

## CHAPTER XV

### CAPITAL

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Land, or natural resources, and labor, or human energy, are spoken of as primary essentials in production because both must be present in every productive operation. The fish in the stream and the coal on the mountain side cannot be converted into wealth if there are no people to catch the one or to pick up the other. In the same way, if there are no fish to catch and if there is no coal to mine, labor will be helpless and unable to produce wealth.

**Character of Capital.** — There is, however, still another factor in production. While land and labor are the primary essentials in any productive operation, there is a secondary essential, — capital. Capital is spoken of as secondary because it is the result of the applica-  
 tion of labor to natural resources. If all the capital in a community were destroyed, it could  
 be replaced by the application of labor to land. In primitive times little, if any, capital really existed. What capital we now have, therefore, is the result of man's utilization of natural resources; it is the offspring of land and labor.

*Its importance:  
In primitive times.*

Modern industry, however, requires the presence of all three factors. To-day, capital is as essential to production as land and labor. All modern productive operations are capitalistic. It is impossible to conceive that a present-day productive enterprise should be carried on without the aid of capital. The old primitive methods have  
 gone forever. The spectacle of a savage catching fish from the brook with his hands, *i.e.* without capital,

*In modern times.*

has no modern counterpart. Hooks and nets, the products of past industry created by application of labor to land, have now become as essential to fishing as the fish and the man himself. Therefore, to catch fish, *i.e.* to produce wealth by creating utilities in the fish, capital is required.

This is one of a thousand ways in which the products of past industry aid man in producing wealth. Capital is an integral element in industry. Under capital are included: (1) improvements on land; (2) roads, railroads, telegraph and telephone lines; (3) tools, machines, and mechanical appliances; (4) raw materials, and partially manufactured materials to be used in later manufacturing. All these constitute wealth and all help man to produce additional wealth. Capital, therefore, may be said to be that part of wealth used to produce more wealth.

All wealth, then, is not capital. The test of whether or not wealth is capital is the way in which it is used. If a nation or an individual has wealth and consumes it unproductively, then this wealth is not capital. The man who dissipates a fortune prevents the employment of so much wealth as capital. The Pyramids of Egypt, although representing a vast outlay of materials and labor, are not capital. Wealth used unproductively, whether by a man or by a society, is not capital.

Wealth may, however, be consumed productively. The wealth represented by railroads, machinery, and buildings is capital because it is being used to produce wealth. Capital, therefore, depends upon the productive use of wealth. A man with a fortune, instead of squandering it, may invest it in a business and thus convert it into capital.

Every individual possessed of wealth has, therefore, two choices open to him. He may use it productively or unproductively. If through extravagant entertaining and sumptuous luxury the man uses his wealth unproductively, he has nothing to show for it except gout and indigestion. On the other hand, if by enlarging his plant and installing new machinery he uses his wealth productively, he not only keeps his original wealth but adds to it through production. *The final consequences.*

One of the first questions that arise in a discussion of capital is the query, "Is money capital?" Money is a product of past industry and is used to assist in production. In order to prepare it for circulation, the mint, equipped with expensive capital, has expended labor in turning the bullion into its present form. Furthermore, money is an absolute necessity in productive operations. The grocer needs money to make change; the manufacturer needs it to pay his employees on Saturday night; the consumer needs it to purchase bread from the baker and milk from the dairy. In other words, money performs a very essential part in aiding modern production. If money, then, is the product of past industry and performs a part in production, it must be capital. *Is money capital? The argument.*

But these arguments do not apply to all money. If a man were to receive one hundred dollars and put them in a stocking behind the chimney, this money would not be capital because it would not be assisting in production. It is, therefore, fair to conclude that, as with other commodities, money may be capital or it may not be capital. The question as to its status at any given time may be determined only by knowing whether or not the money under consideration is being used to assist in production.

This statement represents the older view of capital, according to which things assisting in production, whether directly or indirectly, were included in capital. According to the newer view, in order to be capital a good must aid directly in production. The ax used by a woodman to cut down a tree is capital because it is the product of past industry and is being used directly to assist in future production. On the other hand, the breakfast eaten by the woodman assists production only indirectly and therefore is not capital. Economists are accepting the latter view more and more, so that money in order to be capital must assist directly in productive operations, — that is, it must be used by the grocer to make change or by the employer to pay wages.

*The newer point of view.*

As ordinarily used, the term "capital" refers to a more or less unchangeable thing. A business may be capitalized at fifty thousand dollars for twenty years. During this time, however, every tool and machine used in the work may have been replaced by new ones. The "capital" has remained the same, but the "capital goods" — the various elements making up the capital — have been worn out and replaced. In this fact lies an important distinction. Capital is the intangible, continuous thing which represents the total value of the wealth-producing products of past industry employed in the production of new wealth. Capital goods, on the other hand, represent the individual machines, engines, and other tools of production which wear out in the course of time and are replaced. Capital is a constant factor. Capital goods are constantly changing.

*Capital and "capital goods."*

**Origin of Capital.** — Even within comparatively recent times society possessed only a little wealth, nearly all of

which was needed for present consumption. In such times, therefore, capital could be accumulated only by saving; that is, instead of consuming all that he received, a man abstained from consumption and consumed but a small amount of what he would otherwise have used up. When he had saved sufficient wealth through this abstinence, he used it to secure some new tool, such as a windmill or a sailboat, that would increase his power to produce wealth.

*Capital results from saving:  
How men first saved.*

As a result of this early necessity for saving, the idea was spread through the whole race, by means of the schools, the churches, and other means of instruction, that it was necessary to save. The consequence of this education was the development of a strong desire to save. To-day this attitude is perhaps best illustrated by the immigrant who, coming to the United States, lives on a low standard in order that he may have a competence for his old age.

*How the habit spread.*

Saving has thus become one of the virtues, yet few who save really understand the connection between saving and capital. A child receives a five-dollar gold piece from its grandmother and takes it home in great glee. Acting on the advice of its parents, the child puts the gold piece in the savings bank with the implicit belief that the same five-dollar gold piece will be returned by the bank whenever the demand is made upon it. But the bank is not doing business in this way.

*How savings are capitalised.*

The bank acts as a loan agent. For example, a prospective shoe manufacturer wishes to start business, and the bank, upon being furnished proper security, lends him fifty thousand dollars. The child's five-dollar gold piece, together with hundreds of similar deposits, goes to make up

this loan. With the money or credit thus secured the manufacturer begins work. He builds his factory, employs labor, and enters the shoe market, using his wealth to produce more wealth. At the end of a year he has done such a successful business that he has made fifteen per cent on his original investment. Out of this fifteen per cent he pays the bank six per cent for the use of its money or credit, and out of this six per cent the bank pays the child three per cent or fifteen cents for the use of his five dollars. In this way, every one engaged in this capitalistic transaction has been the gainer.

Formerly this was the most general method of capitalizing savings. The bank acted as a loan agent for any one who wished to secure money and who could furnish reliable securities as collateral. Its loanable funds were secured from a large number of people in the community, each of whom wished to invest a small amount of money, but no one of whom was sufficiently well off to be able to lend a large sum such as a manufacturer would require.

There were, to be sure, cases of individuals who had saved considerable sums; and when Farmer Williams wished to build a barn, he went to Farmer Jones and borrowed five hundred dollars on a mortgage. But this was an uncertain way of carrying on an enterprise. Every community did not have a Farmer Jones. Besides, as industry grew, neither five hundred dollars nor five thousand dollars was enough to start a business. Even though he had them, no person wished to lend the large sums necessary to begin a modern business enterprise.

To meet this contingency a new plan has recently been developed and perfected. As a result of this new method the bank is often eliminated from the transaction. The

shoe manufacturer decides to begin business, but, instead of going to the bank with his collateral and borrowing fifty thousand dollars, he incorporates his business; that is, he secures a charter, a board of directors is appointed, and stocks and bonds are issued. These stocks and bonds are then sold to the people in the community who wish to invest their money and who do not wish to engage in business themselves. Thus, without the intervention of the bank and with the bank's profit eliminated, the business man secures his capital directly from the person who has saved it and who desires to invest it. At the same time, no one is called on to invest a large amount. A company may be capitalized for ten million dollars, but an individual, by buying merely one share, needs to invest only fifty or one hundred dollars in the enterprise.

Trust companies, insurance companies, and, in a limited sense, building loan associations likewise exercise the functions of the bank and act as loan agents for investors and borrowers; but in recent years the corporation, by selling stocks and bonds and paying good rates of interest, has often done away with the intermediary banking establishments and gone directly to the individual saver.

When wealth is scarce and living precarious, man must scrape and save in order to put something aside for the future. But the problem of capital may be looked at from another standpoint. To-day, when wealth is plentiful, man's ability to accumulate capital may depend not so much on saving as on efficiency. For example, a man earning ten dollars a week and desiring to become a capitalist has two courses open to him. He may lower his standard of living and, by consuming less than he requires, save two dollars of his weekly wages. Or,

Capital may  
result from  
efficiency.

by hard work and additional training, he may increase his efficiency so that he now has an earning capacity of twelve dollars a week. This extra two dollars will then form a fund for investment.

**Kinds of Capital.** — We have yet to examine the different kinds of capital and the problems arising from them. Capital is described as “circulating” or “fixed” and as “specialized” or “free.”

*Circulating and fixed capital.* Circulating capital is capital which is destroyed by a single use; such as coal, and other raw materials. In contrast to this, fixed capital is capital which can be used for a considerable length of time without being destroyed. Examples of fixed capital are locomotives, factories, and dump carts.

Again, capital which is molded into a form which can be used only for a particular purpose is called specialized capital. The degree of specialization may be great or moderate. For example, a press which will stamp out twenty-dollar gold pieces is an extreme form of specialization because there are but a few places in the world where twenty-dollar gold pieces are stamped. A crane built to carry fifty tons is a less specialized form of capital. The crane may be of service in any one of several industries, while the coin press can be used in but one.

In contrast to this, capital is said to be free when it exists in a form that may be used in a large number of industries. For example, pig iron is free capital. It can be converted into carriage springs, bicycle pedals, drills, car wheels, and hundreds of other things. The ordinary machinist’s lathe is somewhat specialized, but it would be considered almost free in contrast with a lathe made to turn a ten-thousand-pound shaft. When capital is usable in

only a few ways, it is specialized; when, on the other hand, it is usable in many ways, it is free.

One of the great problems in the development of capital is to determine how much capital should be utilized in the form of fixed and how much in the form of circulating capital. Wealth in the form of fixed capital cannot of course be converted immediately into circulating capital, and the progress of the community may thus be seriously hampered by the lack of a sufficient amount of circulating capital. In the early part of the nineteenth century an enormous amount of wealth was converted into canals, — a form of fixed specialized capital. Many more canals were built than the traffic warranted, and the wealth sunk in many of the canal projects was completely lost. Similarly, one of the causes of the panic of 1873 was the conversion of a large amount of the wealth of the community into fixed capital in the form of railroads. As it turned out, too great a proportion of the country's wealth was put into this form of capital and a business tie-up resulted.

In the same way, if too large a proportion of capital is turned into specialized goods, it is clear that industry will suffer because of a lack of capital which can be diverted into the kinds of production that will meet the changing demands of modern society. The mobility of capital in the United States, that is, its ability to change from one use to another, is shown by the growth of the automobile industry. In 1900 this industry was insignificant. In 1908, it was employing a capital of \$250,000,000 and a labor force of eighty thousand employees. So long as capital is sufficiently mobile to flow readily from one industry to another, or so long as there is sufficient

wealth to form capital for new industries, the industrial conditions in the community are sound.

Since modern production is so intimately connected with the maintenance of capital, the question of its management is of vital importance. Capital is brought together in a corporate form by a great aggregation of small investments. If, therefore, this capital is managed, not in the interest of stockholders, but in the interest of officers of corporations, the whole community will be in danger, because the loss due to mismanagement will fall on the rank and file of industry as well as upon the stockholders. The welfare of the United States is intimately dependent upon wisdom and integrity in the management of capital.

*From mis-  
management  
of capital.*

#### TOPICS FOR CLASS DISCUSSION

1. Is the lead pencil with which you take notes capital?
2. Is a child's slate capital?
3. Why do we put our money into railroads rather than into pyramids?
4. Is money capital?
5. Distinguish accurately between natural resources and capital.
6. Distinguish between wealth and capital.
7. Make a list of things which are capital.
8. Are the following capital: pig iron, a plow, candy on the shelves of a retail dealer, a package of tobacco belonging to a laborer, coal?
9. Does capital really produce? How?
10. Name some employment, if you can, in which labor produces without capital.
11. Are securities capital?
12. Why do Americans look contemptuously upon immigrants who maintain a low standard of living in order to save?
13. What prompts the average man to save?