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FRAGMENT

Carl Menger: *Contribution to the Theory of Capital* (1888), Section V

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Editorial introduction

Carl Menger is an important and well-known figure in the history of economic thought. His habilitation thesis, *Principles of Economics* (1871) and his book on method, *Investigations into the Method of the Social Sciences with Special Reference to Economics* (1883) both had a major impact on the development of our science. Together with William Stanley Jevons's *Theory of Political Economy* (1871) and Léon Walras's *Elements of Pure Economics or the Theory of Social Wealth* (1874), Menger's *Principles* marked the start of the marginal revolution in economics, and his *Investigations* provoked the famous *Methodenstreit* between the historical school of economics on one hand and Carl Menger and his pupils Eugen von Böhm-Bawerk and Friedrich von Wieser on the other.

Menger's contributions to the marginal revolution and the *Methodenstreit* gave rise to the Austrian school of economics. This school of economic thought differs in several respects from both neoclassical and institutional economics. As opposed to Jevons, Walras and their neoclassical followers, Menger did not construct his economic theories on the basis of mental constructs such as perfect competition, equilibrium or the utility calculus (Hülsmann, 2007: 134 f.). Instead, he approached the analysis of the market in a non-mathematical and non-graphical way, thereby leaving room for the discussion of the indeterminacies of actual market processes in the real world. It is a fundamental characteristic of the Austrian school, distinguishing it from mainstream neoclassical economics, that it analyses the market order in terms of dynamic processes and not in terms of equilibria (Kirzner, 1997).

It is more difficult to pinpoint the differences between Austrian and (old) institutional economics. Until now, the relationship between the adherents of the two approaches has been heavily influenced by the fact that the Austrian school originated as an antagonist of the historical school of economics in the *Methodenstreit*. (The historical school is a predecessor of institutional economics.) The historical and institutional schools criticize Austrian economists for their strict adherence to methodological individualism and their corresponding neglect of 'the social and institutional enablers of individual cognition' (Hodgson, 2004: 62), that is, of the institutions that form, structure or even constitute the thoughts and actions of individuals.

Capital theory is a case in point. When it comes to defining capital, the two schools are usually supposed to be diametrical opposites. Austrian school economists use to define capital in a physical way, as a technical requirement for roundabout methods of production. Capital is supposed to consist of capital goods, where 'capital goods' are a different expression for 'produced means of production'. Defined in this way, capital can easily be integrated into the universal means-end framework of human action, which is the main element in the Austrian version of methodological individualism.

Conversely, institutional economists advocate a non-universal approach to capital. Capital is not understood as a physical concept that fits into the means-end framework of human action as such;

instead, it is something that is peculiar to the institutional framework of capitalism. It is broadly defined as money invested in businesses by owners or shareholders. Capital in this sense allows for a *specific* kind of human action, namely the pure pursuit of monetary profit by enterprises, undisturbed by the ethical values of their stakeholders, be they egoistic or altruistic (Sombart, 1919: 101, 119).

There have been several slightly successful attempts at contributing to a mutual understanding of Austrian and institutional economics (Samuels, 1989; Wynarczyk, 1992). In my own work (Braun, 2017; Braun *et al*., 2016), I have tried to show that capital theory could well serve as a bridge between Austrian and institutional economics. To those who are well-read in both traditions, it will sound odd that, of all things, capital theory should be able to serve as a link between them. It seems obvious that the two approaches to capital presented above are in conflict with each other and that they can hardly serve as a common basis for institutional and Austrian economics.

Nevertheless, it is possible to build bridges based on capital theory. Hodgson (2008) pointed out that Frank Fetter's work could be considered a synthesis of institutional and Austrian views because his subjectivist approach to value theory did not prevent him from recognizing the historically specific aspects of economic phenomena, in particular, capital. Furthermore, and it may come as a surprise to many, Ludwig von Mises (1949), the most vocal advocate of the Austrian concept of a universal and a historical theory of human action, deviated from other Austrian economists and stuck to the historically specific business concept of capital, as endorsed by institutional economists (Braun *et al*., 2016).

Moreover, Mises was not the only important Austrian economist who followed an institutionalist approach to capital. Carl Menger, the founder of the school himself, wrote a long essay on capital in 1888, entitled 'Zur Theorie des Kapitals' (Contribution to the Theory of Capital), in which he foreshadowed Mises's later deviation from a universal and physical concept of capital. It appeared in the *Jahrbücher für Nationalökonomie und Statistik*, back then a relevant German economics journal. The fragment following this short introduction is a translation of section five of this essay.

Menger's essay must be considered as a recantation of his earlier views on capital. In his *Principles* of 1871, he had advocated a physical concept of capital. In this book, he laid the foundations for what was later to become, following its elaboration by Böhm-Bawerk (1889), the Austrian theory of capital, with its emphasis on physical means of production and their role in time-consuming production processes. Menger (1871) conceptualized the role of time in the production process and used it to explain what he considered to be a very important cause of economic growth, namely the extension of human plans to the goods of higher orders, i.e. producer goods (Menger, 1871: 73). Menger (1871: 155, 303–304) defined capital as the combination of economic goods of higher order in the present for purposes that lie in the future. Corresponding to his physical capital concept, Menger (1871) turned against the popular notion of capital used by practical businesspeople. He (1871: 304) considered that the interpretation of capital as a sum of money was a 'much too narrow' viewpoint. '[T]he concept of money', he stated, 'is entirely foreign to the concept of capital' (1871: 305).

Later, in his 1888 essay, he took a completely different path. There, he considered it a

> mistake that cannot be disapproved of enough, however, when a science uses expressions of common life, not merely in a more precise conceptual sense, or in a certain narrower or broader sense (technically!), but denotes completely new concepts by words that, in common parlance, already describe a fundamentally different category of phenomena – a category that is also important for the respective discipline – correctly and properly (Menger, 1888a: 2).

The word 'capital', in particular, should not be 'used for whatever kind of new, scientific categories that the evolving theoretical discussion brought to light'; it should only be used in the way 'that is familiar to business practitioners' and that is 'obtained from the direct observation of life and the permanent practical occupation with capital' (Menger, 1888a: 2). Therefore, Menger (1888a: 2) opted for a 'real notion of capital', with 'real' meaning 'realistic'.

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From the perspective of the history of economic thought, it would be interesting to understand the reason behind Menger's change of mind between 1871 and 1888. Nevertheless, there is no indication in Menger (1888a) or any of his other publications as to why he came to reject the physical capital concept in 1888 (Braun, 2015: 93 ff.). I have conjectured that Menger came to the common parlance approach to capital through his reading of Albert Schäffle and, more importantly, Richard Hildebrand, two scholars who were closely associated with the historical school of economics (Braun, 2015: 93 f.). In light of new evidence provided by Petrzak (2020), it also seems probable that Menger had been volatile on the subject for several decades. Apparently, he had already been close to a common parlance interpretation of capital several years before *Principles* appeared in 1871. Why he changed his view while writing *Principles*, however, and why he changed it back before 1888 is not explained by Petrzak.

Readers of the following fragment will find that Menger (1888a) strongly emphasized the futility of developing a general theory of capital interest based on the physical capital concept – something that Böhm-Bawerk was trying in *Positive Theory of Capital* (1889). It may well be that Hayek (1934: 410 f.) was right in that it was Menger's examination of Böhm-Bawerk's interest theory that brought him to realize the limits of the physical capital concept and, instead, make the case for the capital concept used by business practice and common parlance (and endorsed by the historical school).

A large part of Menger (1888a) is dedicated to criticizing scientific approaches that deviate from the capital definition of common parlance. He (tacitly) included in his critique his own earlier approach developed in 1871. I have presented and summarized his critical reflections at length in Braun (2015). We have to bemoan, along with Stigler (1937: 249), that Menger did not elaborate his critical reflections to a positive theory of business capital. Still, the fifth and final section of Menger (1888a) contains an extensive discussion of the capital concept of common parlance and business practice, the capital concept that economists should use, according to Menger, whenever they construct theories of capital.

Menger himself published an abridged French version of his essay (Menger, 1888b), and the German original was translated into Spanish (Menger, 2007). However, an English translation is yet to be published. With the following fragment, the positive part of Menger's essay (section five) is made available to the English-speaking world.

The essay is, of course, a valuable historical document in its own right. However, the hope is that its (partial) publication in the *Journal of Institutional Economics* will also serve another purpose. It is my personal conviction that the old adversaries of the *Methodenstreit* – the Austrian and the historical/institutional schools – are not mutually exclusive approaches but actually complement each other to a large extent. Hodgson (2014: 1063) stated that it 'might reasonably be presumed that to understand capitalism we must understand capital'. It appears that in this crucial respect, two of the most important Austrian economists, Carl Menger and Ludwig von Mises, contributed to the understanding of capital in a way that is valuable to both Austrian and institutional economists (Hodgson, 2019: 105 ff.). If a consensus could be achieved in relation to the fundamental issue of capital – and it seems to be within reach – it would merely be a question of time and goodwill that Austrian and institutional economists collaborate constructively on replacing neoclassical economics with a more realistic and, hopefully, widely acceptable alternative.

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Contribution to the Theory of Capital

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Carl Menger
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V.
The Capital Concept of Common Life.
(The Real Concept of Capital)

1

In common life, and also in the language of jurisprudence that follows the views of the latter [common life], capital is understood in a way that is fundamentally different from that of our science. Business practitioners and lawyers use the above expression to describe neither raw materials, nor auxiliary materials for technical production, nor commercial goods, machines, buildings and the like. Wherever the terminology of the [Adam] Smithian school has not already penetrated common parlance, only sums of money are denoted by the above word.

In common life, it is not amounts of money of any kind, however, that are called capital. The sums of money that are dedicated to the cost economy (the household), e.g. the household budget, even nest eggs, etc., are not regarded as capital by business practitioners and lawyers. The term 'capital' is not used in common life for *each* sum of money that a person has at his disposal. Only sums of money that are dedicated to the generation of income – components of a person's *acquisitive*[1] assets – are designated by this word.

Common life does not confuse *money* and *capital*. There are sums of money of many different kinds that are *not* called capital in the language of business and law but are actually set in opposition to the latter.

It is no objection if one points out that practitioners do not speak of 'acquisitive money' or of 'money dedicated to income generation', but simply of 'money', when they refer to 'capital' in the above sense. For this is merely an elliptical expression. Whoever objects to the expressions 'cheap money', 'expensive money', 'money market', 'lack of money', 'abundance of money' and so forth overlooks the fact that the business world uses similar elliptical phrases in countless other cases as well. In spite of the above phraseology, any practical businessman knows that there is money in his household budget, but no capital, that the 'money market' is something different from the currency market, and that 'cheaper money' does not mean a reduction in the market value of coins, but a reduction in the interest rate; in spite of the peculiar idioms of business language, every practitioner knows that in common life capital does not simply mean money, but only sums of money that are dedicated to income generation or, as practitioners prefer to say, 'working money'.

2

The popular concept of capital requires some explanatory remarks in light of the diversity of the phenomena it covers.

Interest-bearing loans (even amounts of money that are only *assigned* for this purpose) are called capital in common life everywhere; indeed, they constitute the most obvious form of a sum of money dedicated to income generation, i.e. of capital in the popular sense of the word.

[1] [EB: 'Acquisitive' is my translation of the German term 'werbend'. Here 'werbend' means 'dedicated to the generation of income'.]

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Likewise, however, amounts of money intended for other productive investments are generally considered as capital, insofar as they are actual amounts of money. The sums available for the purposes of an enterprise when the latter is opened, the monetary funds of a stock company that has not yet opened its business, the sums of money intended for the purchase of goods that are sources of permanent rent, etc., are, for example, capital in the sense of the popular view just as interest-bearing loans are.

The subsumption of the above categories of productive assets under the popular concept of capital cannot lead to any significant difficulties; the character of capital in the sense of a *sum of money* dedicated to the generation of income is obvious in both cases.

The same is not true of a group of business phenomena that is also called capital in common life (capital in the just presented sense of the word) but has so far been partly misunderstood by scientific economists, partly even completely ignored. It is peculiar to the era of the monetary economy, and indeed, as a matter of course, only to this era, that the wealth[2] of certain persons and individual assets are valued in sums of money. It does not seem odd to the business practitioner when a person is said to possess the wealth of 10,000 thalers, or even to possess this sum *as a part of his wealth*, even if the person in question does not have a single thaler at the given moment, either directly or in the form of a claim. Wherever it is not the technical nature of the assets that is in question, but only their relative *importance* for the business of the respective owners, the treatment of wealth and assets from the point of view of *calculable amounts of money* is the relevant one – from the standpoint of *economic* analysis the essential one.

What has been said applies to wealth in general and to the *wealth of a business*[3] (wealth in the narrow sense of the word) in particular. In our era of the monetary economy, the latter [wealth of a business] also, even if it *actually* does not consist of money but of goods of another kind, is able to present itself to us *in terms of calculation*, as an 'acquisitive amount of money'. A merchant, a manufacturer, a speculator, etc., may, for example, under certain circumstances possess productive assets that amount to many thousands of thalers, without actually having a single thaler at his disposal (either directly or in the form of a claim on a third party). If the above relationship is actually present, the technical nature of the goods in which the business assets[4] consist becomes less important; their 'monetary value' becomes more important for our economic consideration and our economic calculus: In this way, the acquisitive assets in question – whatever their technical nature may be – represent, but only *in terms of calculation*, an amount of money, namely one that is dedicated to the generation of income.[5] In his monetary calculations, the merchant indeed records the stock of goods, the

[2][EB: In most of the paper, I translated 'Vermögen' as assets. However, I translated 'Vermögen' as 'wealth' whenever 'Vermögen' refers explicitly to the monetary value of a sum of assets, as is the case here. A better translation would be 'net assets' or 'total assets', but as it is not clear whether Menger is speaking of net or total assets, I prefer the more literal translation 'wealth'.]

[3][EB: 'Business' is my translation of the German term 'Erwerbswirtschaft'. In its broad sense, 'Erwerbswirtschaft' includes the labourer as well as business, as labour is a means to acquire (erwerben) income. It is clear from the context, however, that Menger does not use it in this broad sense.]

[4][EB: 'Business assets' is my translation of the German term 'Vermögen der Erwerbswirtschaft'.]

[5]Here we also get an answer to the old question of whether consumption goods (better: goods of the first order) can obtain the character of capital – the argument being that it is possible to exchange them against means of production – even if they are not apt, according to their technical nature, to serve as means of production (goods of 'higher' order!). As the conception of capital as 'means of technical production' is untenable (see pp. 9 ff. above [Menger, 1888a: 9 ff.; Braun, 2015, sect. 4.3]) it is irrelevant for our question, and for capital theory in general, that consumption goods cannot become means of production. The only question therefore can be whether consumption goods can become 'acquisitive assets' by being dedicated to a business or whether their monetary value – the sums of money represented by them – can become capital: a question that becomes clear immediately once the nature and function of business assets is understood correctly. The disposal, even if only for a limited period of time, of a quantity of assets that corresponds to the scope and duration of the business, is the necessary prerequisite of any profit-oriented enterprise; under today's trade conditions, however, *this* requirement is fulfilled by assets that are disposable for the business regardless of the technical nature of the assets in question. True, a person who is technically and economically educated properly is not able to establish a cloth factory without having an appropriate amount of assets at his disposal for this acquisitive purpose (he must have assets of his own or entrusted to him); the technical

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industrialist his stock of raw materials, the speculator his shareholdings, etc., as a sum of money, as capital in the sense of an amount of money dedicated to the generation of income.[6]

The real concept of capital includes business assets, whatever their technical nature may be, inasmuch as their monetary value is the object of our economic calculation – that is to say, if they represent an acquisitive sum of money. Capital is understood in common life to be sums of money that are effectively dedicated to business, or business assets of any other kind that represent sums of money (that are in this sense dedicated to the generation of income).[7]

3

The monetary economy has led to a further development of the concept of capital, which will be referred to here because of its practical significance. Within each individual business year[8] (from the beginning to the end of that year), the wealth of a business comprises both the corpus of the business (the original wealth of the business) and the profit made within the year. It is only when the accounts are closed at the end of a particular business year that the profit is separated from the original wealth of the business, whereas within the business year in question the profit acquired, but not yet separated from the original wealth, appears to be devoted to the business as well. Insofar as it [the profit] has not already been allocated to the household within the relevant business year, it is 'acquisitive wealth', even if it was not *originally* (i.e. at the beginning of the business year) devoted to the business. Practical life distinguishes between the two categories of wealth mentioned above, and it is the wealth (recorded in the accounts) that was dedicated to business at the beginning of a business year that in common parlance is preferably referred to as 'capital' in regard to the business year concerned.

Capital is in the view of common life the *corpus* of a business, consisting of or calculated in money, while in a certain broader sense, capital is also understood as all assets of a business, consisting of or calculated in money.[9]

I would like to stress here a circumstance, the emphasis of which is of crucial importance for understanding the real concept of capital. Monetary calculation does not necessarily comprise the totality of the assets or the corpus of the business. It is distinctive of the epochs of transition from the natural economy to the monetary economy, and in certain social classes even of the more developed forms of the monetary economy, that only a part of the assets of a business is recorded or managed in a capitalist manner. A farmer may, after all, already record a part of his business assets through monetary calculation, but he may still not take into account the value fluctuations of land or other real estate, e.g. of his inherited property. Under such circumstances, he will probably consider his working assets as

nature of the goods that constitute the respective assets – whether he possesses wool itself, dyes, etc., or sums of money, or, indeed, respective quantities of clothing, jewellery, etc. – is irrelevant in the present consideration. Those who have worked on capital theory so far tend to overlook the important function of asset ownership *as such* in the business enterprise. The way [Karl] *Knies* (Geld und Kredit, 1885: 44 ff.) treats the above question is a consequence of his flawed theory of capital.

[6]Accordingly, common life distinguishes between actual sums of money dedicated to business, which are capital *as such*, and other types of assets dedicated to the above purpose which are 'capital' only *in terms of calculation*.

[7]Business practitioners call their property, as far as it is dedicated to income generation, simply 'assets'; if they contrast them [assets] to the goods that are dedicated to the cost economy [the household] (or to property in the broader sense of the word!), they call them 'acquisitive' or 'productive assets'; the sums of money represented by the latter, however, (especially vis-a-vis the monetary return generated by the productive assets) they call 'capital'. Stocks of raw materials, a factory, a warehouse, etc., are 'assets', yet not 'capital' in themselves and not as such, but only in relation to the sums of money represented by them. In themselves they are probably understood as (productive) assets, possibly as 'capital investments', but not as capital. The (economic) goods dedicated to the cost economy [the household] are only counted as assets in the broader sense, the sums of money intended for this purpose are called 'household funds' (in the business world also 'private funds'), in contrast to 'business funds'.

[8][EB: 'Business year' is my translation of the German term 'Wirtschaftsepoche', which literally means 'business epoch' or 'business period'.]

[9]The contrast between these two concepts as used in common life is also evident in the different expressions for capital. The words τὸ ἀρχαῖου, Stammvermögen, principal, original capital point to the first, the words κεφαλαῖου, caput, Hauptgut, glownica, etc. to the second concept.

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'capital' as opposed to his real estate holdings (which he does not conceive from the point of view of monetary calculation, and which he probably considers as productive assets, but not as capital), whereas for the speculator, and even the farmer who considers his real estate to be mere capital investment, the above contrast is not present. The fundamental dichotomy in the conception of land and capital, as it is found with the *physiocrats* and, yet in a partly different sense, with *A. Smith*, is not least to be attributed to the fact that they based their theories on the observation of economic conditions in which capitalistic calculation indeed used to cover only the working assets of a farm, but not yet land itself. In certain businesses or certain categories of business, the productive assets may in some circumstances still be subject to commodity calculation in their totality, and thus be recorded in marked contrast to the assets of money-driven enterprises, a circumstance that explains why the capital phenomenon appeared earlier, historically, in trade than in farming and even industrial enterprises.

The facts highlighted here, far from contradicting the popular conception of capital presented above, are rather a confirmation of its universal importance.

4

In common life, *(productive) assets* are divided into fixed and circulating assets and, accordingly, *capital* is divided into fixed and circulating (working) capital. The latter division, which plays such an important role in our science, is less known to business practitioners than the former. By *fixed assets* are understood those components of the corpus of a business that we only *use* in the latter (i.e. whose mere technical uses we employ in the business), by *circulating assets* on the other hand those that are intended to be (technically) consumed or sold by the business.[10] The fixed assets that are depicted as acquisitive sums of money are fixed capital; the circulating assets which are depicted as acquisitive sums of money are circulating or working capital. Not the concrete components of the fixed assets or circulating assets as such, but only the amounts of money that represent the same are – depending on the character of the respective assets as fixed or circulating assets – fixed or circulating (working)

[10]In the corpus of a business, we must distinguish two essentially different kinds of components; *first*, those that, by their nature and their special purpose, we merely *use* (not consume or sell) in our business, and *second*, those that, by their nature and their special purpose, are consumed (technically!) or sold in the business. The economic nature of the former (the *fixed* assets of a business) can be understood without any major difficulty. They are 'durable' goods whose (technical) uses are themselves economic goods. Whether we employ the uses of the goods in question in our own enterprises, or sell them (by renting or leasing out the respective core assets!) – in both cases the explanation of the phenomenon that the respective core assets *remain* permanently in our business while they yield a periodically recurring income, causes relatively few difficulties.

This is not the case when it comes to understanding the economic nature of *circulating assets* and explaining their return. The task of science here is to clarify how the components of the same [circulating assets] can be *sold*, or *consumed*, and at the same time *preserved* in the business (as part of its corpus!), but above all how the technical assembly of the factors of production in order to build the product, or the sale of assets, can generate a *return*. The first of the two questions has been answered, by the theory prevailing at this time, in that the goods in question are indeed consumed or sold, yet their 'value' is preserved (reproduced!) in the business – an explanation that, supported by the prevailing price doctrine, which maintains the cost of production as the determining element of product prices, encounters little resistance. This made it all the more difficult to explain the return on circulating assets. If one does not want to add the latter [the return] to the production costs in the form of a customary profit, which is obviously a circular argument, the prevailing doctrine can only present it [the return] as the result of a certain (technical!) productivity of 'capital', which, by the very nature of the problem, was as easy in the case of fixed capital as it was difficult in the case of circulating assets; and yet the explanation of the return on the latter [circulating assets] is the problem whose solution is at issue, a solution which is thus not at all offered by the usual reference to the 'productivity' of 'land', 'machinery', 'hunting guns' and 'fixed capital'.

In reality, we are confronted, in the *fixed* and the *circulating assets*, with two essentially different categories of business assets, different with regard to their nature, their uses, their productivity and the formation of returns. To be sure, by being combined in monetary calculation, both categories appear as 'acquisitive sums of money', as capital. It is clear, however, that the phenomenon of the return on assets can be explained in a satisfactory manner only by a strict separation of the two above categories of acquisitive assets.

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capital.[11] A factory building, the furnishings of a department store, a motor, if they are intended to serve the business by means of their *use*, are, for their owner, components of fixed productive assets; their calculated monetary value is a part of his fixed capital. The wool stocks, dyes and other raw materials of a cloth manufacturer, these goods as such, are not a part of his circulating capital, only their calculated monetary value. The distinction between fixed and circulating capital does not apply to the actual components of the business assets, but only to their calculated monetary value.

5

The above applies analogously to the popular concept of *capital interest.* Also by this concept, business practitioners do not actually and directly mean the earnings of acquisitive assets of any kind, these earnings as such. Only the monetary income of (acquisitive) sums of money, commonly their financial yield in proportion to the size and the duration of the principal, is denoted with the above term, while the return on acquisitive assets of a different kind, of estates, buildings, enterprises, etc., is called land yield, building yield, etc., and, if it is periodically recurring, land rent, building rent, or simply rent.

However, in common life, the concept of capital interest is extended in a way similar to that of the term 'capital'. In practical life, not only the monetary income from actual sums of money, especially of loan sums, is called interest, but also the monetary income of all other kinds of acquisitive assets, as long as the term [interest] does not relate to the respective assets as such, but to the sums of money represented by them, to the corpus of the business, evaluated in money terms. The return on an estate, a factory, an apartment building, etc. – the return on these assets as such – is called *rent*; the term *capital interest* only applies to monetary income in so far as it is related to the capital that is calculated in money and represented by the above assets.

Capital interest consists of or is valued in money and is the return on actual[12] or calculated capital (usually in proportion to the size and operating life of the capital).

6

If we compare the views of common life on capital and capital interest with the prevailing scientific views, we arrive at the following conclusions:

(1) Common life only recognizes monetary sums as capital, however without confusing the latter with money; practitioners only conceive of monetary sums devoted to business as capital. In our science, in contrast, depending on the various viewpoints of its representatives, capital is considered by some to be all assets devoted to the 'generation of income', by some to be all means of production, and by some finally to be all the 'products devoted to further production'.

(2) Actual sums of money devoted to income generation, especially loan sums, are equally recognized as *capital* in common life and in scientific economics, while with regard to other productive assets, there are substantially different conceptions in practical life and in our science. The former considers only the sums of money represented by productive assets to be *capital*, but (besides actual sums of money) not the assets as such, while our science considers productive assets as such – the objects themselves – as capital. Practical life considers as capital, for example, the acquisitive sums of money represented by raw materials, auxiliary materials, machines, firms, buildings, labour services, land, natural sources of water power,

[11]The fact that in the Latinate languages the opposition between fixed and circulating (productive) assets is identified with that between fixed and circulating capital is explained by the deficient terminology of these languages, to which I have already referred above ([Menger 1888a]: 8). As far as real estates are concerned in particular, they are, *as such*, not capital of course, but rather, as far as they are dedicated to income generation, (productive) assets. In so far as they represent acquisitive sums of money in the calculations of their owner, however, these latter are undoubtedly just as much capital for him, and in fact usually fixed capital, in the same way as other fixed assets.

[12][EB: By 'actual capital', Menger means 'actual sums of money dedicated to the acquisition of income'.]

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mineral springs, etc., while in our science, the respective productive assets are regarded as capital *in themselves*, or their character as capital is denied if they are not means of production in the technical sense of the word, or if they are not *products* but mere *natural things*.

(3) In common life, the acquisitive sums of money represented by productive assets are in general regarded as capital. For the leaseholder who uses part of the stock of his business to acquire the right of use of a piece of land; for the manufacturer who uses part of his capital for the purchasing of work performed by clerks and technical assistants; for the banker who uses his capital to acquire the right of use of other people's financial capital, etc., the sums of money represented by the above-mentioned goods (by the respective labour services and rights of use) are capital, whereas our science only recognizes products (partly also real estate) as capital, but not the mere right of using them, just as little as labour services that are at the disposal of an entrepreneur.

(4) The monetary yield on loan sums is considered, both in common life and in science, as interest on capital, but while the return on other productive assets is only considered as capital interest in common life insofar as it is related (similar to the yield on loan sums as such) to certain sums of money, represented by productive assets, the prevailing economic theory considers the return on productive assets itself to be capital interest (partly *per se*, partly only insofar as the return results from productive assets that are themselves 'products' – not 'natural factors').

7

However close the relationship between the popular concept of assets and that of capital seems to be, and however often these concepts and the economic phenomena on which they are based are confused with each other in economic theory, they are strictly separated by business practitioners.

Wherever the natural consistency of assets (what I call their *technical nature*) is important, practical life considers actual sums of money as *capital* only if they form a part of the productive assets; other parts of productive assets, on the other hand, only insofar as their 'monetary value' determines the business interest (e.g. in balance sheets, in determining the net profit of stock corporations, etc.) whereas their technical nature is not taken into account. No practical businessman is of the opinion that his factory buildings, machines, raw materials, auxiliary materials, etc. – these objects *as such* – are capital, or that his land, apartment buildings, etc., are on the money market (even if they appear as capital for accounting purposes and he offers their use for sale). These goods as such he calls productive assets, or 'assets' pure and simple, but not 'capital'. Nor does a practitioner regard the net return on his productive assets *per se* as capital interest. Wherever practitioners relate the return on acquisitive assets, which do not consist of actual sums of money, to the latter themselves, to the concrete assets (the respective enterprises, the estates, the apartments, etc.), they rather refer to it as land yield, house yield, etc., and if it is a periodically recurring return, as land rent, house rent or rent *per se*. Common life restricts the term 'interest' to the return on *capital*, represented in the accounts by dwellings, estates, enterprises, etc., whereas it uses only the terms 'yield' or 'rent' for the returns on the respective dwellings, estates, enterprises, etc., *as such*.

Admittedly, in our monetary epoch, nothing is more common than that the 'capital value' of acquisitive assets is calculated from the rent that they yield, and that the rent then appears, as a matter of course, as interest on the 'capital' represented by the assets in question. It is equally common for the actual sums of money spent on the production or purchase of acquisitive assets to be accounted for in economic calculation as 'capital', and the return on the assets concerned to appear as capital interest. However, it is clear in these cases as well that the interest payments do not relate to the assets as such, but only to the capital they represent.

8

The difference between (productive) assets and capital, strictly cherished by practical life, is of the greatest importance, especially for theory, and the failure to recognize it is one of the main causes

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of the slow development[13] of the doctrine of the return on acquisitive assets. Only the confusion of the two important categories used in business life mentioned above can explain the misconception of a long series of scholars who put forward a mere theory of capital interest instead of a universal theory of the return on assets, and, by trying to interpret the phenomenon of interest on actual capital, believe that they are solving the much broader problem of explaining the return on assets – its various categories – in general.

Every expert in business knows that the interest rate on loan sums depends essentially on other causes than the net return on rental houses or estates, the return on rented parks[14] on causes other than those of rented fields, and the return on industrial or commercial enterprises on causes other than those of the aforementioned categories of acquisitive assets. It is obvious that the phenomena of return in question here require separate explanations, depending on their different nature and origin. The problem of return on assets is a highly complex one in practical life; it is different from the problem of capital interest; it should be so for our science, too.

A theory of capital interest in the sense of an explanation of the interest on actual capital – such as a theory of the phenomena of the money market – is inadequate for the above purpose since it only offers us an explanation of the yield of a particular category of productive assets; a theory of capital interest in the sense of an explanation of the interest on *calculated* capital, however, already presupposes a theory of return on assets (the return on the various categories of acquisitive assets) since the explanation of the rents (the primary phenomenon), as in life, so in science, must necessarily precede the explanation of the calculated interest yield (the secondary phenomenon). It is not the *capital value* of the productive assets in question, but the latter themselves, that are in fact the source of income, and the determination of the interest yield of the capital represented by the above assets is merely a calculation made on the basis of the previously determined return on assets. A mere theory of capital interest offers, in any event, an inadequate explanation of the return on assets, even of the return on those assets that the prevailing theory specifically calls 'capital'.

The only way to arrive at a complete theory of return on assets is to consider the acquisitive assets in general (all categories of the same), namely the respective assets as such – not only their calculated or accounted monetary value[15] – and to understand the characteristics of the return phenomenon of each individual category of acquisitive assets and to try to explain its origin and its size.[16] Our science cannot avoid the task of classifying productive assets, which show such striking differences with regard to the generation of returns (just think of the examples mentioned above), according to their different behaviour in the process of generating returns, that is, according to the different nature and causes of the phenomena in question, and, on the basis of this knowledge, of developing a comprehensive theory of return on assets, a theory in which the theory of capital interest in today's sense (a theory of the return on actual capital or loan sums) will only have the position of a link that can be systematically integrated into the general theory of return on assets.

The explanation of 'interest' on calculated capital, represented by the other categories of acquisitive assets, and its size may then only cause us little concern, since in science, as in life, this is only a simple calculation; the goal of our science must be a general theory of the return on assets – a theory of the return on all categories of (productive) assets, classified with regard to the way the return is generated – not a mere theory of capital interest.[17]

[13][EB: 'Slow development' is my translation of 'Zurückgebliebenheit'. Literally, it means 'retardation'.]

[14][EB: Park in the sense of a green area.]

[15]The actual capital used, for example, for the purchase or production of the above goods is, as a matter of course, no longer present *as such* in the business and appears, for economic calculation, only as a recorded accounting figure.

[16][EB: 'Size' is my translation of 'Maß'. Literally, it means 'measure'.]

[17]I shall confine myself here to characterizing the task of a theory of return on assets, and in particular to pointing out the characteristic of the problem that, like no other in our science, has preoccupied the most eminent social philosophers for centuries: the problem of capital interest, in particular its relationship to the problem of a general theory of return on assets. It is to be hoped that monographic treatment will prepare the way for the establishment of a general theory of asset return, based on the observation of contemporary economic life, and thus put an end to the helplessness of our science in the face of

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The prevailing doctrine, by dealing only with the problem of capital interest, i.e. with the explanation of interest on actual capital, or by dealing directly with the explanation of interest on calculated capital, circumvents the above fundamental problem and in actual fact offers a theory of return on assets that is inadequate in every respect.

the theories of socialism, which [the helplessness] is such a regrettable symptom of the present state of theoretical economics and which cannot be eliminated by mere antiquarian research. From this point of view, the great importance of E. von Böhm [-Bawerk]'s efforts in the field of capital-interest theory can be seen. In the first part of his comprehensive work on 'Capital and Interest' (1st v.: 'A critical history of economical theory,' 1884), B. did indeed undertake 'an in-depth and comprehensive critical review of the enormous material available'; the publication of the second part of the work, announced in this journal [Jahrbücher für Nationalökonomie und Statistik] (V. XIII, 1886: 67) as forthcoming, is intended to bring the author's positive theory.

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