

## CHAPTER II

### Labor and Wages: Capital and Interest

HOW LABOR AND CAPITAL ARE ESSENTIALLY ONE AND INTER-RELATED, AND THE JUSTIFICATION OF INTEREST.

*Abundant evidence exists . . . to prove that much of America's prosperity . . . exemplified in employment, wages and a generally high standard of living, has been due to the expansion of the nation's durable goods, particularly capital equipment. A large part of the population has gained its livelihood from helping . . . to expand the total property of this kind . . . Millions of jobs have resulted from production of goods for the construction of homes, public buildings and highways, industrial construction, factory machinery and equipment and the like. It is reasonable to assume that much of the prosperity of the future must depend upon the same kind of . . . industrial activity, and if durable goods expansion were to cease, if the capital equipment of the country were to remain in substantially its present form and state of repair, there would . . . be grave doubt as to real prosperity ever returning to America.*

—MACHINERY AND ALLIED PRODUCTS INSTITUTE

**WE** HAVE seen that there are three elements of production: land, labor and capital. How is each compensated for its part in production? In the next three chapters we shall consider labor and capital and their earnings, wages and interest, topics so closely related that they may best be studied together. Rent, the return on land, will be considered later, for land and rent are unique and are governed by peculiar laws.

Picture a primitive community, say a group cast on an island by shipwreck. The first impulse is to secure the essentials of life, to find a spring from which to drink, fruits and nuts to eat, and a cave for shelter. These things, procured by personal effort, are technically wages, for wages are the direct compensation of the worker for his toil and necessarily come from what he produces. Wages must be determined by production, for, if the worker receives less than he produces, he is defrauded: if he receives more, then someone else is defrauded. But now another factor enters the picture.

One man has salvaged from the wreck a few tools, and seeing that fishing will be more productive in deeper waters, he builds a boat. Finding that from it he can bring in twice the catch of those who cast their lines from shore, he lets others

use the boat in return for a share in the fish caught while he builds another boat.

Fishing from the shore, they catch ten fish a day, and from a boat, twenty; it will then be fair for the boat-owner to have perhaps five fish a day for the use of the boat. If the fishermen were to give him more, it might not pay them to bother with the boat; if fewer, it would profit the boat-builder more to continue to fish from shore or to use the boat himself. So now the boat is let every day to others and the ship-builder abandons fishing to devote himself to boat-building, and has become a capitalist.

It might appear as if this sharing of the fish caught by the fishermen with the boat owner vitiates the principle already stated, that the product of labor belongs to the worker and constitutes his natural wage, but there is no conflict. Now the worker and the boat builder are cooperating in fishing, the boat builder by supplying capital in the form of a boat, necessary if fishing is to be made more productive; and, since both cooperate in production, both should share in the product. We often think of wages as being paid by one man to another as compensation for work done, but the word should not imply any relations of employer and employee. In strict economic usage, wages include all the reward of productive labor of any kind, mental or manual, of brain or of brawn. Salary checks and professional fees are as truly wages as are the contents of pay envelopes, and the direct production of such an independent worker as a farmer, fisherman, trapper, or for that matter an author or an artist, constitute wages just as truly as do the contents of a pay envelope. In Adam Smith's words, "The product of labor constitutes the natural recompense of labor." For clear thinking we must rid our minds of any idea that only a "hired man" earns wages.

By accumulating the product of his toil in the form of boats, and letting others use them to increase the catch of fish, the boat builder is in receipt of five fish per boat every day. This is the interest he receives on his capital and gives us another definition: *Interest is benefit received from the use of capital.* And the interest is justified, for by the use of boats the fishermen's wages are increased; and only by sharing in this increase is the boat builder compensated for his labor. We can now amplify our definition of capital: it is wealth conserved and employed to aid labor and to earn interest. The interest is not necessarily paid by one man to another, for it is no more necessary to have a borrower and a lender in order to have interest than it is to have an employer and hired labor to have wages.

True capital always gives a return in increased labor efficiency no matter who uses the capital, and from this arises interest. If this is not attained, there is no object in accumulating capital, and the worker will prefer to spend his earnings for immediate gratification rather than to save and invest. The manufacturer figures the increased production of the better machine and knows what it earns for him. If the machine fails to earn satisfactory interest, his purchase was a mistake; and if tools prove to be no good, if a machine keeps breaking down, or if we lack the ability to use it, such supposed capital does not justify its name; and any business would do well to charge off from its books expenditures, carried as capital, when they fail to earn interest.

Very soon our colonists must have other things—more adequate and varied foods, huts, weapons, clothing, and warmth—so some gather firewood, some build cabins and some make fishing tackle or bows and arrows. They cooperate in meeting these needs, and while some fish, hunt or gather birds' eggs, others build shacks or make tools, supported meanwhile by the hunters and fishermen. They find it difficult to adjust their hours of labor, the division of the tasks, and the products of their joint endeavors; they agree that those who build huts shall have so many fish, so much firewood, so many eggs, and, by mutual consent, a certain quantity of these goods will trade for a fishing rod or a bow and arrow. We begin to have a primitive commerce, with fish or eggs serving as money—our standard of values and "the medium of exchange." But soon life becomes more complex and they seek to better their way of life.

We believe that, though injustice may sometimes result, it will be far less frequent and less disastrous if we leave prices, wages, and business policies generally to free bargaining, guided by self-interest, rather than to political machinery. As long as men are as they are, we shall not have perfection, but the difficulties will be fewer under freedom than under political domination; and there will be less corruption in government.

The interdependence of capital and labor, or of interest and wages, may be illustrated by a personal experience. Years ago on the banks of the Nile, the writer paused to watch the "drawers of water" operating their "shadoof"—that primitive device like an old-fashioned well-sweep by which they raise water for irrigation—hour after hour, day after day, week after week—monotonous and unremitting toil. Getting into conversation with a high-class Egyptian we thoughtlessly asked him why they did not use pumps and engines. With a smile he countered by asking:

"How much money would you invest in machinery to save four-cent-a-day labor?"

This simple story shows the complex relationship between labor and capital. If pumps, engines, and piping cost very little, it might pay to install them. Perhaps if the low-paid Egyptian peasantry were capable of making such things efficiently, it would pay to make and use them; but it does not pay to employ high-paid American labor to save four-cent-a-day Egyptian labor, although it may pay abundantly to employ highly paid labor to build machinery to save highly paid labor.

Perhaps, before going further, we should define interest more definitely. To the economist it means a merited share of production, toward which the capitalist contributes by supplying tools and equipment, enabling the worker to do his task more efficiently and more profitably. For it there is every justification.

The word interest, however, is sometimes used to describe exactions from the poor and needy, by the lending of money at exorbitant rates. Interest of this character, often called usury, should be distinguished from interest on a loan used to buy capital to aid in production. Usury is generally at an excessive rate and it is extorted from those in acute distress. There may be something to be said for fair interest even on a loan of this character, since the lender foregoes the use of his money for investment in capital; but this does not justify excessive interest which we think of as usury.

These are considerations primarily of mortality, generosity, and charity and outside the realm of pure economics. When we speak of interest, we refer to what is the share of production which goes to compensate those who by self-denial provide capital to ease the burden of labor.

There is a tendency to undervalue the contribution to production made by the capitalist, explained perhaps by a human failing to realize the value of past labor and self-denial which capital has cost. We exaggerate the value of the labor of today, which we can see and which we may perhaps perform, but we forget about labor that has gone into the production of the capital which we use. Another explanation of failure to recognize the importance of capital lies in the fact that, generally, only the industrious and thrifty accumulate capital; and these very real but often unrecognized virtues are seldom appreciated, especially by the lazy, shiftless and improvident. The very quality of saving and accumulating means that the capitalist amasses some wealth and often arouses envy in his less far-sighted neighbor. Then,

too, as a consequence of a thrifty, industrious and perhaps a hazardous life, the capitalist often leaves a substantial estate to heirs who may have done little or nothing to earn it, and it is natural for the worker to resent a goodly part of production going as interest to those who play no part in production. This is, however, a question of the ethics of inheritance, quite apart from the question of the ethics of interest, and of it more will be said a little later.

As an example of this attitude to capital, we quote a letter from Miss Mary S. McDowell, published in the *Friends Intelligencer*, in which the writer speaks of the stockholders of a company—of those who furnish the capital—seeking to “get something for nothing” and saying that “they take no part in industry.” This is simply not true, for surely those who supply the tools and machinery contribute much. Miss McDowell asks, “Is it Christian to own capital and make profit from our brother’s labors?” This question has unpleasant implications, but all economic progress results from profiting mutually by each other’s labors. Without team play there can be no cooperation, no specialization, no division of labor, no trading, or buying and selling, and economic life would stagnate. The only alternative to interest is that the worker should profit by having tools, machinery, and buildings produced for him by others, who receive no compensation for rendering this most valuable assistance. Should one man be forced to build a boat for another to use, and receive no reward for life and labor expended in its production?

This attitude of mind betrays a failure to see clearly what capital is and a confusion of capital with money. The capitalist is not always—nor usually—a wealthy man. If we remember that the tools of production are capital, it is quite conceivable that much capital is often owned by workers in moderate circumstances. The dressmaker’s sewing machine, the kit of tools of the plumber, carpenter, or electrician, the automobile of the country physician, and the instruments of torture of the dentist are all of them capital. Surely no one would resent the craftsman receiving some compensation for having saved and acquired the implements of his art, nor would we question that there is good reason for paying more to the worker who does a task for us with his own equipment than we would pay to the man for whom we had to buy or hire tools.

Generally, capital and interest are put in one bracket and labor and wages in another; but both wages and interest are the product and reward of labor, although they take quite different forms.

Wages generally satisfy immediate needs, but capital returns future interest to its owner and from it he receives little immediate satisfaction. This he foregoes for a deferred, prolonged and generally greater return in interest. We must recognize the identity of origin of wages and capital, both the product of labor, but we must also realize the difference between a reward which satisfies today's desires and something which we cannot eat, drink, or wear but which will bring in future benefits—and the problem still remains of the just division of the benefits which, in interest, are the reward of capital, the product of past labor, and a wage which is compensation for current labor.

There can be no question that sometimes the capitalist receives more than is just. He may have something of a monopoly. Our boat builder may own the only site on the island suitable for his operations or he may enjoy a temporary monopoly through our patent laws, devised to give the inventor the exclusive benefits of his invention for a period of years. But the fishermen too may create a monopoly by organizing a union. Such combinations occur quite as frequently among workers as do "conspiracies in restraint of trade" among capitalists, and, as long as men are as they are, occasional evils probably cannot be avoided.

The tremendous part played by capital will be appreciated on a moment's thought, or a visit to any great industrial plant will give some idea of the enormous investment in buildings and equipment necessary to industry. For progress, expansion, and raising our standard of living, a constant increase of capital is necessary, and *interest rates must be high enough to make it worthwhile to save and accumulate*. Most of our great investments and developments were first regarded as interesting toys of no practical value and of no economic use. Their development was the work of courageous souls with vision, who took a chance. As we shall see when we study taxation, our policies keep many a wealthy man from taking the hazards of investment in new enterprises and slow down seriously the development of new capital.

For the "working man" to object to liberal payment to those who furnish capital is short-sighted folly, for he profits by generous compensation to labor whether it be in wages or in interest. He finds broad employment in production of capital, as in building operations and in manufacturing machinery, and again he profits by the higher wages which the use of capital makes possible, as we see in the case of the fishermen. Almost always

the highest wage scales are found in industries using the most capital, because aided by capital, the productivity of labor is greatly increased.

There is also justification for interest in the law of nature. The plant grows and bears seeds and gives rise to hundreds of new plants: the little sapling grows into a mighty tree: wild-life increases and multiplies. The little pig becomes a big hog, the little calf grows into a cow and has other calves, and so there is a constant tendency for things to grow, to increase in value, and to multiply. In the farmer's occupation he gets the constant benefit of this increase of nature, and thus nature returns interest to us. In a way, all wealth is interchangeable, for one form may be traded for another. Will men accumulate and store up the product of their labor, say in fishing boats, if these boats earn no return, when they can just as easily invest their labor in setting out fruit trees or in caring for flocks which will automatically increase in value?

There is also the time element: we often feel aggrieved when we must wait for the satisfaction of our desires, and generally the thing we want is worth more today than tomorrow. A snow shovel is worth more, and we will give more for it, in December than in March, and the reverse is true of the lawn mower. Perhaps because of the transitory nature of life, time is often a real factor in setting values, and again and again we see cases of those who have struggled long to accumulate a fortune, which, by the time it is amassed, profits but little. It is too late to travel; we are too old to enjoy the pastimes for which we have leisure only as we get older, and often the companionship in which we had hopes to enjoy these things is a thing of the past. The writer recalls a conversation with one who had started life as a farm boy and ended as president of one of our greatest banks. He said, with rather a bitter chuckle, that he was not allowed to drink champagne and then added, "And isn't it tough that, until the doctor forbade me to drink it, I couldn't afford it, and now that I can afford it, I can't have it?" That's the way life often is. "We want what we want when we want it," and, if we have to wait, we feel that somebody owes us compensation.

During the great depression we heard much of "idle capital," but what was generally meant was idle money—money hoarded, lying around unused and uninvested. True, idle capital sometimes means closed factories and idle machinery, but often what we mean by idle capital is that money is not invested in capital because of shaken faith in government, uncertainty of the times,

and doubts of the future. If it seems inconsistent to say that the shovel or the typewriter is capital even when not in use, but that uninvested money is not, note a difference. There is every expectation of immediate restoration to productive use of tools and instruments, but cash is another matter. It may be invested and become capital or it may be spent on consumption goods, but the spade and the typewriter have little or no place in the world except as capital. This is not a mere quibble, for it is a very common experience to see funds, which have been considered as capital, dribble away in covering business losses, in foolish experiments, or perhaps in extravagant living. Of course we can sell the spade or the typewriter, in which case they would cease to be capital; but, when temporarily laid aside, we believe that their nature is not changed though they become temporarily inactive. A wise political thinker once defined a stable government as one under which money would seek investment at a normal rate of interest.

This brings us to a difficult question, illustrative of the lack of precision and accuracy of definition of terms in economics in contrast to the more exact sciences. We have said that money is not in itself capital, although it may be exchanged for tools and equipment; but how about what the business man calls "working capital," meaning the cash or credit sometimes loaned by one man to another, or perhaps accumulated, to provide for current expenses, until we have a considerable volume of our finished product actually selling on the market? Such funds, often represented by bonds, notes or even stocks, procured as will be outlined in subsequent chapters, are often necessary to buy materials, to provide quarters, to pay rent, to meet bills for light, heat, power, and a hundred needs of a new enterprise, to meet payrolls during organization, preliminary research, and perhaps to advertise and develop a sales force.

We believe that funds, necessary to an enterprise to "get going" and to start production, are capital: they are essentially tools of production. Whether in the form of cold cash or credit matters little; they are in active use, they are a factor in production, and they earn interest. They are therefore capital; but idle money, hoarded, unused, and uninvested, is not actual capital until it finds its way into investment in the productive process.

The vital importance of capital is not always appreciated: it is a tremendous force in economic life. When times are uncertain and money is hoarded and, instead of being invested, lies under the mattress or in safe-deposit boxes, then progress stops

and "times are hard." When we come to a discussion of taxation, we shall see how present policies discourage the accumulation of capital, giving rise to a dangerous situation and leading to stagnation of industry.

The amount of capital needed in modern industrial life is far greater than many appreciate. A rough idea of how much capital is required to give every man a job can be gathered if we divide the total investments of a corporation, its true capital (buildings, machinery, equipment, but excluding land) by the number of employees. Much depends on the nature of the industry, but it will be found that a five- to ten-thousand-dollar capital investment is generally necessary for each worker employed, and frequently far more.

In recent years there has been an enormous increase in the cost of necessary capital per worker, both because industry must be more highly mechanized to prosper and because, with inflation, everything costs much more. A steel company reports a capital investment of \$14,000 per employee, but today replacement cost would be \$60,000. In an intricate chemical process, one company reports a capital investment of \$100,000 per worker. These great investments must earn proportionate interest or they will not be made: industry will stagnate and all will suffer, and *first of all the wage-worker*.

We have seen how capital increases the production of labor and raises the wage level. This is evidenced by the fact that countries where capital is extensively employed show the highest standard of living and the largest income for the worker. The relation is seen in contrast between industries which are highly technicalized and crude hand industries: the workers in a watch factory or an automobile plant receive wages far higher than basket weavers. A great danger of the present time, when interest rates have fallen so low that capital often earns a small return, and, when the future looks precarious, lies in the fact that we are ceasing to develop and accumulate capital as we should to keep up a growing, thriving industrial life.

If the interdependence of labor and capital were better understood, there would be far less "labor trouble." There is a feeling among many that the introduction of labor machinery puts men out of work, which is very far from the truth. Of course the introduction of machines does put some men out of jobs—generally men who are too old to adapt or to learn a new trade—but this is true of all industrial change and development. The problem of the older worker, displaced by machinery, changes

in markets, or for a hundred reasons, or perhaps just prematurely shelved, is a real one and deserves study; but it will not be solved by sticking to old machinery, obsolete methods, or by general inefficiency, and refusal to progress with the times is no answer. Introduction of labor-saving machinery, or of capital in any form, increases opportunities for employment and the earnings of labor, and it is the worst kind of policy for so-called labor interests to oppose the introduction of machinery.

That capital increases opportunity, employment, and wages will be obvious on a minute's thought. Could anyone imagine that, if we had no railroads or automobiles, there would be as many men employed in transportation as there are today? Before the linotype came into general use, there were thirty thousand compositors in the printing plants of the United States which now employ over 200,000. Before the typewriter came in, about two thousand persons out of every million were engaged in office work: now thirty-three out of each thousand follow office callings. The International Business Machines, a pioneer in accounting mechanisms, states that in 1890 there were one hundred and fifty thousand bookkeepers and accountants, and forty years later nearly a million.

Think it out for yourself. How do you suppose the numbers employed would compare if, instead of printing, we were making all our records and doing all our writing on the skins of sheep with quill pens? Contrast the number of scribes who would work that way with the numbers engaged by great paper industries, type foundries and machine manufacturers turning out printing machinery, and the great army of workers employed in printing and affiliated trades. Beyond question the result of invention and the use of capital has been to increase the volume of printed matter and the numbers employed in producing it. And yet, we read an article in one of our greatest newspapers headed "More Machines Held Threat to Office Workers," reporting an address in which the speaker complains of office machinery restricting employment. Apparently he, although a professor, has no conception of the vital part played by mechanization in the success and expansion of industry, profitable alike to employers and employees.

### QUESTIONS

What are the three elements of production?

Which two are always necessary to the production of wealth, and which is nearly always necessary?

Does the capitalist contribute to production?

What do we call that part of production which is payment for the use of capital?

Is interest an indirect compensation to labor?

Do wages include all the direct compensation of labor—pay envelopes, salary checks, professional fees, or direct production as in the case of the farmer?

Does labor include all productive toil whether of head or of hand, mental as well as manual?

Are wages necessarily paid by one man to another?

Is it wrong to profit by another man's labor?

In all trading, do both parties, buyers and sellers alike, expect to profit? If not, why do they trade?