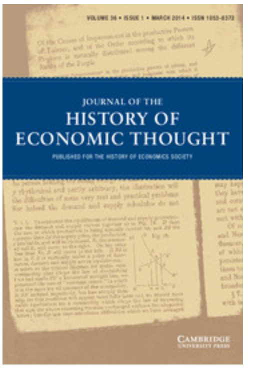

THE MENGER–LACHMANN TRAJECTORY ON CAPITAL: A COMMENT ON ENDRES AND HARPER

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BY

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Endres and Harper (2011) maintain that, within the Austrian tradition of capital theory, Carl Menger and Ludwig M. Lachmann form a distinguishable trajectory. Both these authors, they argue, consider capital as a heterogeneous structure of higher-order goods. In this comment, it is demonstrated that the opposite is true. Menger and Lachmann endorsed contrasting views on the nature of capital. Whereas Lachmann indeed adhered to a heterogeneous capital concept, Menger considered capital to be a homogeneous concept employed in economic calculation.

I. INTRODUCTION

In a recent issue of this journal, Anthony M. Endres and David A. Harper (2011) (hereafter E&H) de-homogenize the Austrian theory of capital. They correctly observe that, although the Austrian School is often regarded as a coherent whole, "there were undertones of strong disagreement in the Austrian tradition over the nature of capital" (p. 359). They thus address themselves to a problem that has been rather neglected until now and that is far from being resolved. Their efforts are, therefore, highly welcome to those who are interested in the evolution of economic thought on the nature of capital. The way that E&H classify the Austrian treatments of capital, however, needs considerable reconsideration. They maintain that the founder of the school, Carl Menger, has to be lumped together with Ludwig M. Lachmann, a mid-twentieth-century capital theorist, in endorsing a "real" and "heterogeneous" concept of capital. Both these authors, E&H argue, have to be contrasted to most other Austrian writers on capital, most notably to Eugen von Böhm-Bawerk, but also to

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Friedrich A. von Hayek, Richard von Strigl, and others. In this short comment, it is demonstrated that the classification provided by E&H does not do justice to Menger's position on capital. In fact, the evidence will show that Menger and Lachmann were not endorsing the same view on the nature of capital at all. Quite the contrary, they were diametrically opposed to each other. Whereas Lachmann indeed stressed the role of the *heterogeneity* of capital goods, as E&H maintain, Menger considered capital to be a *homogeneous* concept employed in business calculations.

II. THE MENGER–LACHMANN TRAJECTORY

According to E&H, Carl Menger must be seen as the one economist responsible for the approach that envisions capital as a combination of *heterogeneous* goods. Menger, they say, "offered the beginnings of a theory in which capital was envisioned as a hierarchically organized, structured combination of economic goods that are used to produce other goods" (p. 358). It is clear from where this interpretation stems. In his *Grundsätze der Volkswirthschaftslehre*, Menger distinguished not only between the consumption and the production sphere each as a whole, as the classical authors had done before him (Skousen 2007, p. 16), but introduced *the notion of the different orders of goods.* According to him, consumption goods are goods of the first order. Goods that help to produce the latter are goods of the second order. Those that help to produce these are goods of the third order and so on (Menger [1871] 2007, pp. 55 ff.). That is, not all goods that are produced are goods of the first order. A large part of the goods that are produced consists of goods of the higher orders, like raw materials, tools, and machines. And, these higher-order goods are not homogeneous but occupy different stages in the production process.

Therefore, E&H (p. 361) argue, Menger insisted on a capital theory that pays attention to this heterogeneity of goods and combinations that the capital structure consists of: "In Menger's view, economic theory must account for the real character of the capital structure and identify the relations existing between the capital combinations comprising the elements of that structure." E&H continue by elaborating to what extent later Austrian economists followed Carl Menger in stressing the structure of capital. To give an example, Friedrich von Hayek, in their opinion, although not following Menger at all points, "follows Menger … by adopting a real-capital doctrine: he envisions capital as real, rent-yielding goods used in production rather than as a monetary, investment phenomenon yielding interest" (E&H, p. 366).

In Ludwig Lachmann, E&H (p. 369) find an economist whose treatment of capital they consider to be "in concordance with Menger's analysis" across all criteria they decide to apply. He restated, as they (p. 369) see it, "a key Mengerian idea," namely: "capital comprises complementary combinations of heterogeneous capital goods." Lachmann (1978, p. 4), it is true, indeed demanded that "we must regard the 'stock of capital' not as a homogeneous aggregate but as a structural pattern." There is also no doubt that, for him (e.g., 1978, p. 2), capital resources are heterogeneous. In the following discussion, E&H (pp. 370 ff.) lump Menger and Lachmann together, call them the "M–L trajectory," and compare them to other Austrian authors writing on capital. In the subsequent section of this comment, it will be demonstrated that E&H, in putting Menger and Lachmann together, are guilty of a serious misinterpretation of the former's attitude regarding capital.

III. CARL MENGER ON THE NATURE OF CAPITAL

Like many other interpreters of the Austrian theory of capital (e.g., Nicolai J. Foss and Peter G. Klein [2012, pp. 113 ff.]; Peter Lewin [2011, pp. 60 ff.]), E&H base their interpretation of Menger's view on capital on the latter's *Grundsätze der Volkswirthschaftslehre*. It must be said, however, that this book does not contain a comprehensive capital theory. George J. Stigler (1937, p. 248), for example, laments "the virtual absence of any theory of capital" in it. In the main text, Menger ([1871] 2007, p. 155) confines himself to saying that one possesses capital if one "already has command of quantities of economic goods of higher order … in the present for future periods of time." In the corresponding appendix, he states what E&H apparently take as a basis for their contention that Menger is the predecessor of Ludwig Lachmann. There, Menger ([1871] 2007, p. 303, emphasis by Menger) says that the "classification of goods into means of production and consumption goods (goods of higher and goods of first order) is scientifically justified, but does not coincide with a classification of *wealth* into capital and non-capital." The former classification, he argues, rests "on the *technical* instead of the *economic* standpoint." On page 304 (emphasis by Menger), he continues this argument:

> The most important difference between capital on the one hand and items of wealth that yield an income (land, buildings, etc.) on the other is that the lat[t]er are *concrete* durable goods whose services themselves have both goods character and economic character, whereas capital represents, directly or indirectly, a *combination* of economic goods of higher order (i.e., complementary quantities of these goods).

One understands why E&H (p. 361) come to the conclusion that, for Menger, capital "is always and everywhere an ordered, structured, and selected combination of economic goods used to produce other goods," and why they class him with Lachmann.

Yet, as has already been said above, Menger ([1871] 2007) deals with capital only cursorily. A closer examination of Menger's other writings reveals the lack of footing of E&H's classification. First of all, as must be noted here, Lachmann himself does not seem to agree with it. In his preface, he (1978, p. xvi) mentions his intellectual debt to Hayek, whose "ideas on capital have helped to shape my own thought more than those of any other thinker." This statement alone is remarkable as, according to E&H (p. 364), Lachmann should be much closer to Menger than to Hayek. Furthermore, Lachmann (1978, p. 54) quotes Menger only once in his book, and only on a pretty peripheral issue.

Second, and more importantly, as becomes obvious on closer inspection, Menger and Lachmann totally disagree on the nature of capital. Lachmann, first and foremost, turns against those economists who employ a homogeneous capital concept. "For the quantitative concept of a homogeneous stock," he writes, "we have to substitute the concept of a functionally differentiated Capital Structure" (Lachmann 1978, p. 11). That so many economists stick to such a homogeneous concept and are blind to the necessity of allowing for the heterogeneity of the capital structure, he (1978, p. 36) traces to the institutions of capital accounting:

> That to the planning entrepreneur his capital resources are primarily given in their heterogeneity, as buildings, machines, tools, etc., may seem obvious to the reader. Unfortunately this fact is at variance with the main trend of the traditional theory of capital which treats capital as a homogeneous value magnitude expressed in money terms. No doubt this notion of capital corresponds in many ways to the concept of capital actually used in business life, in particular in its accounting and financial aspects. (see also pp. 5 and 49)

He finishes his considerations on the common homogeneous accounting view of capital in stating: "[W]e had little to learn from economists who adopt the point of view of the accountant, private or social, to whom the common denominator of the capital account is the heart of the matter, and most economists have at least implicitly adopted the accountant's point of view" (Lachmann 1978, pp. 72 f.).

As should be clear from the quotes given, it is fair to label Lachmann's capital theory a "real capital doctrine," like E&H (p. 369) do. Yet, E&H (p. 369) argue that Lachmann, in this, follows Menger. However, textual evidence can be provided that unambiguously demonstrates that, concerning *capital theory*, Lachmann does not follow Menger at all. Instead, Menger endorses exactly the capital doctrine that Lachmann vehemently opposes. This becomes obvious when one takes a look at what Menger writes in his monograph on capital, entitled *Zur Theorie des Kapitals* – the only publication where he dealt with the concept of capital in depth.

In this regard, it is important not to be deluded by Menger's terminology. In the said monograph, he (1888, p. 37) endorses a "real notion of capital" (*Realbegriff des Kapitals*). But he does not understand this term in the way current economists do. At the outset (p. 2), he declares it

> a mistake that cannot be disapproved of enough when a science … 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.

Therefore, he introduces his "real notion of capital." By "real," he just means "realistic" (see Heller 1941, p. 383, n. 3). He thinks of the "popular" notion of capital, the one "that is familiar to business men" and that is "obtained from the direct observation of life and the permanent practical occupation with capital" (all quotes from Menger 1888, p. 2). On page 6, he adds that "no science, least of all a science like economics which deals with phenomena of everyday life, has the right to … arbitrarily redefine popular terms."

But what is the practical meaning of capital that he endorses? Menger (1888, p. 37, emphasis added) is crystal clear on this point:

> When business men and lawyers speak about capital, they do mean neither raw materials, nor auxiliary materials, nor articles of commerce, machines, buildings and other goods like this. Wherever the terminology of the Smithian school has not already penetrated common parlance, *only sums of money are denoted by the above word.*

He specifies this view a few lines below in saying that "[o]nly sums of money that are dedicated to the acquisition of income … are denoted by this word." George J. Stigler (1937, pp. 249 f.) expresses Menger's view eloquently in a few words. The most important theme of the latter's article, he writes as a side note, "is the necessity for conducting capital analysis in the monetary terms in which entrepreneurs deal with capital problems."

Menger, in short, adheres to the capital concept of which Lachmann is so critical. It is the homogeneous notion of capital that is taken from business accounts. E&H ignore this evidence for the fundamental disagreement between Lachmann and Menger. Instead, they try to rescue their argument by pointing out that Menger (1888, pp. 43–45) actually has *two* viewpoints on capital. According to them, he distinguishes

> between two levels of reality: production activity and investment activity. Heterogeneous capital goods have a central place in the realm of production; when combined to form capital by entrepreneurs, they have a rate of return or yield. By contrast, money or financial capital is used for acquisitive purposes in the realm of investment and returns interest. (E&H, p. 363)

However, pages 43–45 do not, in any way, contain what E&H maintain. What Menger does there is to distinguish *between circulating and fixed capital*. There is no trace, neither there nor elsewhere in Menger (1888), of the distinction between a heterogeneous capital concept and financial capital. On page 43, he even explicitly states that *both circulating and fixed capital still only refer to sums of money*: "Not the concrete fixed assets or circulating assets as such, but *only the sums of money they represent* are—according to their character as fixed or circulating assets—fixed or circulating capital" (emphasis added).

So, Menger definitely adopts the point of view of business life and, therefore, of the accountant. He belongs to the economists of whom Lachmann says that he "had little to learn from"—at least in regard of capital theory. It is totally unjustified to treat these authors as if they envisioned the same notion of capital.

IV. CONCLUSION

A considerable part of the paper of Endres and Harper is dedicated to the demonstration that Carl Menger and Ludwig Lachmann endorse the same concept of capital and that their approach has to be distinguished from those of other members of the Austrian School. In this short comment, it has been shown that this interpretation cannot be upheld at all. Rather, the opposite is true. Lachmann strongly rejects the capital concept envisioned by Menger. Their notions of capital are diametrically opposed to each other, and it is very misleading to lump them together and call them the Menger–Lachmann Trajectory. This does not imply that Lachmann's capital theory does not build upon some central ideas contained in Menger's *Grundsätze*. Even in his monograph, Menger (1888, p. 9) refers to his classification of goods into those of lower and higher order as a very important one. However, Menger makes clear that these ideas have nothing to do with *capital* theory. For him, "capital" is a term that belongs to the sphere of economic calculation, not to the theory of production. Menger (1888) does not elaborate on this point because his intention is mainly to criticize other theories of capital. But, in view of the evidence provided in this short comment, it should be clear that it constitutes a misclassification to lump Menger and Lachmann together. Perhaps it would be accurate to say that Lachmann built his capital theory upon Menger's vision of the production process, but that Menger would not have agreed with Lachmann that the latter was writing about capital or capital theory at all.

These results indicate that the Austrian theory of capital is more heterogeneous than is usually supposed. Future research might reveal how and to what extent Menger's point of view can be reconciled with the one that envisions capital as a heterogeneous structure of economic goods. Menger himself, at least, did not think that his homogeneous capital concept contradicts his theory of the production process, which stresses the heterogeneity of producers' goods.

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