

19. Capital — Real and Spurious

Most of us are in some way or other concerned with one or more of the arts and sciences. In respect of all of them none would deny the absolute necessity for precise definition.

Generally speaking, the artist, musician or tradesman is able to communicate in precise terms. The doctor, the lawyer, the surveyor and the accountant have their definitions and, although a member of one trade or profession may be unable to communicate with those of other trades and professions, he can with precision communicate with members of his own.

When an astronomer speaks of a galaxy every other astronomer knows what he means. When the musician refers to intervals or to tone or theme he is immediately understood by every other musician. When a lawyer refers to land he uses the statutory definition which includes not only land itself but all fixed improvements thereon. When an accountant refers to a man's capital, generally speaking, he includes all his assets other than his income, whether land, buildings, machinery or rights held by him or obligations due to him such as shares, mortgages, debentures and the like. The essential thing is that every art, whether law, accountancy or carpentry, and every science, whether it be astronomy or mathematics, should make for itself definitions so that everything can be seen "in its substance, in its nudity and in its complete entirety",¹ thereby enabling men to communicate with each other with certainty and precision.

An almost total lack of definition in the science of economics is largely responsible for the fact that it is in a state of utter confusion. The old cliché about all economists being laid end to end and unable to reach a conclusion is still, unfortunately, apt; the reason being that they are unable to communicate. This situation does not start from an argument as to whether economics is a science or an art, or from any lack of intelligence on the part of economists, but from an inherent characteristic, in fact from the very nature of the science.

Unlike the physical sciences, each with its clearly defined boundaries and acknowledged laws (though even in these the synthesising of knowledge is tending to blur the boundaries in some cases), economics embraces man in his aspect of 'economiser', in his behaviour as exchanger of material things, and this has tended to a dispersal of observation and an imprecision in conclusions as to with what in reality the science is properly concerned.

Arthur Koestler, in his *The Ghost in the Machine*,² writing about psychology, attacks Behaviourism in these words: "By far the most powerful school in academic psychology, which at the same time

otherwise maintain the labourer during the process, are capital.”⁷ He at least makes clear that money “is no more synonymous with capital than it is with wealth.”⁸

Henry George quotes McCulloch, from the latter’s *Notes on the Wealth of Nations*, “The capital of a nation really comprises all those portions of the produce of industry existing in it that may be directly employed either to support human existence (our italics) or to facilitate production.”⁹ And George continues with other economists of his own day, American and English,¹⁰ all of whom bear out his contention that the examples are “sufficient to show how wide a difference exists as to the comprehension of the term capital.”

One could carry George’s investigation into economic confusion further by examining the works of present-day writers ad nauseam. A few examples will suffice. Keynes, in his *General Theory of Employment, Interest and Money*, devotes two whole columns of his index to the subject of capital, but readers will search in vain among the bewildering array of references for any clear definition of the term; on the other hand, there is ample evidence throughout this monument to economic esoterica of his confusion of capital with money, and with land.

Samuelson even extends the definition of capital to include human beings.¹¹ And, of course, both money and land.

Among more recent writers, the contributors to *The Australian Economy* (reviewed earlier in this book)¹² discuss capital in terms of investment, in Keynesian formulae, and plunge headlong into dissecting the complexities of the modern ‘mixed economy’ without bothering to define the term capital at all. By implication, one can assume that such a definition, if made, would include both money and land, as in Keynes and Samuelson.

Hunt and Sherman, in their *Economics*¹³ (also examined elsewhere in this book), while adding a new category to ‘the factors of production’ — technology — as distinct from labour, do correctly, if inadequately, state that “capital includes inventories of raw materials and goods in process as well as all plant and equipment.” (In a rather quaint afterthought, they include ‘land’ in their definition of natural resources.)¹⁴

Reverting to an earlier work, the mounting uncertainty among economists, previous to and contemporary with himself, indicated by their concepts and definitions, moved Professor Lindley Fraser to write his *Economic Thought and Language*,¹⁵ in the preface to which he explains that his purpose was to “assist students of economics to think clearly and logically about the fundamentals of their science, by exposing some of the main sources of error and confusion with which economics is surrounded.” As an example of the latter, Fraser, in his chapter on *Capital*, devotes no less than 84 pages to an analysis of three broad divisions and what appear to be eighteen variations of the sense in which the term capital is used. Little

wonder that Lindley Fraser is a name rarely found in later and more recent bibliographies.

One of the main factors in producing the confusion in the minds of the earlier economists (another being their ambivalence on the subject of 'property') was their aberration about the role of capital as the fund from which labour was employed and sustained — the Wage Fund Theory; as though capital had come into existence by some magical process without the hand of man in order that the latter should be able to work and produce. As though Adam, on being ejected from the Garden of Eden, had had the consolation of knowing that, while he had to 'live by the sweat of his brow', he could rely on a pre-existing fund of capital, like any one of the resources of the earth, to keep him from starving. The truth being, of course, that *man (labour), using his own strength and skill applied to the resources of nature (land), produces capital in the process.*

What has confused the moderns, is that, having abandoned the fallacy of the Wage Fund Theory, and having likewise abandoned the concept 'wealth' as too difficult, they got lost in a fog of imprecision over the terms and boundaries of their science and allowed themselves to be misled into embracing theories that comprised a mishmash of economics and politics. Thus developed the crazy edifice of the 'mixed economy' and all the dreadful jargon of 'the private and public sectors', of 'growth' and the G.N.P. Hence Keynes's preoccupation with money as the 'deus ex machina' and Samuelson's 'two bob each way' economics by which it is possible to accept the twin evils of inflation and the Welfare State as natural, if uncomfortable, furniture of the macro-economic society.

Henry George (whom no self-respecting economist dares to quote these days for fear of being considered a crank, or at least an eccentric) devoted a large part of his *Progress and Poverty* to the elucidation of 'capital', from a study of which one is rewarded with the only succinct and logical definition: "Capital is that part of the reward of labour in production devoted to further production." George reminds us that "Land, in the economic sense, embraces all natural materials, forces and opportunities; therefore, nothing that is freely supplied by nature can be classed as capital."¹⁶

It follows that something is gravely wrong with the present-day concept of capital held by professional economists, and by those who took degrees at their hands, the bankers and accountants of modern commerce — for the verification of which see any company balance-sheet. The latter, while being a valid representation of the company's transactions, does not, and cannot pretend to relate to economics as a science.

A balance-sheet may correctly include, under the heading 'assets', money in the form of cash in bank accounts, and loans and mortgages on various properties, debtors' balances, shares in other companies, etc. (offset by similar items under the heading 'liabilities'). Money in these forms actually represents tangible things (ignoring for the moment a distinction between things and *rights* or obligations)¹⁷ though their value must be subject to the fluctuations of the market, which is affected by, among other things, such

political manipulations as appreciation and depreciation of the currency in which the values are expressed — assuming that currencies are not free floating. 'Capital', in this situation, correctly represents the difference between the two sides of the balance sheet — assuming that this document has been correctly drawn up.

When the 'assets' side of a balance-sheet includes the item 'land and buildings', we have a very different situation. Buildings, like plant and machinery, can be valued from time to time according to their actual 'life', and in a true situation their deterioration over a term of years will be allowed for in the trading accounts until they are 'written-off' at the time of their obsolescence and replacement. (Under the taxation system 'depreciation' is nowadays more a device for the avoidance of tax than a writing down of actual values, and thus often no more a true expression of fact than the figures shown as the value of the assets concerned at any one time truly represents those values. Everyone is familiar with the terms 'hidden assets' and 'book values'. Similarly, under the blight of inflation, the true trading profit is something very different from that disclosed in the published accounts, as every accountant knows. Hence the recent moves for a new system which allows for the effects of inflation before the profit on which the company's taxation will be paid is declared.)

The term 'land and buildings', however, whether correctly or incorrectly stating the true value of the buildings, almost never indicates the value placed on the land on which the former stand. And the most effective indication of how false, or at best precarious, those 'assets' are, is the number of companies, in recent times in Australia for instance, which have fallen into the hands of receivers and whose capital has been found, after costly investigation, to be either a fraction of the figure represented by the shares in the balance sheet or nil. The cause of such 'collapses' has too often been the manipulation of land values, where it has not been the direct result of fraud perpetrated upon shareholders and creditors alike by entrepreneurs in pursuit of their own private gains, in which land values play a major role.

Apart from the cases of actual fraud and the devastation caused by these activities, what is overlooked or is not perceived by the public at large is the gigantic overall fraud involved in this whole concept of land values as capital. Land being, in economic terms, the basic substance of human existence, without which all human existence would cease, from which by the application of labour all production is drawn, can never, by its very nature, become capital in any but the purely rhetorical sense — as, say, the 'capital' of mankind, indivisible as the air he breathes. In the economic reality in which wealth is the product of labour applied to land, and capital is wealth, or products, applied to the purpose of further production, how can land, except by the inversion of all logic, be both the source from which capital is produced and capital itself? The great fraud lies in the fact that the traffic in land values — caused by the right enjoyed by owners of particular sites to confiscate the economic rent — is a predominant factor, along with excessive taxation, in the inflationary spiral which deprives more and more of the less affluent members of the society of more and more of what little wealth they possess.

In the natural economy, with the exchanging of products in the market, the resultant supply of wealth is divided into two broad divisions. One part passes into the hands of the final consumer for his personal enjoyment, thus reaching its ultimate end; the other part remains in the economy, its owners having elected to relinquish its immediate enjoyment in order to outlay, or *invest* it in future production. And for the act of such investment — a form of labour inasmuch as it is an exercise of reason and will — the investor is entitled to a reward from the society. It is this latter division of wealth which falls logically into the category of capital, and the reward, or return, to which this investment is entitled is the only true *interest*: a share of the additional wealth produced by the investment.

(It should be noted that money loaned does not, in the economic sense, return interest to the lender; it simply commands a *price*. In the event that the borrower invests the money he has borrowed in production he receives interest thereby which enables him to repay the loan *plus its price*. Confusion through the misuse of the term interest in this way has served to exacerbate the confusion over capital.)

Apart from the major reform, with which this book is concerned, there is one solution to the problem here portrayed; this is the re-writing of the Companies Acts, so that the term capital is defined in its true economic sense and its use in balance sheets expressed in this sense. The business world cannot be blamed for the existing confusion. The blame lies with the economists who, failing to invent exclusive, or special terms, have adopted the generalities of commercial language in their retreat from the uncomfortable truths of political economy.

Because of man's natural propensity to trade, the conversion of part of his product into capital as an instrument for increasing his productive powers enables him to secure greater mastery over the material resources of the earth. Thus it can be seen that the *capitalistic* mode of production is a system ideally suited to man the exchanger. And it is not difficult to deduce from this that it is a system essential to production in a civilized community, since without capital there can be no economy.

Recognition of this, the fundamental nature and function of capital, could, and should have exploded the absurdities of Marxism, the pseudo-scientific theory which today dominates the minds of so many intelligent people. The whole Marxist philosophy, where it does not drift off into the shadowy realms of para-psychology, is dominated by confusion over real and spurious capital. To Marx, all incomes, whether from ownership of natural resources, ownership of artificial things that facilitate production, or ownership of legally supported claims upon producers through land values, mortgages, customs duties and the like, were indistinguishable in that they were all *surplus value* extracted from the products of labour.

Unfortunately, the proponents and defenders of the capitalist system are no less confused, making no distinction between the value that attaches to products and the value that arises from the political destruction of competition in the market, and which attaches to such things as licences that grant special privileges and restrict trade (for example hotel and taxi

licenses) and the shares of companies enjoying the protection of tariffs and import quotas. Added to which, of course, is the major error in including in the concept of capital the value attaching to land.

The great and evil consequences of this failure to distinguish between fundamental concepts by those who purport to advise governments and who devise schemes for 'managing the economy' appear in the whole structure of taxation and escalating costs resulting from the accepted right of individuals and favoured groups to claim, not simply the exclusive occupancy of a site necessary for the purposes of production, but also the enjoyment of that additional return, the economic rent, which arises, not from their own exertion in production, but from the strategic location of the site in relation to the presence and density of population; so that it is possible to build a private or corporate fortune by trading in these counterfeit 'values', values which have no validity in terms of economic science and which would cease to exist once society took the rational step of collecting this Surplus Product as the natural revenue of government.

The capital, therefore, of any person, company or other organisation of people, is real which comprises its real wealth, its true assets — actual products such as buildings, machinery and inventories of stock-in-trade. Capital comprising 'land' or 'land values' is *spurious capital* based on the anachronism that you can both have your cake and eat it.

NOTES TO CHAPTER 19

1. Marcus Aurelius Antoninus.
2. *The Ghost in the Machine* by Arthur Koestler; Pan Books Ltd., London, 1970.
3. *Ibid.*: p.19
4. Henry George: *Progress and Poverty*; Shalkenbach Foundation edn. 1958. Chap. 2, p.31
5. Adam Smith: *The Wealth of Nations*; Everyman edn. Bk. 2, p.241 et seq.
6. Ricardo: *Principles of Political Economy and Taxation*; Everyman edn. Chap. 5, p.53.
7. John Stuart Mill: *Principles of Political Economy*; Longman's London, 1896 edn. Bk. 1, chap. IV, p.34.
8. *Ibid.*
9. *Progress and Poverty*; Chap. 2, p.34 et seq.
10. *Ibid.*
11. Paul A. Samuelson: *Economics* (Australian edn.) p.50. footnote: "When you look at a university graduate you are in a certain sense looking at a chunk of capital."
12. *The Australian Economy*: ed. R. I. Downing; Wiedenfeld & Nicholson, London, 1973.
13. *Economics*: E. K. Hunt and Howard J. Sherman; Harper & Row, New York, 1972; p.499.
14. *Ibid.*
15. *Economic Thought and Language* by Lindley Fraser; A. C. Black Ltd., London, 1937.
16. *Progress and Poverty*, Chap. 2, p. 38 et seq.
17. It should never be forgotten that, while the value which attaches to things, to exchangeable products of labour, is a tangible value, that which inheres in such things as mortgages, liens, etc., represents a value only from legally constituted *obligation* — from 'right' in the legal sense, as distinct from right in the moral sense.