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Eugen von Böhm-Bawerk: A Sesquicentennial Appreciation

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In January 1914 there appeared three articles in one of the leading newspapers in Vienna, Austria-Hungary, by Eugen von Böhm-Bawerk, world-renowned member of the Austrian school of economics and a three-time minister of finance. He warned his readers that the Austrian government was following a policy of fiscal irresponsibility. During the preceding three years, government expenditures had increased by 60 percent, and for each of these years the government's deficit had equaled approximately 15 percent of total spending.

The reason, Böhm-Bawerk said, was that the Austrian parliament and government were enveloped in a spider's web of special-interest politics. Made up of a large number of different linguistic and national groups, the Austro-Hungarian Empire was being corrupted through abuse of the democratic process, with each interest group using the political system to gain privileges and favors at the expense of others:

••We have seen innumerable variations of the vexing game of trying to generate political contentment through material concessions. If formerly the Parliaments were the guardians of thrift, they are today far more like its sworn enemies. Nowadays the political and nationalist parties . . . are in the habit of cultivating a greed of all kinds of benefits for their co-nationals or constituencies that they regard as a veritable duty, and should the political situation be correspondingly favorable, that is to say correspondingly unfavorable for the Government, then political pressure will produce what is wanted. Often enough, though, because of the carefully calculated rivalry and jealousy between parties, what has been granted to one has also to be conceded to others—from a single costly concession springs a whole bundle of costly concessions.

He accused the Austrian government of having “squandered amidst our good fortune [of economic prosperity] everything, but everything, down to the last penny, that could be grabbed by tightening the tax-screw and anticipating future sources of income to the upper limit” by borrowing in the present at the expense of the future. For some time, he said, “a very large number of our public authorities have been living beyond their means.”^[1] Such a fiscal policy, Böhm-Bawerk feared, was threatening the long-run financial stability and soundness of the entire country.

Eight months later, in August 1914, Austria-Hungary and the rest of Europe stumbled into the cataclysm that became the First World War. And far more than merely the finances of the Austro-Hungarian Empire were in ruins when that war ended four years later.

A “Great Mind”

Eugen von Böhm-Bawerk was born on February 12, 1851 in Brno, capital of the Austrian province of Moravia (now the eastern portion of the Czech Republic). He died on August 27, 1914, at the age of 63, just as the First World War was beginning.^[2] Ten years after Böhm-Bawerk's death, one of his students, the Austrian economist Ludwig von Mises, wrote a memorial essay about his teacher. Mises said:

••Eugen von Böhm-Bawerk will remain unforgettable to all who have known him. The students who were fortunate enough to be members of his seminar [at the University of Vienna] will never lose what they have gained from the contact with this great mind. To the politicians who have come into contact with the statesman, his extreme honesty, selflessness and dedication to duty will forever remain a shining example. And no citizen of this country [Austria] should ever forget the last Austrian minister of finance who, in spite of all obstacles, was seriously trying to maintain order of the public finances and to prevent the approaching financial catastrophe. Even when all those who have been personally close to Böhm-Bawerk will have left this life, his scientific work will continue to live and bear fruit.^[3]

Another of Böhm-Bawerk's students, Joseph A. Schumpeter, spoke in the same glowing terms of his teacher,

saying, “he was not only one of the most brilliant figures in the scientific life of his time, but also an example of that rarest of statesmen, a great minister of finance As a public servant, he stood up to the most difficult and thankless task of politics, the task of defending sound financial principles.”^[4]

The scientific contributions to which both Mises and Schumpeter referred were Böhm-Bawerk’s writings on what has become known as the Austrian theory of capital and interest, and his equally insightful formulation of the Austrian theory of value and price. These works have served as the foundation stones for much of twentieth-century Austrian economics and have also been starting points for some of the ideas of others as well, including the Swedish, or Stockholm, school of economics, beginning with Knut Wicksell. The sesquicentennial of Böhm-Bawerk’s birth seems an appropriate opportunity for an appreciation of his life and work.

The Founder, Menger

The Austrian school began 1871 with the publication of Carl Menger’s *Principles of Economics*. In this work, Menger challenged the fundamental premises of the classical economists, from Adam Smith through David Ricardo to John Stuart Mill. Menger argued that the labor theory of value was flawed in presuming that the value of goods was determined by the relative quantities of labor that had been expended in their manufacture. Instead, Menger formulated a subjective theory of value, reasoning that value originates in the mind of an evaluator. The value of means reflects the value of the ends they might enable the evaluator to obtain. Labor, therefore, like raw materials and other resources, derives value from the value of the goods it can produce. From this starting point Menger outlined a theory of the value of goods and factors of production, and a theory of the limits of exchange and the formation of prices.

Böhm-Bawerk and his future brother-in-law and also later-to-be-famous contributor to the Austrian school, Friedrich von Wieser, came across Menger’s book shortly after its publication. Both immediately saw the significance of the new subjective approach for the development of economic theory. During a year of postgraduate studies at the University of Heidelberg in Germany, they wrote research monographs extending Menger’s ideas.

In the mid-1870s, Böhm-Bawerk entered the Austrian civil service, soon rising in rank in the Ministry of Finance working on reforming the Austrian tax system. But in 1880, with Menger’s assistance, Böhm-Bawerk was appointed a professor at the University of Innsbruck, a position he held until 1889. During this period he wrote the two books that were to establish his reputation as one of the leading economists of his time, *Capital and Interest*, Vol. I: *History and Critique of Interest Theories* (1884) and Vol. II: *Positive Theory of Capital* (1889). A third volume, *Further Essays on Capital and Interest*, appeared in 1914 shortly before his death.^[5]

In the first volume of *Capital and Interest*, Böhm-Bawerk presented a wide and detailed critical study of theories of the origin of and basis for interest from the ancient world to his own time. Though later analysts have sometimes suggested that Böhm-Bawerk had not shown sufficient sympathy in evaluating the ideas of those who preceded him, there is nonetheless the clear image of an absolutely logical and encyclopedic mind at work.

But it was in the second work, in which he offered a *Positive Theory of Capital*, that Böhm-Bawerk’s major contribution to the body of Austrian economics may be found. In the middle of the volume is a 135-page digression in which he presents a refined statement of the Austrian subjective theory of value and price. He develops in meticulous detail the theory of marginal utility, showing the logic of how individuals come to evaluate and weigh alternatives among which they may choose and the process that leads to decisions to select certain preferred combinations guided by the marginal principle. And he shows how the same concept of marginal utility explains the origin and significance of cost and the assigned valuations to the factors of production.

In the section on price formation, Böhm-Bawerk develops a theory of how the subjective valuations of buyers and sellers create incentives for the parties on both sides of the market to initiate pricing bids and offers. He explains how the logic of price creation by the market participants also determines the range in which any market-clearing, or equilibrium, price must fall, given the maximum demand prices and the minimum supply prices, respectively, of the competing buyers and sellers.^[6]

Theory of Capital and Interest

It is impossible to do full justice in the space available to Böhm-Bawerk's theory of capital and interest. But in the barest of outlines, he argued that for man to attain his various desired ends he must discover the causal processes through which labor and resources at his disposal may be used for his purposes. Central to this discovery process is the insight that often the most effective path to a desired goal is through "roundabout" methods of production. A man will be able to catch more fish in a shorter amount of time if he first devotes the time to constructing a fishing net out of vines, hollowing out a tree trunk as a canoe, and carving a tree branch into a paddle.

Greater productivity will often be forthcoming in the future if the individual is willing to undertake, therefore, a certain "period of production," during which resources and labor are set to work to manufacture the capital—the fishing net, canoe, and paddle—that is then employed to paddle out into the lagoon where larger and more fish may be available. But the time involved to undertake and implement these more roundabout methods of production involve a cost. The individual must be willing to forgo (often less productive) production activities in the more immediate future (wading into the lagoon using a tree branch as a spear) because that labor and those resources are tied up in a more time-consuming method of production, the more productive results from which will only be forthcoming later.

This led Böhm-Bawerk to his theory of interest. Obviously, individuals evaluating the production possibilities just discussed must weigh ends available sooner versus other (perhaps more productive) ends that might be obtainable later. As a rule, Böhm-Bawerk argued, individuals prefer goods sooner rather than later. Each individual places a premium on goods available in the present and discounts to some degree goods that can only be achieved further in the future. Since individuals have different premiums and discounts (time-preferences), there are potential mutual gains from trade. That is the source of the rate of interest: it is the price of trading consumption and production goods across time.

Refuting Marx

One of Böhm-Bawerk's most important applications of his theory was the refutation of the Marxian exploitation theory that employers make profits by depriving workers of the full value of what their labor produces. He presented his critique of Marx's theory in the first volume of *Capital and Interest* and in a long essay originally published in 1896 on the "Unresolved Contradictions in the Marxian Economic System." In essence, Böhm-Bawerk argued that Marx had confused interest with profit. In the long run no profits can continue to be earned in a competitive market because entrepreneurs will bid up the prices of factors of production and compete down the prices of consumer goods.

But all production takes time. If that period is of any significant length, the workers must be able to sustain themselves until the product is ready for sale. If they are unwilling or unable to sustain themselves, someone else must advance the money (wages) to enable them to consume in the meantime.

This, Böhm-Bawerk explained, is what the capitalist does. He saves, forgoing consumption or other uses of his wealth, and those savings are the source of the workers' wages during the production process. What Marx called the capitalists' "exploitative profits" Böhm-Bawerk showed to be the implicit interest payment for advancing money to workers during the time-consuming, roundabout processes of production.^[7]

He also defended his theory of capital, production, and interest against a variety of critics, the most important of the exchanges being with the American economist John Bates Clark, one of the early developers of the marginal productivity theory of the value of a factor of production.^[8] At the turn of the century, Böhm-Bawerk also defended his theory of the benefits of saving and roundabout investment, and the competitive market's coordination of consumption and production, against L. G. Bostedo, who presented a proto-Keynesian argument that saving was inimical to the necessary incentives to stimulate investment activity.^[9] And he also wrote an essay defending the Austrian emphasis on deductive theory as the foundation of economic analysis against the arguments of the German historical school, which believed that "theory" emerged through an examination of "the facts."^[10]

In 1889, Böhm-Bawerk was called back from the academic world to the Austrian Ministry of Finance, where he

worked on reforming the systems of direct and indirect taxation. He was promoted to head of the tax department in 1891. A year later he was vice president of the national commission that proposed re-establishment of a gold standard. Three times he served as minister of finance, briefly in 1895, again in 1896-1897, and then from 1900 to 1904. During the last term Böhm-Bawerk demonstrated his commitment to fiscal conservatism. Ernest von Koerber, the Austrian prime minister in whose government Böhm-Bawerk served, devised a grandiose and vastly expensive public works scheme in the name of economic development. An extensive network of railway lines and canals were to be constructed to connect various parts of the Austro-Hungarian Empire—subsidizing in the process a wide variety of special-interest groups.

Böhm-Bawerk tirelessly fought what he considered fiscal extravagance that would require higher taxes and greater debt when there was no persuasive evidence that the industrial benefits would justify the expense. At Council of Ministers meetings Böhm-Bawerk even boldly argued against spending proposals presented by the Austrian Emperor, Franz Josef, who presided over the sessions. When he resigned from the Ministry of Finance in October 1904, Böhm-Bawerk had succeeded in preventing most of Prime Minister Koerber's giant spending project.^[11] But Böhm-Bawerk's 1914 articles on government finance indicate that the wave of government spending he had battled so hard against broke through once he was no longer there to fight it.

University Seminar

During the 1890s, while serving in various capacities in the Ministry of Finance, Böhm-Bawerk also ran a highly acclaimed seminar at the University of Vienna.^[12] It was discontinued from 1900 to 1904, when he was minister of finance, but in 1905 he returned to a full-time professorship at the University of Vienna, teaching "Introduction to Economics" and "Investigations into Political Economy," as well as an advanced seminar titled "Topics on Themes in Economic Theory." This seminar soon attracted some of the keenest minds among the younger Austrian economists, including Mises and Schumpeter, in the years before Böhm-Bawerk's death in August 1914.

A few months after his passing, in December 1914, his last essay appeared, a lengthy piece on "Control or Economic Law?"^[13] He explained that various interest groups in society, most especially trade unions, suffer from a false conception that through their use or the threat of force, they are able to raise wages permanently above the market's estimate of the value of various types of labor. Arbitrarily setting wages and prices higher than what employers and buyers think labor and goods are worth merely prices some labor and goods out of the market.

Furthermore, when unions impose high nonmarket wages on the employers in an industry, the unions succeed only in temporarily eating into the employers' profit margins and creating the incentive for those employers to leave that sector of the economy and take with them those workers' jobs. What makes the real wages of workers rise in the long run, Böhm-Bawerk argued, was capital formation and investment in those more roundabout methods of production that increase the productivity of workers and therefore make their labor services more valuable in the long run, while also increasing the quantity of goods and services they can buy with their market wages.

To his last, Eugen von Böhm-Bawerk defended reason and the logic of the market against the emotional appeals and faulty reasoning of those who wished to use power and the government to acquire from others what they could not obtain through free competition. This sesquicentennial of his birth reminds us of his lasting contributions as one of the greatest economists of all time, as well as his example as a principled man of uncompromising integrity who in the political arena unswervingly fought for the free market and limited government.

1. Quoted in Eduard Marz, *Austrian Banking and Financial Policy: Creditanstalt at the Turning Point, 1913-1923* (New York: St. Martin's Press, 1984), pp. 26-27.

2. The biographical material about Böhm-Bawerk's life and career are drawn primarily from two works, Shigeki Tomo, *Eugen von Böhm-Bawerk: Ein grosserösterreichischer Nationalökonom zwischen Theorie und Praxis*

(Marburg: Metropolis-Verlag, 1994); and Klaus H. Hennings, *The Austrian Theory of Value and Capital: Studies in the Life and Work of Eugen von Böhm-Bawerk* (Brookfield, Vt.: Edward Elgar, 1997).

3. Ludwig von Mises, "Eugen von Böhm-Bawerk: In Memory of the Tenth Anniversary of His Death," *Neue Freie Presse*, August 27, 1924, p. 9; an English translation of this article will appear in Richard M. Ebeling, ed., *Selected Writings of Ludwig von Mises*, vol. I (Indianapolis, Ind.: Liberty Fund, forthcoming 2001).
4. Joseph A. Schumpeter, "Eugen von Böhm-Bawerk, 1851-1914," reprinted in Schumpeter, *Ten Great Economists: From Marx to Keynes* (New York: Oxford University Press, 1951), p. 145.
5. Eugen von Böhm-Bawerk, *Capital and Interest*, 3 vols. (South Holland, Ill.: Libertarian Press, 1959). There are also earlier English translations of these works, prepared by William Smart: *Capital and Interest: A Critical History of Economical Theory* (New York: Augustus M. Kelley, 1965 [1890]) and *The Positive Theory of Capital* (New York: Books for Libraries Press, 1971 [1891]). A translation of some of Böhm-Bawerk's essays on the same themes, translated by William Scott, was published under the title *Recent Literature on Interest (1884-1899): A Supplement to "Capital and Interest"* (London: Macmillan, 1900).
6. Böhm-Bawerk presented and defended the Austrian theory of value and price in several articles. Two of them, "The Austrian Economists" (1891) and "The Ultimate Standard of Value" (1894), are reprinted in *Shorter Classics of Böhm-Bawerk* (South Holland, Ill.: Libertarian Press, 1962), pp. 1-24, 303-70.
7. Eugen von Böhm-Bawerk, "Unresolved Contradiction in the Marxian Economic System" (1896), reprinted in *Shorter Classics*, pp. 201-302; the same translation was published earlier under the title, *Karl Marx and the Close of His System* (New York: Macmillan, 1898).
8. Eugen von Böhm-Bawerk, "The Positive Theory of Capital and Its Critics, I: Professor Clark's Views on the Genesis of Capital," *Quarterly Journal of Economics*, January 1895, pp. 113-31; "The Origin of Interest," *Quarterly Journal of Economics*, July 1895, pp. 380-87; "Capital and Interest Once More: I. Capital vs. Capital Goods," *Quarterly Journal of Economics*, November 1906, pp. 1-21; "Capital and Interest Once More: II. A Relapse to the Productivity Theory," *Quarterly Journal of Economics*, February 1907, pp. 247-82; and, "The Nature of Capital: A Rejoinder," *Quarterly Journal of Economics*, Nov. 1907, pp. 28-47; and by John Bates Clark, "The Genesis of Capital," *Yale Review*, November 1893, pp. 302-315; "The Origin of Interest," *Quarterly Journal of Economics*, April 1895, pp. 257-78; "Real Issues Concerning Interest," *Quarterly Journal of Economics*, October 1895, pp. 98-102; and "Concerning the Nature of Capital: A Reply," *Quarterly Journal of Economics*, May 1907, pp. 351-70.
9. L. G. Bostedo, "The Function of Savings" (1900), and Eugen von Böhm-Bawerk, "The Function of Savings" (1901), both reprinted in Richard M. Ebeling, ed., *Austrian Economics: A Reader* (Hillsdale, Mich.: Hillsdale College Press, 1991), pp. 393-413.
10. Eugen von Böhm-Bawerk, "The Historical vs. the Deductive Method in Political Economy," *Annals of the American Academy of Political and Social Science*, vol. I (1891), pp. 244-71.
11. This episode is discussed in great detail in Alexander Gerschenkron, *An Economic Spurt That Failed: Four Lectures in Austrian History* (Princeton, N.J.: Princeton University Press, 1977). The author's interpretation, however, is that Böhm-Bawerk was a disloyal cabinet member irresponsibly opposing Koerber's railway and canal projects. Böhm-Bawerk is called an "anti-hero," and the chapter devoted to detailing his role in fighting these public-works projects is titled "The Stumbling Block."
12. For a brief description of the seminar, see, Henry R. Seager, "Economics in Berlin and Vienna" (1893), reprinted in Bettina Bien Greaves, ed., *Austrian Economics: An Anthology* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1996), pp. 44-46.
13. Eugen von Böhm-Bawerk, "Control or Economic Law?" (1914), reprinted in *Shorter Classics*, pp. 139-99.