Chapter 5 The Law of Interest

Let us turn now to the law of interest, keeping in mind two things to which attention has heretofore been called—viz:

First—That it is not capital which employs labor, but labor which employs capital.

Second—That capital is not a fixed quantity, but can always be increased or decreased, (1) by the greater or less application of labor to the production of capital, and (2) by the conversion of wealth into capital, or capital into wealth, for capital being but wealth applied in a certain way, wealth is the larger and inclusive term.

Capital is not a fixed quantity, but can be increased or decreased.

It is manifest that under conditions of freedom the maximum that can be given for the use of capital will be the increase it will bring, and the minimum or zero will be the replacement of capital; for above the one point the borrowing of capital would involve a loss, and below the other, capital could not be maintained.

The maximum return to capital is the increase that capital will, on the average, bring. The minimum is just its replacement.

Observe, again: It is not, as is carelessly stated by some writers, the increased efficiency given to labor by the adaptation of capital to any special form or use which fixes this maximum, but the average power of increase which belongs to capital generally. The power of applying itself in advantageous forms is a power of labor, which capital as capital cannot claim nor share. A bow and arrows will enable an Indian to kill, let us say, a buffalo every day, while with sticks

A bow and arrows might enable an Indian to kill a buffalo every day, while with sticks and stones he might kill only one per week. But the weapon maker could not claim six of every seven buffaloes.

and stones he could hardly kill one in a week; but the weapon maker of the tribe could not claim from the hunter six out of every seven buffaloes killed as a return for the use of a bow and arrows; nor will capital invested in a woolen factory yield to the capitalist the difference between the produce of the factory and what the same amount of labor could have obtained with the spinning wheel and hand loom. William when he borrows a plane from James does not in that obtain the advantage of the increased efficiency of labor when using a plane for the smoothing of boards over what it has when smoothing them with a shell or flint. The progress of knowledge has made the advantage involved in the use of planes a common property and power of labor. What he gets from James is merely such advantage as the element of a year's time will give to the possession of so much capital as is represented by the plane.

The reproductive force of nature seems to vary enormously.

Now, if the vital forces of nature which give an advantage to the element of time be the cause of interest, it would seem to follow that this maximum rate of interest would be determined by the strength of these forces and the extent to which they are engaged in production. But while the reproductive force of nature seems to vary enormously, as, for instance, between the salmon, which spawns thousands of eggs, and the whale, which brings forth a single calf at intervals of years; between the rabbit and the elephant, the thistle and the gigantic redwood, it appears from the way the natural balance is maintained that there is an equation between the reproductive and destructive forces of nature, which in effect brings the principle of increase to a uniform point. This natural balance man has within narrow limits the power to disturb, and by the modification of natural conditions may avail himself at will of the varying strength of the reproductive force in nature. But when he does so, there arises from the wide scope of his desires another principle which brings about in the increase of wealth a similar equation and balance to that which is effected in nature between the different forms of life. This equation exhibits itself through values. If, in a country adapted to both, I go to raising rabbits and you to raising horses, my rabbits may, until the natural limit is reached, increase faster than your horses. But my capital will not increase faster, for the effect of the varying rates of increase will be to lower the value of rabbits as compared with horses, and to increase the value of horses as compared with rabbits.

Rabbits may increase faster than horses, for example, resulting in a lower value of rabbits and higher value of horses.

Thus both types of capital will increase in value at the same rate.

Though the varying strength of the vital forces of nature is thus brought to uniformity, there may be a difference in the different stages of social development as to the proportionate extent to which, in the aggregate production of wealth, these vital forces are enlisted. But as to this, there are two remarks to be made. In the first place, although in such a country as England the part taken by manufactures in the aggregate wealth production has very much increased as compared with the part taken by agriculture, yet it is to be noticed that to a very great extent this is true only of the political or geographical division, and not of the industrial community. For industrial communities are not limited by political divisions, or bounded by seas or mountains. They are limited only by the scope of their exchanges, and the proportion which in the industrial economy of England agriculture and stock raising bear to manufactures is averaged with Iowa and Illinois, with Texas and California, with Canada and India, with Queensland and the Baltic—in short, with every country to which the world-wide exchanges of England extend. In the next place, it is to be remarked that although in the progress of civilization the tendency is to the relative increase of manufactures, as compared with agriculture, and consequently to a proportionately less reliance upon the reproductive forces of nature, yet this is accompanied by a corresponding extension of exchanges, and hence a greater calling in of the power of increase which thus arises. So these tendencies, to a great extent, and, probably, so far as we have yet gone, completely balance each other, and preserve the equilibrium which fixes the average increase of capital, or the normal rate of interest.

The normal point of interest will be such that all things considered, the reward of capital and the reward of labor will give an equally attractive result for the exertion or sacrifice involved.

Now, this normal point of interest, which lies between the necessary maximum and the necessary minimum of the return to capital, must, wherever it rests, be such that all things (such as the feeling of security, desire for accumulation, etc.) considered, the reward of capital and the reward of labor will be equal—that is to say, will give an equally attractive result for the exertion or sacrifice involved. It is impossible, perhaps, to formulate this point, as wages are habitually estimated in quantity, and interest in a ratio; but if we suppose a given quantity of wealth to be the produce of a given amount of labor, co-operating for a stated time with a certain amount of capital, the proportion in which the produce would be divided between the labor and the capital would afford a comparison. There must be such a point at, or rather, about, which the rate of interest must tend to settle; since, unless such an equilibrium were effected, labor would not accept the use of capital, or capital would not be placed at the disposal of labor.

For labor and capital are but different forms of human exertion. Capital is produced by labor.

For labor and capital are but different forms of the same thing—human exertion. Capital is produced by labor; it is, in fact, but labor impressed upon matter—labor stored up in matter, to be released again as needed, as the heat of the sun stored up in coal is released in the furnace. The use of capital in production is, therefore, but a mode of labor. As capital can be used only by being consumed, its use is the expenditure of labor, and for the maintenance of capital, its production by labor must be commensurate with its consumption in aid of labor. Hence the principle that, under circumstances which permit free competition, operates to bring wages to a common standard and profits to a substantial equality—the principle that men will seek to gratify their desires with the least exertion operates to establish and maintain this equilibrium between wages and interest.

This natural relation between interest and wages—this equilibrium at which both will represent equal returns to equal exertions—may be stated in a form which suggests a relation of opposition; but this opposition is only apparent. In a partnership between Dick and Harry, the statement that Dick receives a certain proportion of the profits implies that the portion of Harry is less or greater as Dick's is greater or less; but where, as in this case, each gets only what he adds to the common fund, the increase of the portion of the one does not decrease what the other receives.

Labor and capital each get only what each adds to the common fund, so an increase in one does not mean a decrease in the other.

And this relation fixed, it is evident that interest and wages must rise and fall together, and that interest cannot be increased without increasing wages; nor wages lowered without depressing interest. For If wages fall, interest must also fall in proportion, else it becomes more profitable to turn labor into capital than to apply it directly; while, if interest falls, wages must likewise proportionately fall, or else the increment of capital would be checked.

This shows that interest and wages must rise and fall together. For if wages fall, interest must also fall, else it becomes more profitable to turn labor into capital than to apply it directly.

We are, of course, not speaking of particular wages and particular interest, but of the general rate of wages and the general rate of interest, meaning always by interest the return which capital can secure, less insurance and wages of superintendence. In a particular case, or a particular employment, the tendency of wages and interest to an equilibrium may be

In particular cases, this tendency to equilibrium may be impeded,

impeded; but between the general rate of wages and the general rate of interest, this tendency must be prompt to act. For though in a particular branch of production the line may be clearly drawn between those who furnish labor and those who furnish capital, yet even in communities where there is the sharpest distinction between the general class laborers and the general class capitalists, these two classes shade off into each other by imperceptible gradations, and on the extremes where the two classes meet in the same persons, the interaction which restores equilibrium, or rather prevents its disturbance, can go on without obstruction, whatever obstacles may exist where the separation is complete. And, furthermore, it must be remembered, as has before been stated, that capital is but a portion of wealth, distinguished from wealth generally only by the purpose to which it is applied, and, hence, the whole body of wealth has upon the relations of capital and labor the same equalizing effect that a flywheel has upon the motion of machinery, taking up capital when it is in excess and giving it out again when there is a deficiency, just as a jeweler may give his wife diamonds to wear when he has a superabundant stock, and put them in his showcase again when his stock becomes reduced. Thus any tendency on the part of interest to rise above the equilibrium with wages must immediately beget not only a tendency to direct labor to the production of capital, but also the application of wealth to the uses of capital; while any tendency of wages to rise above the equilibrium with interest must in like manner beget not only a tendency to turn labor from the production of capital, but also to lessen the proportion of capital by diverting from a productive to a nonproductive use some of the articles of wealth of which capital is composed.

because the line between laborers and capitalists may be sharp. But in any community, there are some people who are in both classes, and some wealth which may become capital, or not be capital, depending on the need for capital, so the general rate of interest and general rate of wages will adjust readily.

To recapitulate: There is a certain relation or ratio between wages and interest, fixed by causes, which, if not

To recapitulate: The ratio between wages and interest is fixed by causes absolutely permanent, slowly change, at which enough labor will be turned into capital to supply the capital which, in the degree of knowledge, state of the arts, density of population, character of occupations, variety, extent and rapidity of exchanges, will be demanded for production, and this relation or ratio the interaction of labor and capital constantly maintains; hence interest must rise and fall with the rise and fall of wages.

which change slowly if at all, which cause enough labor to be turned into capital to supply the capital which, in that time and place, will be demanded for production. Therefore interest must rise and fall with wages.

To illustrate: The price of flour is determined by the price of wheat and cost of milling. The cost of milling varies slowly and but little, the difference being, even at long intervals, hardly perceptible; while the price of wheat varies frequently and largely. Hence we correctly say that the price of flour is governed by the price of wheat. Or, to put the proposition in the same form as the preceding: There is a certain relation or ratio between the value of wheat and the value of flour, fixed by the cost of milling, which relation or ratio the interaction between the demand for flour and the supply of wheat constantly maintains; hence the price of flour must rise and fall with the rise and fall of the price of wheat.

Or, as, leaving the connecting link, the price of wheat, to inference, we say that the price of flour depends upon the character of the seasons, wars, etc., so may we put the law of interest in a form which directly connects it with the law of rent, by saying that the general rate of interest will be determined by the return to capital upon the poorest land to which capital is freely applied—that is to say, upon the best land open to it without the payment of rent. Thus we bring the law of interest into a form which shows it to be a corollary of the law of rent.

Looking at this another way,

We may prove this conclusion in another way: For that interest must decrease as rent increases, we can plainly see if we eliminate wages. To do this, we must, to be sure, imagine a universe organized on totally different principles. Nevertheless, we may imagine what Carlyle would call a fool's paradise, where the production of wealth went on without the aid of labor, and solely by the reproductive force of capital—where sheep bore ready-made clothing on their backs, cows presented butter and cheese, and oxen, when they got to the proper point of fatness, carved themselves into beefsteaks and roasting ribs; where houses grew from the seed, and a jackknife thrown upon the ground would take root and in due time bear a crop of assorted cutlery. Imagine certain capitalists transported, with their capital in appropriate forms, to such a place. Manifestly, they would get, as the return for their capital, the whole amount of wealth it produced only so long as none of its produce was demanded as rent. When rent arose, it would come out of the produce of capital, and as it increased, the return to the owners of capital must necessarily diminish. If we imagine the place where capital possessed this power of producing wealth without the aid of labor to be of limited extent, say an island, we shall see that as soon as capital had increased to the limit of the island to support it, the return to capital must fall to a trifle above its minimum of mere replacement, and the landowners would receive nearly the whole produce as rent, for the only alternative capitalists would have would be to throw their capital into the sea. Or, if we imagine such an island to be in communication with the rest of the world, the return to capital would settle at the rate of return in other places. Interest there would be neither higher nor lower than anywhere else. Rent would obtain the whole of the superior advantage, and the land of such an island would have a great value.

imagine a place where wealth is produced by capital only, entirely without labor.

When rent arose, the landowners would be able to demand as rent nearly all of the produce, since capitalists could not produce without land.

To sum up, the law of interest is this:

The relation between wages and interest is determined by the average power of increase which attaches to capital from its use in reproductive modes. As rent arises, interest will fall as wages fall, or will be determined by the margin of cultivation.

The law of interest: *The relation between wages and interest is determined by the average power of increase which capital has in reproductive modes. As rent arises, interest will fall along with wages, or will be determined by the margin of production.*

I have endeavored at this length to trace out and illustrate the law of interest more in deference to the existing terminology and modes of thought than from the real necessities of our inquiry, were it unembarrassed by befogging discussions. In truth, the primary division of wealth in distribution is dual, not tripartite. Capital is but a form of labor, and its distinction from labor is in reality but a subdivision, just as the division of labor into skilled and unskilled would be. In our examination we have reached the same point as would have been attained had we simply treated capital as a form of labor, and sought the law which divides the produce between rent and wages; that is to say, between the possessors of the two factors, natural substances and powers, and human exertion—which two factors by their union produce all wealth.

In truth, capital is but a form of labor.