

Henry George School

2

Political Economy

This lesson will deal with the gains of labor, which are called WAGES, and the gains which accrue to the owners of capital, which are called INTEREST. The cause of interest and the mechanism which distributes wealth between the owners and the users of capital may be seen by way negotiations.

#1. If I make and offer to lend you a bow and a set of arrows, and in exchange I ask for the difference between the game you catch with those weapons and what you would have caught with your bare hands, you would simply make your own bow and arrows. If you could not, we would be valuing my superior skill, not my capital.

Hypothetically: you could take the first two weeks of a year, make a bow and arrows and use them for the remaining 50 weeks, at which time they would be worn out. Or, you could borrow a bow and arrows, use them for the first 50 weeks and take the remaining two weeks to make a new bow and arrows for return. Either way, at the end of a year, you would have 50 weeks worth of game and a worn out bow and arrows. If the loan of the bow and arrows was conditioned upon the payment of any of the game as interest, no borrowing would have taken place. Capital increased the results of labor, but no interest was justified. The primary benefit of capital was in its use, and was taken by the user.

#2. However, suppose by the potential for repetitive production and trade, either you or I could by producing 10 sets of bows and arrows, in 10 weeks. And by the large demand of people who wanted such instruments, people were drawn to mass producing them. As the supply increased, the demand would diminish until the rewards of producing bows and arrows would be no higher than producing any thing else requiring equally difficult skill and risk. If the value of a bow and arrows fell until it was equal to the results of only one weeks labor, then you would, because of the potential to trade, gain from the loan of my capital and be willing to pay interest.

#3. Or suppose you have built a kiln for baking bricks. Having once been built, this kiln can be used to bake the bricks used to make other kilns with far less work and time. If I ask to borrow your kiln, which I shall use to bake the bricks and make another kiln for return, you will expect a payment which represents the saving of time in not having to repeat the original steps of building the first kiln.

If the payment of interest was not agreed to, no lending would have taken place. This principle applies to mining the first ore and making the first tools and machines. Once produced, many of these tools and machines are used in mining each succeeding unit of ore and making new tools and machines. As long as they are maintained, some of the original steps are eliminated from the productive process. The owner of capital is paid that wealth which represents the time saved in not having to repeat original steps.

#4. Or, suppose, you have made two casks of freshly made wine; each will support your needs for several years. Observing this, I propose to borrow one of your casks until such time as you have need for it, say in two or three years. I will then make a fresh cask of wine and return it. This proposal would not be acceptable to you, because the wine would have aged and increased in quality and value. Although periodic applications of labor are necessary, there is, independent of the human factor, an increase in the value of the wine (capital). This principle applies to seeds that grow while the farmer sleeps or plows new fields, or to solar collectors that continuously produce energy, or any product that harnesses the productive or reproductive forces of nature. Here, there is an increase of capital which accrues to its owner.

In the first example: a bow and arrows, there was no advantage in borrowing capital. The benefit of capital was in the use, and was enjoyed by the user. In the second example, repetitive production (economies of scale) and trade gave a greater result which could only be attained by the loan. That wealth which resulted from trade and economies of scale is enjoyed by the owner of capital. In the third example: a kiln for baking bricks, the benefit was also in the use, and enjoyed by the user, except for the savings which resulted from the use of existing capital, which was enjoyed by the owner of the capital. In the third example, making wine, the benefit was in the increase of capital, which was enjoyed by the owner of the capital.

Any workers (labor) involved in assisting the increase of capital must be paid for out of that increase. And they must be paid as much as they could have produced in the first example, where the benefit of capital was in the use and enjoyed by the user. Any owner of capital who lends it for a use incapable of increase, like a bow and arrows, will have to be paid as much as his capital would have increased had it been maintained in a form which is capable of increase. Through the laws of supply and demand, the general rate of interest will be equal to the average savings and increase of capital as a whole. The general rate of wages will be equal to the average results of labor which have produced and used capital in changing matter in form or in place as in the example of a bow and arrows, or as in building a house. The wages of individuals will differ with their own abilities.

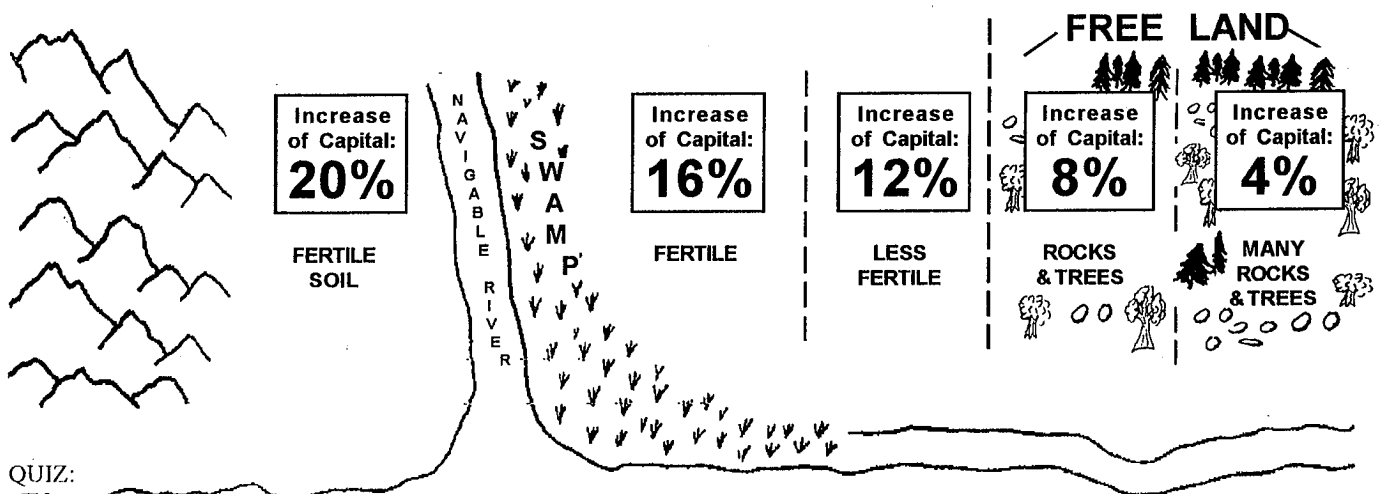
This explanation illustrates a mutual support system between workers and capitalists. Interest represents the advantage of time which results from the use of existing capital. If the advantage does not equal the demanded rate of interest, labor can always produce additional capital and use that. There is an equilibrium between wages and interest in regard to the supply and demand balance between the two, and therefore the rewards to each. Example: at the frontier the Sawyer cuts trees and makes boards. He changes matter in form or in place and his rewards are wages. Near by a farmer plants seeds and nurtures crops. He harnesses the productive or reproductive forces of nature causing an increase of capital. His rewards are interest.

If the rewards for farming (interest) rise above the rewards for sawing (wages) workers start farming and stop sawing. The increased supply of food lowers the price and the profit (interest). The decreased supply of boards raises the price and the profit (wages) and draws the workers back to cutting trees. This maintains an equilibrium.

Land, however is different; no amount of labor or capital can produce land, but they depend upon it to produce everything. So, the general rate of wages will be equal to the average production of labor where the land is free. All production resulting from labor's application upon superior land is enjoyed by the landowners as rent. The same mechanism is true of interest. The general rate of interest will be equal to the average savings and increase of capital where the land is free. All savings and increase of capital which result from its application on land of superior quality will be enjoyed by the landowner as rent.

To conceptualize this distribution, observe the following model. The different percents represent the expected increase of capital on each grade of land. Imagine a farmer (capitalist) who owns \$100,000 worth of capital: a tractor, machinery, seeds, fertilizer and so on. He employs his capital on the most fertile land. After he pays his labor, he will have worn his equipment, and he will have no seed or fertilizer - but he will have a crop. His assets (capital)

will be worth \$120,000 at the end of the year, an increase of 20%. On the next grade of land, which is less fertile, there will only be a 16% increase. Where the land is free there will be an 8% increase.



QUIZ:

- #1. Does capital employ labor? Y()N() Does labor employ capital? Y()N()
- #2. Interest arises from: the increase in the power of the tool. (A)(); the advantage of time in having the concrete results of labor for immediate use. (B)()
- #3. The most that the owners of capital can ever demand is: the entire product. (A)(); the entire increase of capital. (B)()
- #4. On the best land in the model, how much of the 20% increase does the capitalist get?(); how much does the landowner get?()