Disproves George well. (Tho not perfectly) Then gets inadequate.

The Nature and Causes of Interest

By PAUL PEACH

A Georgist discussion of interest should do three things:

1. It should deal with George's theory and indicate agreement or disagreement.
2. If George's theory is not accepted, it should offer an alternative theory.
3. If an alternative theory is offered, its conformity or non-conformity to the rest of George's theories should be brought out.

George properly rejects Bastiat's suggestion that interest arises from "'the power which exists in the tool to increase the productiveness of labor'" (P & P 179), reasoning correctly that if this were the source and reason of interest, the rate of interest must increase with the march of invention—which is not the case. Moreover, on the following page, George gives what is to me a very penetrating discussion of interest to the extent that it can be said to arise from inanimate capital; this paragraph, which begins, "And I am inclined to think that if all wealth consisted of such things as planes . . ." should be read in this connection. (P & P 180.) George recognizes that even without the inducement of interest, there would still be accumulation; indeed, he says in so many words that the hope of receiving interest is not the main motive for saving. He also recognizes that there might still be borrowing and lending, with mutual advantage to both parties, even though no interest were paid.

It is in the following paragraph that George makes his basic distinction between animate and inanimate capital by which his own theory must stand or fall. If it is competent to distinguish between the reproductive forces of nature on the one hand, and all the non-reproductive forces on the other, the "natural usufruct" theory merits further examination. If it is true that there exists "something which, though it generally requires labor to utilize it, is yet distinct and separable from labor" in a sense in which we can not say the same of the forces of chemistry and physics, then there may be something in what George says.

George says, "If I put away wine, at the end of a year I will have an increased value, for the wine will have improved in quality." Böhm-Bawerk uses a similar illustration. Let us see.

In the first place, we need not assume that the change in the quality of the wine is due to any biological activity. Even if fermentation is complete, and the concentration of alcohol such as to provent further growth, there will still be an increase in the quality of the wine (as a rule) due to slow chemical changes which proceed independently of biological action. We have the same thing when raw whiskey is stored; after a few years' aging, due to purely chemical and physical changes, the liquor is much improved. No form of life can survive in alcohol stronger than about 15%—30 proof.

We see, then, that increments to wealth which take place "by mere lapse of time" do not depend upon the presence of any biological activity. Any theory which traces interest to such increments must assume the burden of establishing the validity of a distinction between increments due to biological action, and increments due to non-biological forces of nature. George does not recognize the need for doing this, and it is not easy to see how the difficulty can be surmounted.

We have seen that there may be an increase of value through mere inorganic change, without the interposition of life. It is easy to demonstrate that the converse is also true—there may be an interposition of living forces without any increase of value.

On page 181, George gives as examples bees, sheep, swine or cattle, but unconsciously commits the double error of begging the question and neglecting an obvious application of the law of rent. He says, "Supposing that **in a country adapted to them,** I set out bees" and "**where there is a range,** I turn out sheep." In the underlined passages George assumes the very thing he seeks to prove, hence the petitio principii. I might as easily prove that all wealth results from digging holes in the ground by saying "supposing that, **where there is an oil field,** I drill a well." Obviously, the increase of the bees and cattle is due, not to the vital forces of the animals, but to the special suitability of the land used; if it gives rise to anything at all, it would be rent. To turn out sheep or cattle on **random land,** instead of **selected land,** would be in most cases to doom them to speedy extinction. In most of the remaining cases the species, though managing to survive, would become feral, reverting to the land—that is, to the economic status of a wild animal.

All this assumes, of course, that no labor is performed upon the animals. If we ride herd, build fences, shoot wolves and other enemies, maintain a watch against the encroachments of disease, or provide emergency food and shelter, the situation is changed, and in order to maintain George's theory we must fall back upon his own argument (page 181) that even though labor is indeed expended, there is yet an increase "over and above that which is to be attributed to labor."

This is mere bald assertion, without a scintilla of logic or evidence to support it. In no productive process is it possible to distinguish between that part of the product due to labor and the part due to capital. How much return may we attribute to labor? Unless we can answer this question, we cannot answer questions about an alleged excess. In order to maintain the position of George in this matter, we must first of all accept a labor theory of value and a value measurement for wealth —then we may speak, as Marx does, of an "average amount of socially necessary labor time" and reason from that to a possible excess. The fact is, of course, that neither the value nor the quantity of wealth produced has any necessary relation to the amount of labor expended. The general rule is that with increasing efficiency in production, the **total quantity** of wealth increases, while the **value** of the total product may increase or decline, all with the use of the same amount of labor. All capital increases the power of labor to produce wealth; this property is not peculiar to capital used in the reproductive modes. As for the reproductive modes yielding an increase greater in proportion than that yielded in non-reproductive modes, this is equivalent to saying that a manufacturer works harder than a farmer. Is it true?

These arguments may be summarized as follows:

1. Increase of value by mere storage is not peculiar to capital used in reproductive modes. If such increase is the source of interest, we cannot confine it to reproductive origins.

2. Capital used in reproductive modes does not in general increase except (a) on unusually favorable land or (b) by more or less constant application of labor.

3. There is no basis in either fact or logic for the assertion that capital used in reproductive modes yields a return which exceeds that attributable to labor, while capital used in non-reproductive modes yields no such return.

* * *

Can we derive a sound theory of interest? I think we can. In fact, George has done it for us, at least in part. It is a great pity that, after nearly thirty pages of bad logic which finds its culmination in an indefensible statement of a bad law of interest on page 203, P & P, George immediately pulls himself partially out of his own quagmire with the paragraph which stands at the end of Chap. 5, Book 3. If he had only ventured a bit further along this road! A little more, and he might have come to the conclusion that there isn't any law of interest; that interest isn't even an avenue of distribution; that to distinguish capital as a factor of production is no more and no less meaningful than to distinguish between a man's muscles and the man himself. One is part of the other. When George wrote, "Capital is but a form of labor, and its distinction from labor is in reality but a subdivision, just as the division of labor into skilled and unskilled would be" he laid the groundwork for a sound theory of interest. We need only build upon this as a foundation.

To show how capital is but a form of labor, let us consider a party of tourists who encounter a hunter in the woods. For a consideration, the hunter undertakes to cook them a meal. He gathers sticks and builds a fire.

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Where'd Steele go?

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These sticks are capital. The meal which the hunter eventually serves to the tourists is wealth, in the production of which the stick-capital is not merely utilized, but consumed. This disappearance of capital is characteristic of all capital production, though of course economic disappearance need not mean physical disappearance.

Now, assume that the hunter has never heard of interest. Undertake to explain to him that the meal he produces is not merely wages, but wages and interest. (We assume marginal land, but the assumption is for convenience, not necessity.) I should not care to undertake the job myself. He will reason, correctly as I think, "At the beginning there was a dead rabbit. At the end there was hasenpfeffer. The change was solely the result of my own efforts. In the course of effecting the change something appeared (the sticks) and disappeared. All production save the most primitive is like that. Of course I needed the sticks; I needed the rabbit too, and the knowledge of how to make fire, and so on. Granting that a distinction can be made, why make it? I'm getting along swell without."

If indeed, as George recognizes, interest is but a form of wages, or (more accurately) capital is but a form of labor, then why indeed make the distinction? The answer is obvious, once the question has been put in this form; the distinction is necessary **when, and only when,** the use of the capital results in a **distinguishable claim** upon the product. This happens only when a man uses capital that does not belong to him —when he uses borrowed capital. Interest is a concept which cannot even arise in the mind until the practice of using borrowed capital has become an accepted part of the community's routine.

In order to see how this might come about, consider the hypothetical case of a world in which the common ownership of land rent has been practiced since the beginning. In this community there is no involuntary poverty. What a man has is what

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he has produced, neither more nor less; this includes his share of the rent fund, regardless of the particular manner in which it has been distributed to him. There is no restriction upon his production; he may, if he wishes, work long hours and produce less. Our first problem is to describe a set of circumstances such that this man will borrow the capital of someone else, instead of producing or using his own.

To state an individual case is simple enough—a temporary disability resulting from illness or accident would account for it. So does a housewife borrow sugar and eggs from her next door neighbor, with the implicit pledge of mutuality in accommodation. But to evolve an explanation for widespread and customary borrowing and lending of capital in an economy of plenty is like supposing a customary borrowing back and forth of sugar and eggs, when there is ample opportunity of using one's own. I borrow eggs rather than walk some distance to the store; would I borrow them when all I need to do to obtain my own is push the button of my egg-laying machine? Would I pay for the privilege of using borrowed eggs? Why should I?

bull—

how about gigantic enterprises joint stock companies

But if I needed the eggs right away, and had no better way of getting them, I might not only borrow, but agree to pay a bonus to the lender. Here, I think, we have the essential ingredient of interest—a temporary emergency so that the mere possession of wealth is not enough; the possession must be **now.** There must be what Oppenheimer calls a unilateral urgency—an inequality of bargaining position which gives one party an advantage over the other. Then and only then will one party agree to give back more than he receives from the other.

Good!

something missing

(What I consider an almost conclusive argument can be made out for the proposition that in a free economy there would still be a unilateral urgency, but that the positions of lender and borrower would be reversed, the capital bailment assuming the character of a **locatio operis faciendi,** instead of (as at present) a **locatio rei.** Then the lender would pay a bonus to the borrower—the so-called "negative interest." The complete argument is too long for inclusion here.)

Doesn't say (what?)

The subsequent argument on the nature of interest need not be elaborated. The theory that interest arises from inequality of bargaining position, in which the borrower is at a disadvantage as compared with the lender, explains, as I see it, everything we can observe today. If we remember that it is labor that employs capital, not capital that employs labor, we realize that it is labor that pays interest to capital, not capital that pays wages to labor. It is common observation that in our present society the ownership of capital, when not identical with the ownership of land, is usually the result of coincidence, luck, accident—anything but special merit or produtiveness. Without access to land, labor cannot produce its own capital; with wages depressed nearly to the minimum, it cannot make any important accumulation. It has no choice but to borrow. But even so, interest rates are prevented from rising by constant accumulations of capital that pour into the market, despite the meager promise of return.

SUMMARY

Interest arises when, and only when, the possession of capital confers a bargaining advantage. In general, whenever there is borrowing of capital, and one party has a bargaining advantage, we may expect a bonus to be paid by the party at a disadvantage. No law of nature tells us that the advantage must always be with the lender. The distribution of wealth is into rent and wages, not into rent, wages and interest. If the need for borrowed capital becomes small in proportion to the supply of capital available, we may expect "interest" to become negative, forced by the competition of would-be investors to a point approximately equal to depreciation and storage cost.

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armies and navies. Thus can the nation be strengthened against foreign foes who would re-introduce the system of exploitation, but under new masters. This, too, may be part of the explanation of the strength of Russia today as compared with its weakness in the days of the Czar and his landed nobility. Certainly something has been accomplished since that unhappy era, in industrial development and in modernizing, equipping and training a great army.

Or shall we rather say that all Russia's rapid accumulation of industrial equipment, all the mechanization of the vast Russian army since the Bolshevist revolution, are utterly unrelated to the destruction of landlordism and the diversion of landlord incomes to the use of the whole people? Shall we say that Russia would be no less industrialized and powerful if her workers had still to support in luxury a landlord aristocracy such as their fathers and grandfathers, through many generations, did have to support?

There is much vague talk about the great changes which the present war is bound to bring and the likelihood that after it is over there will dawn—for common folks—a new and better day. Who can tell? Not seldom, in the past, the aftermath of war has been violent reaction towards illiberalism, and the suppression or attempted suppression of all protest or criticism. And even if—this time!—there should be a spirit favoring reform after the war, what can reform amount to unless men understand the significance of the distinction between income earned by contributing to the productive process and income gained by **permitting** men to work and live on the earth? Perhaps, indeed, we shall find ourselves, soon, living in the Great Age, the age of radical and truly sigificant reform. But perhaps, instead, we shall see only inconsequential reform or no reform at all! Where is the prophet who will tell us—and truly—what we may expect?