

CHAPTER 3 OF INTEREST AND THE CAUSE OF INTEREST

Having made sure of the law of rent, we have obtained as its necessary corollary the law of wages, where the division is between rent and wages; and the law of wages and interest taken together, where the division is between the three factors. What proportion of the produce is taken as rent must determine what proportion is left for wages, if but land and labor are concerned; or to be divided between wages and interest, if capital joins in the production.

But without reference to this deduction, let us seek each of these laws separately and independently. If, when obtained in this way, we find that they correlate, our conclusions will have the highest certainty.

And, inasmuch as the discovery of the law of wages is the ultimate purpose of our inquiry, let us take up first the subject of interest.

I have already referred to the difference in meaning between the terms profits and interest. It may be worth while, further, to say that interest, as an abstract term in the distribution of wealth, differs in meaning from the word as commonly used, in this: That it includes all returns for the use of capital, and not merely those that pass from borrower to lender; and that it excludes compensation for risk, which forms so great a part of what is commonly called interest. Compensation for risk is evidently only an equalization of return between different employments of capital. What we

The law of rent determines what is left over for wages and interest. If no capital is used, then it is actually the law of wages also.

But to be sure of ourselves, let us seek the laws of interest and wages separately. We should expect all three laws to correlate.

Interest includes all returns for use of capital, not merely those that pass from borrower to lender, and it excludes compensation for risk.

want to find is, what fixes the general rate of interest proper? The different rates of compensation for risk added to this will give the current rates of commercial interest.

The real interest rate varies between different countries and different times.

Now, it is evident that the greatest differences in what is ordinarily called interest are due to differences in risk; but it is also evident that between different countries and different times there are also considerable variations in the rate of interest proper. In California at one time two per cent. a month would not have been considered extravagant interest on security on which loans could now be effected at seven or eight per cent. per annum, and though some part of the difference may be due to an increased sense of general stability, the greater part is evidently due to some other general cause. In the United States generally the rate of interest has been higher than in England; and in the newer States of the Union higher than in the older States; and the tendency of interest to sink as society progresses is well marked and has long been noticed. What is the law which will bind all these variations together and exhibit their cause?

That interest does not depend on the productiveness of labor and capital is proved by the fact that where labor and capital are most productive interest is lowest. That it does not depend inversely on wages is proved by the general fact that interest is high when and

It is not worth while to dwell more than has hitherto incidentally been done upon the failure of the current political economy to determine the true law of interest. Its speculations upon this subject have not the definiteness and coherency which have enabled the accepted doctrine of wages to withstand the evidence of fact, and do not require the same elaborate review. That they run counter to the facts is evident. That interest does not depend on the productiveness of labor and capital is proved by the general fact that where labor and capital are most productive interest is lowest. That it does not depend reversely upon wages (or the cost of labor), lowering as wages rise, and increasing as wages fall, is proved by the general fact that

interest is high when and where wages are high, and low when and where wages are low.

Let us begin at the beginning. The nature and functions of capital have already been sufficiently shown, but even at the risk of something like a digression, let us endeavor to ascertain the cause of interest before considering its law. For in addition to aiding our inquiry by giving us a firmer and clearer grasp of the subject now in hand, it may lead to conclusions whose practical importance will be hereafter apparent.

What is the reason and justification of interest? Why should the borrower pay back to the lender more than he received? These questions are worth answering, not merely from their speculative, but from their practical importance. The feeling that interest is the robbery of industry is wide-spread and growing, and on both sides of the Atlantic shows itself more and more in popular literature and in popular movements. The expounders of the current political economy say that there is no conflict between labor and capital, and oppose as injurious to labor, as well as to capital, all schemes for restricting the reward which capital obtains; yet in the same works the doctrine is laid down that wages and interest bear to each other an inverse relation, and that in-terest will be low or high as wages are high or low¹. Clearly, then, if this doctrine is correct, the only objection that from the standpoint of the laborer can be logically made to any scheme for the reduction of interest is that it will not work, which is manifestly very weak ground while ideas of the omnipotence of legislatures are yet so widespread; and though such an objection may lead to the abandonment of any one particular scheme, it will not prevent the search for another.

¹This is really said of profits, but with the evident meaning of returns to capital.

where wages are high, and low when and when and where wages are low.

What is the justification for interest?

The expounders of the current political economy say that there is no conflict between labor and capital, yet they say that interest will be low or high as wages are high or low. If this is correct, then interest needs somehow to be reduced, if a way can be found to do so.

Why should interest be?

It cannot simply be a reward for abstinence, since abstinence in itself produces nothing.

It can be said that in lending capital I do the borrower a service, but he also does me a service in keeping it safely.

Many forms of capital will not keep, but must be constantly renewed.

Why should interest be? Interest, we are told, in all the standard works, is the reward of abstinence. But, manifestly, this does not sufficiently account for it. Abstinence is not an active, but a passive quality; it is not a doing—it is simply a not doing. Abstinence in itself produces nothing. Why, then, should any part of what is produced be claimed for it? If I have a sum of money which I lock up for a year, I have exercised as much abstinence as though I had loaned it. Yet, though in the latter case I will expect it to be returned to me with an additional sum by way of interest, in the former I will have but the same sum, and no increase. But the abstinence is the same. If it be said that in lending it I do the borrower a service, it may be replied that he also does me a service in keeping it safely—a service that under some conditions may be very valuable, and for which I would willingly pay, rather than not have it; and a service which, as to some forms of capital, may be even more obvious than as to money. For there are many forms of capital which will not keep, but must be constantly renewed; and many which are onerous to maintain if one has no immediate use for them. So, if the accumulator of capital helps the user of capital by loaning it to him, does not the user discharge the debt in full when he hands it back? Is not the secure preservation, the maintenance, the recreation of capital, a complete offset to the use? Accumulation is the end and aim of abstinence. Abstinence can go no further and accomplish no more; nor of itself can it even do this. If we were merely to abstain from using it, how much wealth would disappear in a year! And how little would be left at the end of two years! Hence, if more is demanded for abstinence than the safe return of capital, is not labor wronged? Such ideas as these underlie the widespread opinion that interest can accrue only at the expense of labor,

and is in fact a robbery of labor which in a social condition based on justice would be abolished.

The attempts to refute these views do not appear to me always successful. For instance, as it illustrates the usual reasoning, take Bastiat's oft-quoted illustration of the plane. One carpenter, James, at the expense of ten days' labor, makes himself a plane, which will last in use for 290 of the 300 working days of the year. William, another carpenter, proposes to borrow the plane for a year, offering to give back at the end of that time, when the plane will be worn out, a new plane equally as good. James objects to lending the plane on these terms, urging that if he merely gets back a plane he will have nothing to compensate him for the loss of the advantage which the use of the plane during the year would give him. William, admitting this, agrees not merely to return a plane, but, in addition, to give James a new plank. The agreement is carried out to mutual satisfaction. The plane is used up during the year, but at the end of the year James ceives as good a one, and a plank in addition. He lends the new plane again and again, until finally it passes into the bands of his son, "who still continues to lend it," receiving a plank each time. This plank, which represents interest, is said to be a natural and equitable remuneration, as by giving it in return for the use of the plane, William "obtains the power which exists in the tool to increase the productiveness of labor," and is no worse off than he would have been had he not borrowed the plane; while James obtains no more than he would have had if he had retained and used the plane instead of lending it.

Is this really so? It will be observed that it is not affirmed that James could make the plane and William could not, for that would be to make the plank the reward of superior skill. It is only that James had abstained from consuming the result

Attempts by Bastiat and others to demonstrate the legitimacy of interest do not appear to me always successful.

of his labor until he had accumulated it in the form of a plane—which is the essential idea of capital.

Now, if James had not lent the plane he could have used it for 290 days, when it would have been worn out, and he would have been obliged to take the remaining ten days of the working year to make a new plane. If William had not borrowed the plane he would have taken ten days to make himself a plane, which he could have used for the remaining 290 days. Thus, if we take a plank to represent the fruits of a day's labor with the aid of a plane, at the end of the year, had no borrowing taken place, each would have stood with reference to the plane as he commenced, James with a plane, and William with none, and each would have had as the result of the year's work 290 planks. If the condition of the borrowing had been what William first proposed, the return of a new plane, the same relative situation would have been secured. William would have worked for 290 days, and taken the last ten days to make the new plane to return to James. James would have taken the first ten days of the year to make another plane which would have lasted for 290 days, when he would have received a new plane from William. Thus, the simple return of the plane would have put each in the same position at the end of the year as if no borrowing had taken place. James would have lost nothing to the gain of William, and William would have gained nothing to the loss of James. Each would have had the return his labor would otherwise have yielded—viz., 290 planks, and James would have had the advantage with which he started, a new plane.

But when, in addition to the return of a plane, a plank is given, James at the end of the year will be in a better position than if there had been no borrowing, and William in a worse.

James will have 291 planks and a new plane, and William 289 planks and no plane. If William now borrows the plank as well as the plane on the same terms as before, he will at the end of the year have to return to James a plane, two planks and a fraction of a plank; and if this difference be again borrowed, and so on, is it not evident that the income of the one will progressively decline, and that of the other will progressively increase, until at length, if the operation be continued, the time will come when, as the result of the original lending of a plane, James will obtain the whole result of William's labor—that is to say, William will become virtually his slave?

Is interest, then, natural and equitable? There is nothing in this illustration to show it to be. Evidently what Bastiat (and many others) assigns as the basis of interest, “the power which exists in the tool to increase the productiveness of labor,” is neither in justice nor in fact the basis of interest. The fallacy which makes Bastiat's illustration pass as conclusive with those who do not stop to analyze it, as we have done, is that with the loan of the plane they associate the transfer of the increased productive power which a plane gives to labor. But this is really not involved. The essential thing which James loaned to William was not the increased power which labor acquires from using planes. To suppose this, we should have to suppose that the making and using of planes was a trade secret or a patent right, when the illustration would become one of monopoly, not of capital. The essential thing which James loaned to William was not the privilege of applying his labor in a more effective way, but the use of the concrete result of ten days' labor. If “the power which exists in tools to increase the productiveness of labor” were the cause of interest, then the rate of interest would increase with the march of invention. This is not so. Nor yet will I be expected

to pay more interest if I borrow a fifty-dollar sewing machine than if I borrow fifty dollars' worth of needles; if I borrow a steam engine than if I borrow a pile of bricks of equal value. Capital, like wealth, is interchangeable. It is not one thing; it is anything to that value within the circle of exchange. Nor yet does the improvement of tools add to the reproductive power of capital; it adds to the productive power of labor.

And I am inclined to think that if all wealth consisted of such things as planes, and all production was such as that of carpenters—that is to say, if wealth consisted but of the inert matter of the universe, and production of working up this inert matter into different shapes, that interest would be but the robbery of industry, and could not long exist. This is not to say that there would be no accumulation, for though the hope of increase is a motive for turning wealth into capital, it is not the motive, or, at least, not the main motive, for accumulating. Children will save their pennies for Christmas; pirates will add to their buried treasure; Eastern princes will accumulate hoards of coin; and men like Stewart or Vanderbilt, having become once possessed of the passion of accumulating, would continue as long as they could to add to their millions, even though accumulation brought no increase. Nor yet is it to say that there would be no borrowing or lending, for this, to a large extent, would be prompted by mutual convenience. If William had a job of work to be immediately begun and James one that would not commence until ten days thereafter, there might be a mutual advantage in the loan of the plane, though no plank should be given.

But all wealth is not of the nature of planes, or planks, or money, which has no reproductive power; nor is all production merely the turning into other forms of this inert matter of the universe. It is true that if I put away money, it will not

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increase. But suppose, instead, I put away wine. At the end of a year I will have an increased value, for the wine will have improved in quality. Or supposing that in a country adapted to them, I set out bees; at the end of a year I will have more swarms of bees, and the honey which they have made. Or, supposing, where there is a range, I turn out sheep, or hogs, or cattle; at the end of the year I will, upon the average, also have an increase.

Now what gives the increase in these cases is something which, though it generally requires labor to utilize it, is yet distinct and separable from labor—the active power of nature; the principle of growth, of reproduction, which everywhere characterizes all the forms of that mysterious thing or condition which we call life. And it seems to me that it is this which is the cause of interest, or the increase of capital over and above that due to labor. There are, so to speak, in the movements which make up the everlasting flux of nature, certain vital currents, which will, if we use them, aid us, with a force independent of our own efforts, in turning matter into the forms we desire that is to say, into wealth.

While many things might be mentioned which, like money, or planes, or planks, or engines, or clothing, have no innate power of increase, yet other things are included in the terms wealth and capital which, like wine, will of themselves increase in quality up to a certain point; or, like bees or cattle, will of themselves increase in quantity; and certain other things, such as seeds, which, though the conditions which enable them to increase may not be maintained without labor, yet will, when these conditions are maintained, yield an increase, or give a return over and above that which is to be attributed to labor.

Now the interchangeability of wealth necessarily involves

Many types of capital will of themselves, aided by labor, increase in quality or quantity, or otherwise yield an increase. Cattle, bees, and wine are examples.

The interchangeability of wealth necessarily involves an average of all types of wealth, so the reproductive or vital force of nature inherent in some types of capital must average with all, otherwise no one would be willing to use the types of capital which do not give an increase.

an average between all the species of wealth of any special advantage which accrues from the possession of any particular species, for no one would keep capital in one form when it could be changed into a more advantageous form. No one, for instance, would grind wheat into flour and keep it on hand for the convenience of those who desire from time to time to exchange wheat or its equivalent for flour, unless he could by such exchange secure an increase equal to that which, all things considered, he could secure by planting his wheat. No one, if he could keep them, would exchange a flock of sheep now for their net weight in mutton to be returned next year; for by keeping the sheep he would not only have the same amount of mutton next year, but also the lambs and the fleeces. No one would dig an irrigating ditch, unless those who by its aid are enabled to utilize the reproductive forces of nature would give him such a portion of the increase they receive as to make his capital yield him as much as theirs. And so, in any circle of exchange, the power of increase which the reproductive or vital force of nature gives to some species of capital must average with all; and he who lends, or uses in exchange, money, or planes, or bricks, or clothing, is not deprived of the power to obtain an increase, any more than if he had lent or put to a reproductive use so much capital in a form capable of increase.

The increase in wealth resulting from exchange resembles that from the forces of nature.

There is also in the utilization of the variations in the powers of nature and of man which is effected by exchange, an increase which somewhat resembles that produced by the vital forces of nature. In one place, for instance, a given amount of labor will secure 200 in vegetable food or 100 in animal food. In another place, these conditions are reversed, and the same amount of labor will produce 100 in vegetable food or 200 in animal. In the one place, the relative value of

vegetable to animal food will be as two to one, and in the other as one to two; and, supposing equal amounts of each to be required, the same amount of labor will in either place secure 150 of both. But by devoting labor in the one place to the procurement of vegetable food, and in the other, to the procurement of animal food, and exchanging to the quantity required, the people of each place will be enabled by the given amount of labor to procure 200 of both, less the losses and expenses of exchange; so that in each place the produce which is taken from use and devoted to exchange brings back an increase. Thus Whittington's cat, sent to a far country where cats are scarce and rats are plenty, returns in bales of goods and bags of gold.

Of course, labor is necessary to exchange, as it is to the utilization of the reproductive forces of nature, and the produce of exchange, as the produce of agriculture, is clearly the produce of labor; but yet, in the one case as in the other, there is a distinguishable force co-operating with that of labor, which makes it impossible to measure the result solely by the amount of labor expended, but renders the amount of capital and the time it is in use integral parts in the sum of forces. Capital aids labor in all of the different modes of production, but there is a distinction between the relations of the two in such modes of production as consist merely of changing the form or place of matter, as planing boards or mining coal; and such modes of production as avail themselves of the reproductive forces of nature, or of the power of increase arising from differences in the distribution of natural and human powers, such as the raising of grain or the exchange of ice for sugar. In production of the first kind, labor alone is the efficient cause; when labor stops, production stops. When the carpenter drops his plane as the sun sets, the increase of value, which he with his plane is

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producing, ceases until he begins his labor again the following morning. When the factory bell rings for closing, when the mine is shut down, production ends until work is resumed. The intervening time, so far as regards production, might as well be blotted out. The lapse of days, the change of seasons, is no element in the production that depends solely upon the amount of labor expended. But in the other modes of production to which I have referred, and in which the part of labor may be likened to the operations of lumbermen who throw their logs into the stream, leaving it to the current to carry them to the boom of the sawmill many miles below, time is an element. The seed in the ground germinates and grows while the farmer sleeps or plows new fields, and the overflowing currents of air and ocean bear Whittington's cat toward the rat-tormented ruler in the regions of romance.

To recur now to Bastiat's illustration. It is evident that if there is any reason why William at the end of the year should return to James more than an equally good plane, it does not spring, as Bastiat has it, from the increased power which the tool gives to labor, for that, as I have shown, is not an element; but it springs from the element of time—the difference of a year between the lending and return of the plane. Now, if the view is confined to the illustration, there is nothing to suggest how this element should operate, for a plane at the end of the year has no greater value than a plane at the beginning. But if we substitute for the plane a calf, it is clearly to be seen that to put James in as good a position as if he had not lent, William at the end of the year must return, not a calf, but a cow. Or, if we suppose that the ten days' labor had been devoted to planting corn, it is evident that James would not have been fully recompensed if at the end of the year he had received simply so much planted corn, for during the year

So the justification for interest is that some types of capital naturally tend to increase in value.

the planted corn would have germinated and grown and multiplied; and so if the plane had been devoted to exchange, it might during the year have been turned over several times, each exchange yielding an increase to James. Now, therefore, as James' labor might have been applied in any of those ways—or what amounts to the same thing, some of the labor devoted to making planes might have been thus transferred—he will not make a plane for William to use for the year unless he gets back more than a plane. And William can afford to give back more than a plane, because the same general average of the advantages of labor applied in different modes will enable him to obtain from his labor an advantage from the element of time. It is this general averaging, or as we may say, “pooling” of advantages, which necessarily takes place where the exigencies of society require the simultaneous carrying on of the different modes of production, which gives to the possession of wealth incapable in itself of increase an advantage similar to that which attaches to wealth used in such a way as to gain from the element of time. And, in the last analysis, the advantage which is given by the lapse of time springs from the generative force of nature and the varying powers of nature and of man.

Were the quality and capacity of matter everywhere uniform, and all productive power in man, there would be no interest. The advantage of superior tools might at times be transferred on terms resembling the payment of interest, but such transactions would be irregular and intermittent—the exception, not the rule. For the power of obtaining such returns would not, as now, inhere in the possession of capital, and the advantage of time would operate only in peculiar circumstances. That I, having a thousand dollars, can certainly let it out at interest, does not arise from the fact that there are others, not having a thousand dollars, who will gladly pay me for the

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use of it, if they can get it no other way; but from the fact that the capital which my thousand dollars represents has the power of yielding an increase to whosoever has it, even though he be a millionaire. For the price which anything will bring does not depend upon what the buyer would be willing to give rather than go without it, so much as upon what the seller can otherwise get. For instance, a manufacturer who wishes to retire from business has machinery to the value of \$100,000. If he cannot, should he sell, take this \$100,000 and invest it so that it will yield him interest, it will be immaterial to him, risk being eliminated, whether he obtains the whole price at once or in installments, and if the purchaser has the requisite capital, which we must suppose in order that the transaction may rest on its own merits, it will be immaterial whether he pay at once or after a time. If the purchaser has not the required capital, it may be to his convenience that payments should be delayed, but it would be only in exceptional circumstances that the seller would ask, or the buyer would consent, to pay any premium on this account; nor in such cases would this premium be properly interest. For interest is not properly a payment made for the use of capital, but a return accruing from the increase of capital. If the capital did not yield an increase, the cases would be few and exceptional in which the owner would get a premium. William would soon find out if it did not pay him to give a plank for the privilege of deferring payment on James' plane.

In short, when we come to analyze production we find it to fall into three modes—viz:

ADAPTING, or changing natural products either in form or in place so as to fit them for the satisfaction of human desire.

GROWING, or utilizing the vital forces of nature, as by raising vegetables or animals.

In short, there are three modes of production: Adapting, and Growing, and

EXCHANGING, or utilizing, so as to add to the general sum of wealth, the higher powers of those natural forces which vary with locality, or of those human forces which vary with situation, occupation, or character.

Exchanging.

In each of these three modes of production capital may aid labor—or, to speak more precisely, in the first mode capital may aid labor, but is not absolutely necessary; in the others capital must aid labor, or is necessary.

Capital may aid labor in any of these modes, and is absolutely necessary in growing and exchanging.

Now, while by adapting capital in proper forms we may increase the effective power of labor to impress upon matter the character of wealth, as when we adapt wood and iron to the form and use of a plane; or iron, coal, water, and oil to the form and use of a steam engine; or stone, clay, timber, and iron to that of a building, yet the characteristic of this use of capital is, that the benefit is in the use. When, however, we employ capital in the second of these modes, as when we plant grain in the ground, or place animals on a stock farm, or put away wine to improve with age, the benefit arises, not from the use, but from the increase. And so, when we employ capital in the third of these modes, and instead of using a thing we exchange it, the benefit is in the increase or greater value of the things received in return.

Primarily, the benefits which arise from use go to labor, and the benefits which arise from increase, to capital. But, inasmuch as the division of labor and the interchangeability of wealth necessitate and imply an averaging of benefits, in so far as these different modes of production correlate with each other, the benefits that arise from one will average with the benefits that arise from the others, for neither labor nor capital will be devoted to any mode of production while any other mode which is open to them will yield a greater return. That is to say,

Benefits will average out because neither labor nor capital will be devoted to any mode of production while any other mode which is open to them will yield a greater return.

labor expended in the first mode of production will get, not the whole return, but the return minus such part as is necessary to give to capital such an increase as it could have secured in the other modes of production, and capital engaged in the second and third modes will obtain, not the whole increase, but the increase minus what is sufficient to give to labor such reward as it could have secured if expended in the first mode.

Thus interest springs from the power of increase which the reproductive forces of nature, and the in effect analogous capacity for exchange, give to capital. It is not an arbitrary, but a natural thing; it is not the result of a particular social organization, but of laws of the universe which underlie society. It is, therefore, just.

They who talk about abolishing interest fall into an error similar to that previously pointed out as giving its plausibility to the doctrine that wages are drawn from capital. When they thus think of interest, they think only of that which is paid by the user of capital to the owner of capital. But, manifestly, this is not all interest, but only some interest. Whoever uses capital and obtains the increase it is capable of giving receives interest. If I plant and care for a tree until it comes to maturity, I receive, in its fruit, interest upon the capital I have thus accumulated—that is, the labor I have expended. If I raise a cow, the milk which she yields me, morning and evening, is not merely the reward of the labor then exerted; but interest upon the capital which my labor, expended in raising her, has accumulated in the cow. And so, if I use my own capital in directly aiding production, as by machinery, or in indirectly aiding production, in exchange, I receive a special and distinguishable advantage from the reproductive character of capital, which is as real, though perhaps not as clear, as though I had lent my capital to another and he had paid me interest.

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