

Chapter 12

The Cause of Interest

WE HAVE DETERMINED the law of rent and its necessary corollaries. Still, let's seek each law separately and independently—without deduction from the law of rent. If we discover them independently—and find they correlate—then our conclusions will be certain. To start, let's examine the general subject of interest.

I have already warned of confusing profits with interest. Additionally, the economic meaning differs from common usage. Interest properly includes all returns for the use of capital—not just payments from borrower to lender.

Further, the economic meaning excludes compensation for risk—which makes up a great part of what is commonly called interest. But compensation for risk is merely an equalization of return between different uses of capital. We want to discover what determines the general rate of interest proper.

Rates also vary considerably in different countries and at different times. Interest generally has been higher in the United States than in England. Indeed, it has long been well known that interest tends to sink as society progresses.

What can bind these variations together and reveal their cause? It is obvious that current explanations run counter to facts. It is easily proved that interest does not depend on productiveness, for interest is lowest where labor and capital are

most productive. Nor does interest vary inversely with wages. The fact is, interest is high when and where wages are high. Likewise, low interest and low wages are found together.

So let us begin at the beginning. Even at the risk of digressing, we must establish the cause of interest before considering its law. In other words, why should borrowers pay back more than they received from lenders? Why should there be interest at all?

The standard texts all claim interest is a reward for abstinence. But abstinence is a passive quality, not an active one. Abstinence in itself produces nothing. So why should part of anything produced be given for it? If I bury my money for a year, I have exercised as much abstinence as if I had loaned it. Yet when loaned, I expect it to be returned with an additional sum as interest.

Some may say I provide a service to the borrower by lending my capital. But the borrower also does me a service by keeping it safely. Under some conditions, such a service may be very valuable. Many forms of capital must be constantly maintained, an onerous task if there is no immediate use for them. The secure preservation, the maintenance, or the restoration of capital is an offset to its use. So isn't the debt discharged when the capital is returned?

Accumulation is the purpose of abstinence. It can do no more. In fact, by itself, it can't even do this. Think how much wealth would disappear in just a few years if we simply abstained from using it!

Bastiat* and many others say the basis of interest is

* Frederic Bastiat (1801-1850), French economist, gave a well-known illustration of interest involving the loan of a carpenter's plane. George's analysis of the fallacies in this illustration is somewhat complex. It is not necessary for our discussion here.

“the power which exists in tools to increase the productivity of labor.” Clearly, however, this is not the basis in justice or in fact. A fallacy allows it to pass as conclusive to those who do not stop to analyze it. It is true that tools increase labor’s productive power. The mistake lies in assuming that the loan transfers this power. This is really not involved.

The essential thing loaned is *not* the increased power that labor acquires. To suppose this, we would have to assume that such things were trade secrets or patent rights. In such case, the illustration would become one of monopoly, not capital. The essential thing loaned is this: the use of the concrete results of the effort expended in producing the tools—not the privilege of applying labor in a more effective way.

If interest were based on increased productivity, the rate of interest would increase with technology. This is not so. Nor do I expect to pay more to borrow a fifty-dollar sewing machine than to borrow fifty dollars’ worth of needles. Nor if I borrow a steam engine rather than a pile of bricks.

Capital, like wealth, is interchangeable. It is not one particular thing—it is anything within the circle of exchange. Moreover, tools and machinery do not add to the reproductive power of capital—they add to the productive power of labor.

Now, consider for a moment a world in which wealth consisted only of inert matter, and production was only working this inert matter into different shapes. Such things have no reproductive power of their own. If I put away hammers or barrels or money, they will not increase.

But suppose, instead, I put away wine. At the end

of a year, the wine will have improved in quality and its value will be greater. Or suppose I release a swarm of bees. At the end of a year, I will have more bees, as well as the honey they have made. Or suppose I put cattle out on the range. At the end of the year, I will, on average, also have an increase.

What provides the increase in these cases is something distinct and separate from labor. Though it generally requires labor to make use of it, we can readily distinguish it from labor. It is the active power of nature—the principle of growth, or reproduction, which characterizes all forms of what we call life.

It seems to me that this is the true cause of interest—that is, the increase of capital over and above that due to labor. Certain powers in nature—with a force independent of our own efforts—help us turn matter into forms we desire. In other words, they aid us in producing wealth.

Both types of things are included in the terms wealth and capital—things that have no innate power of increase, and things that yield over and above what can be attributed to labor. With inanimate things, labor alone is the efficient cause. When labor stops, all production stops. But in these other modes, time is an element. The seed grows whether the farmer sleeps or works.

Furthermore, there are also variations in the powers of nature and of people. Through exchange, these variations can be used to obtain an increase in net output. This somewhat resembles the increase produced by the vital forces of nature.

For instance, in one place a given amount of labor will secure either what we may call 200 units of vegetable food or 100 units of animal food. In another place, the

conditions are reversed: The same amount of labor will produce 100 of vegetable or 200 of animal food. The relative value of animal to vegetable food will be two to one in one location, but one to two in the other. If equal amounts are required, the same amount of labor in either place will secure 150 units of both. But suppose in one place labor is used to procure vegetables, while in the other to procure animal food. Then an exchange is made in the quantity required. Thus, the people of each place—with the same amount of labor—will acquire 200 of both (less the losses and expenses of exchange). In each place, the product that is exchanged brings back an increase.

Since wealth is interchangeable, it necessarily involves an average between all types of wealth. So any special advantage that accrues from the possession of any one particular type must be averaged with all others. For no one would keep capital in one form when it could be changed into a more advantageous form.

So, in any circle of exchange, the power of increase that nature gives to some forms of capital must be averaged with all forms of capital. Thereby, those who lend money or bricks are not deprived of the power to obtain an increase. They will get the same as if they had lent (or used) an equivalent amount of capital in a form capable of increase.

This general averaging—or “pooling” of advantages—inevitably takes place wherever society carries on different modes of production simultaneously. Thus, all types of wealth maintain similar advantages. In the final analysis, the advantage given by time comes from the generative force of nature and from the varying powers of nature and of people. If the quality and capacity of matter everywhere

were uniform, and if productive power existed only in humans, then there would be no interest.

If I have a thousand dollars, I can certainly loan it out at interest. But that does not arise because those without funds would gladly pay me for the use of it. Rather, it comes from the fact that capital, which my money represents, has the power to yield an increase. The price something will bring does not depend so much on what the buyer would be willing to give rather than go without it—it depends on what the seller can get otherwise. Interest is not a payment made for the use of capital—it is a return accruing from the increase of capital.

In short, then, when we analyze production, it falls into three modes:

ADAPTING—Changing natural products, in form or place, to fit them to satisfy human desire.

GROWING—Utilizing the vital forces of nature, as in raising vegetables or animals.

EXCHANGING—Increasing the general sum of wealth by exploiting local variations in the forces of nature, or variations among human forces due to situation, occupation, or character.

In adapting, capital gains its benefit in its use. In growing, the benefits arise not from use but from increase. In exchanging, capital is exchanged rather than used. The benefit is in the increase, or greater value, of things received in return. Essentially, benefits arising from use go to labor; those from increase go to capital.

But the division of labor and the interchangeability of wealth compel an averaging of benefits. For neither labor nor capital will pursue any method of production while

another is available offering a greater return.

We can say this another way. In adapting, labor will not get the whole return—but less enough to give capital the increase it could have gotten in the other modes. Likewise, capital in the second and third modes will not get the whole increase—but less enough to give labor the reward it could have gotten from the first mode.

Thus, interest springs from the power of increase given to capital by the reproductive forces of nature, or by the analogous capacity of exchange. This is not arbitrary, it is natural. It is not the result of a particular social organization, but of laws of the universe.