

## **Subject – History of Economic Thought - II**

### **Notes Unit 2 Part B**

**By -**

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### **Economic Ideas of Eugen Von Bohm-Bawerk:**

#### **1. Methodology:**

Bohm Bawerk paid little attention to methodological controversy because he was much interested in theoretical analysis. According to him, the main work of economists was not together more facts, but to study, digest and analyse the facts already known. This could be done by abstraction.

#### **2. Explanation of Capital:**

Bohm Bawerk discussed the nature, origin and functions of capital. According to him capital or capital goods were the result of round-about methods of production. Capital goods were used for the production of consumer goods. For him there existed a close connection between saving and capital formation. As for as satisfaction of wants were concerned, capital goods were future goods.

#### **3. Aagio Theory of Interest:**

Bohm Bawerk's main contribution to economics is in the field of interest. Before developing his own theory of interest, he criticised the existing theories of interest. The problem of interest, according to him, is to find out how and why the owner of capital draws from it, "a permanent net income". He grouped the past theories of interest into various groups like: "The Productivity

Theories”, “The Abstinence Theories”, “The Labour Theories”, “The Exploitation Theory” and “Minor Systems”.

After rejecting all the old theories, Bohm Bawerk constructed his own theory which is known as Agio Theory of Interest.

According to Bohm Bawerk human beings prefer the present satisfaction to future satisfaction. People generally prefer the present as more important. They discount the future. As the popular saying goes, “A bird in the hand is worth two in the bush”.

**This tendency on the part of the human beings to prefer the present satisfaction, according to Bohm Bawerk is due to three reasons:**

- (a) There is perspective underestimate of the future. Future is not clearly visualised due to lack of imagination,
- (b) Present wants are felt more strongly than future wants. This is due to the fact that the demand for the present goods is relatively greater than that of the future,
- (c) There is the technical superiority of the present goods over future goods. Production in modern world is round about. It is a time-consuming process; we do not know the nature of the commodity to be produced in future. Hence present goods possess technical superiority over future goods.

Owing to the complexity of the modern capitalist system, the capitalist has to wait for a return on the money that he has invested in production. Meanwhile the other factors of production demand immediate payment for their services. After paying the remuneration to other factors, since the capitalist waits for his return, he is eligible for some reward and that reward is interest. Agio means premium for waiting.

#### **4. Rate of Interest:**

According to Bohm Bawerk the rate of interest could be fixed at the macro level for the whole market.

**Three factors were involved in the equilibrium rate of interest. They were:**

- (1) Size of the subsistence fund
- (2) Number of available workers
- (3) Degree of productivity achieved or technological conditions.

It must be noted that larger the subsistence fund, lower would-be rate of interest and larger the other two factors, higher would be the rate of interest.

### **5. Marginal Pairs Theory of Value:**

Bohm Bawerk presented a novel theory of value.

#### **He explained exchange transactions with the help of:**

- (a) Isolated exchange
- (b) One-sided competition
- (c) Two-sided competition.

Suppose there is a buyer and seller (an example of an isolated exchange). The buyer would not pay a higher price than he considers the commodity is worth to him. The seller would not be willing to accept less than what he considered the object is worth to him. The price would be determined somewhere between these two limits. The exact point depended on their bargaining capacities.

The second case is where there is one sided competition among buyers. The buyer who is willing to pay the highest price (above that of his nearest competitor) will purchase it. Thirdly, combining the two ideas, a market can be considered where a two-sided competition between the buyers and sellers emerges.

This is a case of perfect competition. Under this, price would be determined between the limits to be set by two marginal pairs—one marginal pair of potential buyers and sellers who failed to do business and another pair which succeeded in its last transaction. The actual price to be paid would depend upon subjective considerations.

## **Critical Estimate of Eugen Von Bohm-Bawerk:**

Bohm-Bawerk's reputation was firmly established when he published his "Capital and Interest". Bohm-Bawerk did not care for the battle of methods that existed during his period and also practical applications.

His Agio Theory of Interest was the first systematic theory of interest. It was one of the remarkable achievements in economic theory. His theory of imputation was a great contribution to the Austrian price theory. He was the only Austrian economist who gave importance to the three factors of production—land, labour and capital.

Bohm-Bawerk applied subjective analysis in his theories of capital and interest. His contribution to economics was greater than that of the other two Austrians. He acquired immortality, "On account of his fruitful original ideas, far reaching constructive power, brilliant way of presentation, outstanding gift of leadership, ever-ready preparedness for aggressive and defensive polemics and all the qualities of character and intellect which are the mark of a teacher in the most exalted sense of this word".

Contributions of P.H. Wicksteed:

### **1. Labour Theory of Value:**

By applying Jevon's analysis, Wicksteed criticized the Marxian Theory of value. He considered the labour theory of value was wrong.

### **2. Principle of Marginal Utility:**

In his book "The Alphabet of Economic Science" Wicksteed introduced the term 'marginal utility'. He insisted that this principle should be used in the allocation of all kinds of resources. Wicksteed believed that the utility of a commodity depended not only upon the quantity of that

commodity but also of other goods. In his “Commonsense of Political Economy” he introduced another term ‘Significance’.

In his market analysis, he emphasised the importance of expectations and the speculative element in all economic activities. Even though he admitted that it was very difficult to establish an equilibrium price due to miscalculations, he claimed that there always existed such a price at any given moment.

### **3. Supply Curve:**

In his paper “The Scope and Method of Political Economy in the Light of the Marginal Principle”, Wicksteed spoke about this supply curve. The supply curve was indeed the demand curve. He pointed out that under changing conditions, the same person might be a supplier at one moment and buyer at another moment.

### **4. Co-Ordination of the Laws of Distribution:**

This is the most important contribution of Wicksteed to economic analysis. Before Wicksteed, some economists notably Wicksell, J.B. Clark, Marshall, Walras and Edgeworth discussed about marginal productivity Theory. They discussed the rewards of each factor of production separately.

So, the laws of distribution could not be co-ordinated. He suggested that these laws could be discussed commonly. Wicksteed believed that the law of exchange value was itself the law of distribution. The exchange value of each good was determined by the marginal unit of that good.

### **Critical Appraisal of P.H. Wicksteed:**

Just like Jevons and Menger, Wicksteed also has a unique place in the history of economic thought. He was an original thinker. Among his contributions, the notable is his theory of distribution, market supply curve, analysis of economic equilibrium and the subjective theory of

value. “The Common sense of Political Economy” is the most exhaustive non-mathematical explanation of marginal theory of pure economics.

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