Negative intrest: the nemesis of time preference theory?

Towards a praxeological foundation of psychology

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1. Introduction

The concept of time preference, together with the concept of marginal utility, is one of the cornerstones of modern Austrian economic theory. It says that individuals will always prefer to achieve their ends sooner than later, and that intrest therefore can be understood as a discount on the future, accounting for this difference. The more an individual prefers present goods above future goods, the higher his time preference will be, and hence the higher the intrest he will charge and/or be willing to pay. Vice versa, the less an individual prefers present goods above future goods, the lower his time preference is, and the lower the intrest he will charge and/or be willing to pay. Time preference theory, more than any other theory, has been very successful in explaining intrest rates.

However, in recent years, an important issue with the time preference theory of intrest has occurred: that of negative intrest rates. According to Mises namely, the idea of negative time preference is unthinkable. That would mean that there are individuals who prefer the satisfaction of their wants later than sooner, which directly runs against the axiom of human action. Man acts, and as the very act of pursuing a goal implies that there is a temporal gap between means and ends, it is impossible to assume that this gap could be inverse, that time would run backwards, that ends come before means, or, in short: that human action altogether would not even occur. So the conclusion, from Mises' point of view, *had* to be that time preference can only be positive.

Nevertheless, negative intrest rates do exist. In 2009 and 2010 Sweden and in 2012 Denmark used negative intrest rates to stem hot money flows into their economies. In 2014 the European Central

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Bank (ECB) instituted a negative intrest rate on bank deposits with the intention to prevent the Eurozone from falling into a deflationary spiral. And at the time of this writing the financial website Bloomberg reports that one out of three European corporate bonds “yields” a negative intrest. In other words: if intrest rates indeed are an expression of time preference, Mises would have a hard time explaining how this could ever happen. In his theoretical framework, time preference cannot even be zero, let alone negative.

The argument that negative intrest rates are not a natural phenomenon but a reality forced upon the market by central bankers does not come to the rescue. If time preference indeed is truly a praxeological explanation for the phenomenon of intrest, it must hold true for all individuals, *including those individuals we call central bankers*. Mises clearly demonstrated that social phenomena, although they might appear to exist in and of themselves, nevertheless must have arisen from concrete human action. As such, negative intrest, having become a such a recognized social phenomenon in capital markets (and a very troublesome at that), cannot be an exception. It must have originated from some mind. The question is: who’s mind? And how?

This is not a moot point. Up until now, the occurrence of the business cycle has been explained as the practical result of failed monetary theories, with heavy emphasis on the erroneousness of the concepts central bankers use to explain economic reality. But as of yet, no explicit link has been formulated between the occurrence of these concepts, and the individual minds of these people. Although the praxeological perspective must be maintained at all times - Mises warned us for the dangers of psychologization - it is simply not tenable to argue that negative intrest rates, although being a social phenomenon, bear no connection to the individual minds of those that originated it. If we would deny the fact that negative intrest rates too originated from the desire to remove uneasiness, we would deny *their* human action.

So the conundrum comes down to this: if we deny the existence of negative intrest rates, we save the time preference theory. But if we save the time preference theory, we deny at least *some* human action. In the first case, we dismiss an ever growing amount of observations, just to save a theory. In the second case, it is even worse: theorists holding this position disqualify themselves from the Austrian explanation of social reality all together. One cannot at the same time hold that human action is the all-explaining axiom of the social sciences, but then, in some cases, act as if it can be dismissed. Either human action is an axiom at all times, or it is not an axiom.

The importance of this debate cannot be underestimated. The facts are these: we have no other option than to recognize that negative intrest rates exist (1), that they are a social phenomenon (2), and that, as such, *they too must have originated from human action* (3). Yet Mises, by excluding the possibility of negative time preference (4) implicitly denied that such an action could exist. (5). But how then for instance, can the very act of deliberately lowering the intrest rate by injecting fiat money into the existing money supply *not* be explained as negative time preference in the sense that it negates the positive time preference of society? Or how, in more general terms, can negative intrest rates *ever* have arisen from individuals that supposedly *all* have positive time preference?

The problem is inescapable. What we would be doing, in case we dismissed negative intrest as nothing but a loose emanation of a failed intrest policy, disconnected to any mind, is the obverse of what Mises called the logical fallacy of "hypostatization". Just as some people treat "society" as a phenomenon that exists in its own right, without reference to the many discrete human actions that gave rise to it, just in the same way, but in the obverse direction, "negative intrest" would be treated as a phenomenon that came about, spontaneously, out of nowhere, without reference to *any* human action. No human action engendered it, no individual mind had something to do with it. Negative intrest rates, in this view, forms part of some sub-real realm of disconnected floating notions.

The problem, thus, can be stated as follows: if we truly want a praxeological understanding of negative intrest rates, then we must acknowledge that it *must* have come from a certain type of human action. But this action, *which must exist*, seemingly is incompatible, either with the theorem of time preference theory, or maybe even with the axiom of human action itself. Which is it? Could it really be that the axiom of human action is wrong? Or is it more plausible to assume that some aspect of time preference theory is erroneous? If so, which aspect would this be? And if time preference theory can be proven (partly) erroneous, then what do we have to replace it with? Is there a way to explain the phenomenon of intrest that does not take time as its constituent element? And this without resorting to defunct productivity theories of intrest?

I say there is. But the implications of this view go far wider than anything I could have fathomed at the outset of my research: it expands praxeology to four new fields of study, psychology being only one of them. Theorists interested in my views can contact me at brechtarnaert@safecapital.eu

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