker's) wage without the assistance of the capital; he cannot charge for the sacrifice of his wealth as wealth and for the sacrifice of his wealth as capital. The truth is that, in this case, the one sacrifice of labour admits of being estimated in two ways:

one by the cost to vital force; the other and more common, by the greater satisfaction which would have been got from the immediate use of capital as wealth at an earlier period of time.

In view of the unsatisfactoriness of the answers hitherto given to our problem it is easy to see how another answer would arise. The power wielded by the owners of wealth in the present day needs no statement. It is not only that "every gate is barred with gold," but that, year by year, the burden of the past is becoming heavier on the present. Wealth passes down from father to son like a gathering snowball, at the same time as industry gets massed into larger and larger organisations, and the guidance and spirit of industry is taken more and more out of the hands of the worker and given to the capitalist. Of two men, in other respects equal, the one who has wealth is able not only to preserve the value of his wealth intact, but to enjoy an annual income without risk or trouble, and, providing that he lives well within his income, can add steadily to the sum of his wealth. The other has to work hard for all he gets; time does nothing for him. If he saves it is at a sacrifice; yet only in this sacrifice is there any chance of his rising out of the dull round which repeats each day the labour of the last—that is, only as he becomes an owner of capital. Thus, in course of time there appears a favoured class who are able not only to live without working, but to direct, control, and even limit the labour of the majority.

Now if, when the onus of justifying its existence is thrown upon capital, economic theory can only account for this income without risk and without work by pointing to the "productive power" of capital, or to the "sacrifice of the capitalist," it is easy to see how another theory should make its appearance, asserting that interest is nothing else than a forced contribution from helpless or ignorant people; a tribute, not a tax. Rodbertus's picture of the working man as the lineal descendant of the slave

—"hunger a good substitute for the lash"; Lassalle's mockery of the Rothschilds as the chief "abstainers" in Europe; Marx's bitter dialectic on the degradation of labour, are all based on generous sympathy with the helpless condition of the working classes under capitalist industry, and many shut their eyes to the weakness of Socialist economics in view of the strength of Socialist ethics.

The Exploitation theory then makes interest a concealed contribution; not a contribution, however, from the consumers, but from the workers. Interest is not a pure surplus obtained by combination of capitalists. It does represent a sacrifice made in production, but not a sacrifice of the capitalists. It is the unpaid sacrifice of labour. It has its origin in the fact that labour can create more than its own value. A labourer allowed free access to land, as in a new country, can produce enough to support himself and the average family, and have besides a surplus over. Translate the free labourer into a wage earner under capitalism, pay him the wage which is just sufficient to support himself and his family, and here also it is the case that he can produce more than his wage. Suppose the labourer to create the value of his wage, say 3s. in six hours' work, then, if the capitalist can get the worker to work longer than six hours for the same wage, he may pocket the extra value in the name of profit or interest. Here the modern conditions of industry favour the capitalist. The working day of ten to twelve hours is a sort of divine institution to the ignorant labourer. As the product does not pass into his own hand, he has no means of knowing what the real value of his day's work is. The only lower limit to his wage is that sum which will just keep himself and his family alive, although, practically, there is a lower limit when the wife and children become the breadwinners and the capitalist gets the labour of five for the wage of one. On the other hand, the increase of wealth

over population gradually displaces labour, and allows the same amount of work to be done by fewer hands; this brings into existence a "reserve" to the industrial army, always competing with those left in work, and forcing down wages. Thus the worker, unprotected, gets simply the reproduced value of a portion of his labour; the rest goes to capital, and is falsely, if conscientiously, ascribed to the efficiency of capital.

I feel that it would be impertinence in me to say anything here that would anticipate the complete and masterly criticism brought against this theory in Book VI. The crushing confutation of the Labour Value theory is work that will not require to be done twice in economic science, and the vindication of interest as a price for an economic service or good suggested by the very nature of things ("which may be modified but cannot be prevented") will necessitate reconsideration by the Socialist party of their official economic basis.

But it would be easy to misunderstand the precise incidence of this criticism, and perhaps it is well to point out what it does and what it does not affect.

It proves with absolute finality that the Exploitation theory gives no explanation of interest proper. But this is far from saying that Exploitation may not explain a very large amount of that further return to the joint operation of capital and labour which is vaguely called "profit." We saw that the value paid by a Limited Liability Company as dividend, or the return to capital which a private owner generally calls his profit, consists of two parts: of interest proper and of undertaker's profit. The latter, rightly considered, is a wage for work, for intellectual guidance, organisation, keen vision, all the qualities that make a good businessman. There are two ways in which this wage may be obtained: to use a Socialist phrase, by exploiting nature and by exploiting man. To the first category belongs all work of which the farmer's is the natural type: that which

visibly produces its own wages, whether by directly adding to the amount and quality of human wealth, or preserving that already produced, or changing it into higher forms, or making it available to wider circles. In this category A's gain is B's gain. To the second category belong those perfectly fair modes of business activity where one uses his intelligence, tact, taste, sharpness, etc., to get ahead of his fellows; and "take the trade" from them. Here A's gain is B's loss, but the community share in A's gain, and even B shares in it, by being better served as a consumer. But to this category also belong those numerous forms of occupation which involve taking advantage of poor men's wants and necessities to snatch a profit, and one of those forms is the underpaying of labour.

Any one who has realised the difficulty of the wages question will understand that this underpaying may be quite unintentional. Capitalists, no less than labourers, are under the domination of the capitalist system, and, under the steady pressure of competition, it is difficult for an employer to be just, not to say generous. His prices are regulated not by his own cost of production, but by the costs of production in the richest and best appointed establishments of his rivals; and yet his workers' wages have to be regulated by an equation between these prices, and the wages of labour in similar trades and in the near vicinity. In fact the difficulties of determining a "just" wage are so great that the temptation is overwhelming to ascertain what labour is worth by the easy way of ascertaining what labour will take, and if fifty women are at the gate offering their services for a half of what fifty men are earning, who is to determine what a "fair wage" is?

It should then be at once and frankly confessed that the Socialist contention may afford an explanation of a great proportion of what is vaguely known as "undertaker's profit." To go farther however, and extend this explanation to all return to capitalist production which is not definitely

wage, is 'economic shortsightedness, that brings its own revenge.

Böhm-Bawerk's refutation of the Exploitation theory is not a refutation of Socialism, but of a certain false economical doctrine hitherto assumed by the great Socialist economists as negative basis for that social, industrial, and political reconstitution of things which is Socialism. Morality and practical statesmanship may determine that, in the interests of the community, purely economic laws be subordinated to moral and political laws; or, to put it more accurately, that economic laws, which would assert themselves under "perfect competition," be limited by a social system which substitutes co-operation for competition. That is to say, the work of capital in production may be quite definitely marked out, and its proper relation to the value it accompanies be exactly determined, and yet the distribution of its results may be taken from private owners and given over to the corporate owning of the state. But while the advantage accruing from the use of capital would here be regulated by a mechanical system, interest would remain, economically, exactly as Böhm-Bawerk has stated it.

As to Dr. Böhm-Bawerk's own theory of interest I do not feel at liberty to anticipate, or put in short compass, the contents of the second volume now published, *Die Positive Theorie des Kapitals*. The reader will find the essence of it in pp. 257-259 of the present work. ^{Ref. 003}

It might be advisable, however, to put his theory into concrete terms. According to it, when we lend capital, whether it be to the nation or to individuals, the interest we get is the difference in popular estimation and valuation between a present and a future good. If we lend to direct production, the reason we get interest is not that our capital is capable of reproducing itself and more. The explanation of this reproduction is to be found in the work

of those who employ the capital, both manual and intellectual workers. We get interest simply because we prefer a remote to a present result. It is not that by waiting we get more than we give; what we get at the year's end is no more than the equivalent value of what we lent a year before. Capital plus interest on 31st December is the full equivalent of capital alone on 1st January preceding. Interest then is in some sense what Aquinas called it, a price asked for time. Not that any one can get the monopoly of time, and not that time itself has any magic power of producing value, but that the preference by the capitalist of a future good to a present one enables the worker to realise his labour in undertakings that save labour and increase wealth. But as capital takes no active rôle in production, but is simply material on which and tools by which labour works, the reward for working falls to the worker, manual and intellectual; the reward for waiting, to the capitalist only. Economically speaking, as wage is a fair bargain with labour, because labour can produce its own wage, so is interest a fair bargain with the capitalist, because in waiting the capitalist merely puts into figures the universal estimate made by men between present and future goods, and the capitalist is as blameless of robbery as the labourer.

Dr. Böhm-Bawerk's theory of Interest, then, is an expansion of an idea thrown out by Jevons but not applied. "The single and all-important function of capital," said Jevons, "is to enable the labourer to await the result of any long-lasting work—to put an interval between the beginning and the end of an enterprise." Capital, in other words, provides an indispensable condition of fruitful labour in affording the labourer time to employ lengthy methods of production.

If we view the possession of riches as, essentially, a command over the labour of others, we might say that interest is a premium paid to those who do not present

their claims on society in the present. The essence of interest, in short, is Discount.

In concluding, I should like to say with Dr. James Bonar Ref. 004 —that, while it would be bold to affirm that Professor Böhm-Bawerk has said the last word on the theory of Interest, his book must be regarded as one with which all subsequent writers will have to reckon.

My thanks are due to Professor Edward Caird, of Glasgow University, at whose instance this translation was undertaken, for many valuable suggestions, and, not less, for the stimulus afforded by hope of his approval; to my former student Miss Christian Brown, of Paisley, whose assistance in minute and laborious revision of the English rendering has been simply invaluable; and not least, to Professor Böhm-Bawerk himself; who has most patiently answered all questions as to niceties of meaning, and to whose criticism all the proofs—and this preface itself—were submitted.

The time I have given to this work may excuse my suggesting that a valuable service might be rendered to the science, and a valuable training in economics given, if clubs were organised, under qualified professors, to translate, adapt, and publish works which are now indispensable to the economic student.

GLASGOW, April 1890.

Introduction. The Problem of Interest

It is generally possible for any one who owns capital to obtain from it a permanent net income, called Interest. Ref. 005

This income is distinguished by certain notable characteristics. It owes its existence to no personal activity of the capitalist, and flows in to him even where he has not moved a finger in its making. Consequently it seems in a peculiar sense to spring from capital, or, to use a very old metaphor, to be begotten of it. It may be obtained from any capital, no matter what be the kind of goods of which the capital consists: from goods that are barren as well as from those that are naturally fruitful; from perishable as well as from durable goods; from goods that can be replaced and from goods that cannot be replaced; from money as well as from commodities. And, finally, it flows in to the capitalist without ever exhausting the capital from which it comes, and therefore without any necessary limit to its continuance. It is, if one may use such an expression about mundane things, capable of an everlasting life.

Thus it is that the phenomenon of interest, as a whole, presents the remarkable picture of a lifeless thing producing an everlasting and inexhaustible supply of goods. And this remarkable phenomenon appears in economic life with such perfect regularity that the very conception of capital has not infrequently been based on it. Ref. 006

Whence, and why does the capitalist, without personally exerting himself, obtain this endless flow of wealth?

These words contain the theoretical problem of interest. When the actual facts of the relation between interest and

capital, with all its essential characteristics, are described and fully explained, that problem will be solved. But the explanation must be complete both in compass and in depth. In compass, inasmuch as all forms and varieties of interest must be explained. In depth, inasmuch as the explanation must be carried without a break to the very limits of economical research: in other words, to those final, simple, and acknowledged facts with which economical explanation ends; those facts which economics rests on, but does not profess to prove; facts the explanation of which falls to the related sciences, particularly to psychology and natural science.

From the theoretical problem of interest must be carefully distinguished the social and political problem. The theoretical problem asks why there is interest on capital. The social and political problem asks whether there should be interest on capital—whether it is just, fair, useful, good,—and whether it should be retained, modified, or abolished. While the theoretical problem deals exclusively with the causes of interest, the social and political problem deals principally with its effects. And while the theoretical problem is only concerned about the true, the social and political problem devotes its attention first and foremost to the practical and the expedient.

As distinct as the nature of the two problems is the character of the arguments that are used by each of them, and the strictness with which the arguments are used. In the one case the argument is concerned with truth or falsehood, while in the other it is concerned for the most part with expediency. To the question as to the causes of interest there can be only one answer, and its truth every one must recognise if the laws of thought are correctly applied. But whether interest is just, fair, and useful or not, necessarily remains to a great extent a matter of opinion. The most cogent argumentation on this point, though it may convince many who thought otherwise, will never