

## Chapter 14

### The Law Of Interest

WE MAY NOW SEEK the law of interest, recalling two things: Capital does not employ labor; labor employs capital. Capital is not a fixed quantity; the amount can be increased or decreased.

Capital is simply wealth applied in a certain way—wealth being the larger category. Therefore, capital can be increased (1) by applying more labor to its production; or (2) by converting wealth into capital. Likewise, capital can be decreased (1) by applying less labor; or (2) by converting capital back into wealth.

Under free conditions, the maximum that can be given for the use of capital is the increase it will bring. Above this, borrowing capital would involve a loss. The minimum is the replacement of capital, or else capital could not be maintained. Interest will vary between these two points.

We must repeat: the maximum is not fixed—as some writers carelessly state—by the increased efficiency capital gives to labor. Rather, the maximum is set by the average power of increase that belongs to capital in general.

The power of applying itself in advantageous forms is a power of labor. Capital, as capital, cannot claim nor share in this. Indians using only sticks and stones might kill one buffalo a week. Yet with bows and arrows, they may kill one every day. But the tribe's weapon maker would not claim six

out of seven buffaloes. Neither will capital invested in a woolen factory entitle the owner to the difference between the output of the factory and what could be made with a spinning wheel. The march of knowledge has made these advantages a common property and power of labor.

We established (in chapter 12) that the cause of interest is the vital forces of nature that give an advantage to the element of time. And this should set the maximum rate of interest. But the reproductive force of nature varies enormously. For instance, if I raise rabbits and you raise horses, my rabbits will multiply faster than your horses. But my capital will not increase faster! The effect of the varying rates will be to lower the value of rabbits compared to horses. Thus, differences are brought to a uniform level that determines the average increase of capital.

Whatever this point, it must be such that the reward to capital and the reward to labor will be equal. That is to say, the normal point of interest will give an equally attractive result for the exertion or sacrifice involved.

For labor and capital are merely different forms of the same thing—human exertion. Capital is produced by labor. It is labor impressed upon matter. This labor has been stored up to be released as needed—as the heat of the sun is stored in coal. Capital can be used only by being consumed. In order for it to be maintained, labor must produce it in proportion to its consumption in aiding labor. Therefore, capital used in production is simply a mode of labor.

Under free competition, a principle operates to maintain this equilibrium between wages and interest. This principle is: People seek to gratify their desires with the least exertion.

The natural relation between interest and wages is an equilibrium at which both will represent equal return for equal exertion. Although this may be stated in a form that suggests opposition, this is only in appearance. For each gets only what they add to the common fund. Increasing the portion of one does not decrease what the other receives.

We are, of course, speaking of the general rate of wages and the general rate of interest. In a particular case or a particular occupation, this equilibrium may be impeded. But it will act quickly between the general rate of wages and the general rate of interest. A particular situation may have a clean line between labor and those who furnish capital. Yet even in communities where this distinction is the sharpest, the two shade off into each other by imperceptible gradations, until they meet in the same persons. Here, the interaction that restores equilibrium goes on without obstruction.

Furthermore, remember that capital is only a portion of wealth. It is distinguished from wealth only by the purpose it is used for. Hence, the whole body of wealth has an equalizing effect. This operates like a flywheel: taking up capital when there is excess, and giving it out again when there is lack. A jeweler may wear her diamonds while she is overstocked, but returns them to the showcase when stock is low. If interest rises above the equilibrium with wages, it produces two results: It will direct labor to produce capital. It will also direct wealth to be used as capital. Meanwhile, if wages rise above the equilibrium, that will also produce two results: Labor will turn away from producing capital. And the proportion of wealth used as capital will be reduced, as some will now be diverted to nonproductive uses.

Thus, there is a certain relation between wages and interest, which changes slowly, if at all. Hence, interest must rise or fall *with* wages.

To illustrate: The price of flour is determined by the price of wheat and cost of milling. Even over long intervals, the cost of milling hardly varies. But the price of wheat varies greatly and frequently. Hence, we correctly say that the price of flour is governed by the price of wheat.

To put this in the same form as the preceding discussion: The cost of milling fixes a certain relation between the value of wheat and the value of flour. This ratio is constantly maintained by the interaction between the demand for flour and the supply of wheat. Hence, the price of flour must rise and fall with the price of wheat. We can leave the connecting link, the price of wheat, to inference. We would then say that the price of flour depends upon the character of the seasons, wars, etc.

In the same way, we can put the law of interest in a form that connects it directly with the law of rent. The general rate of interest, then, will be determined by the return to capital on the poorest land freely available. That is to say, the return from the best land open to it without the payment of rent. The law of interest, therefore, is shown to be a corollary of the law of rent.

We can prove this conclusion another way. If we were to eliminate wages, we could plainly see that interest must decrease as rent increases. Of course, to do this we must imagine a place where production occurs without labor. Houses grow from seeds, and a jackknife thrown on the ground bears a crop of assorted cutlery.\*

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\* A modern reader might imagine a land of robots in the near future.

Capitalists here would keep *all* the wealth produced from their capital—but only as long as none of it was demanded in rent. When rent arose, it would come from their interest. As rent increased, the return to the owners of capital must necessarily decrease. If this place were an island, interest would fall to just above its minimum (mere replacement) as soon as capital reached the limit of the island to support it. Landowners would receive almost the entire output—for the only alternative would be for capitalists to throw their capital into the sea.

This, in sum, is the law of interest:

*The relation between wages and interest is determined by the average power of increase that 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 production.*

In truth, the principal distribution of wealth is into two—not three—parts. Capital is simply a form of labor. Its distinction is a subdivision, like dividing labor into skilled and unskilled. That is to say, wealth is divided between the possessors of two factors: (1) natural substances and forces, and (2) human exertion. For all wealth is produced by the union of these two factors.