Economic Interest Is Zero

Mr. M. S. Lurio, a trustee of the Boston Henry George School, commented upon the article by Dr. Harry Gunnison Brown on The Causation of Interest in part as follows:

"If it is demonstrable that economic interest (the riskless, assumed increment obtained merely by virtue of ownership of capital) is theoretically zero, vast superstructures of economic reasoning must topple. After the debris was cleared away, the full import of the Newtonian postulates of Henry George and of the laws of rent and of wages would be recognized, for they are the solid foundation for the proper structure of the science of political economy. Discussions of surplus value, saving and investment propensities, monetary manipulation would appear in their glaring speciousness. No longer would it be possible to find in an economic textbook (such as the one now used at the Massachusetts Institute of Technology) an early footnote that rent is like interest on capital and, therefore, needs no special treatment. Rent then would stand out for what it is, the income of a privilege."

THE SPECIFIC premises and concrete examples set forth so clearly by Dr. Brown in his article, "Henry George and the Causation of Interest" (Henry George News, October, 1948), enable us to focus our sights on the very essence of his argument as to the cause of economic interest. If, on his own ground we can show that the fundamental assumptions beg the question and have no basis in fact, we may get closer toward resolving this highly controversial subject.

Dr. Brown starts with "two vital facts." The first is that the use of capital is a "roundabout" process. The second is that its use involves "saving" and "waiting" and "sacrifice." On the surface, these are plausible and pertinent premises. Despite their several connotations, each generation of economists has borrowed and passed along the words "roundabout" and "saving," in this connection, generally without careful examination and statement of the limited senses in which they are applicable. The uncritical use of these words, as descriptive of the essential elements of production and the employment of capital, implies a necessary reward called economic interest.

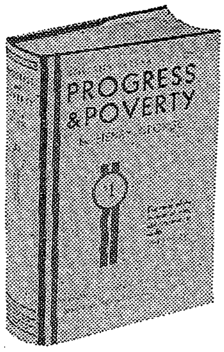
If roundabout means only that there must be a machine before that machine can be used, then we must agree. But see how much further Dr. Brown goes when he uses this word. "We can, in general, produce more, if, instead of making directly the goods we desire to consume, we *first* produce other goods—buildings, trucks, locomotives, fruit trees, etc.—from which, over a period of time, we can expect to get help in producing the goods and services we ultimately desire." The statement that one must have a machine before one can use it, is not the same as the statement that one must *first* divert his labor toward the production of that specific machine. Production of all things goes on synchronously, concurrently. "It is only necessary that there should be, somewhere within the circle of exchange, a contemporaneous production of sufficient subsistence for the laborers, and a willingness to exchange this subsistence for the thing on which the labor is being bestowed." *Progress and Poverty*, page 74.) The process is not roundabout in its superficial sense of longer, indirect, circuitous, delayed. Production is immediately improved.

Consider the concept of "saving." The fact that life goes on and that capital exists everywhere, shows that man, even under the many restraints imposed, can and does produce more than maintenance. But is not "saving" a misleading word to express the fact that the rate of capital formation exceeds the rate of capital dissipation? Capital is produced not to be saved but to be used — at once.

I submit that producers must accumulate capital always, in so far as they can, regardless of economic interest, but solely and sufficiently for the purpose of maintaining and maximising wages.

Let us refer to the example of the fisherman given by Dr. Brown. To be typical, we must not consider an isolated individual, because we are talking of an economic society. We must consider a number of people who fish part of the time as the best means of obtaining some of the food they need.

When it becomes apparent that a few logs fastened together will float as a raft and enable the fishermen to go farther out and catch more fish, one or more of their number, either for himself or for others, will spend some time building such rafts, while at the same time, he subsists in part on the fish caught daily in excess of the needs of the fishermen. No one has to store up a month's supply of fish and other foods so that he can first complete the raft. No patent laws prevent anyone from building his own raft or having it built for him. Even in the rudest beginnings, the process immediately involves risk and credit when one works at making things for another. Other things being equal, there is no reason why the raft builder can obtain more for his labor than the fisherman.



But when all use rafts and fish are relatively plentiful, the exchange value of fish must fall and less time will be devoted to fishing. Taking this into account, how can we assume that the owners of rafts, if they be different from the fishermen, can sit back and do nothing and continue to get fish or *their equivalent in exchange* from the users of the rafts, in such amount as not only to cover replacement but to give them something in addition called economic interest? Would it not follow, if such were temporarily the case due to disaster or other sharp dislocation (the risk-factor), that more rafts would soon be built until the owners of rafts obtained for their labor no more than fishermen, assuming equal quality and quantity of labor?

We have been talking of rafts and machines as if they were the only forms of capital. But as soon as producers accumulate inventory, such inventory is also capital. Here again it is obvious that inventory as a whole cannot increase unless subsistence needs are not only met but exceeded. We know that the division of labor requires the accumulation of inventory but this too is a gradual and evolutionary as well as a synchronous process.

The real point at issue is as to the cause, the incentive, the motive, the reward involved in the accumulation of both inventory and machines. Is it economic interest or is it the necessity resulting from competition with others who are also seeking to satisfy their desires with the least exertion?

With Dr. Brown's refutation of George's reasoning that interest is due to the reproductive forces of Nature, I am in full agreement. Where these forces are free and available to all, such as the aging of wine, price restores the balance with mechanical forms of production. Where these reproductive forces are localized on particular land, the excess product falls in the category of rent.

Briefly, let me summarize several lines of reasoning that converge upon and culminate in the conclusion that economic interest does not exist, as such. I do not say that economic interest tends to zero but that it is exactly equal to zero, *under riskless conditions.* Pure theory requires idealized conditions, just as a point has no dimensions, a line has one dimension, etc. in theory though there is no such thing in reality. Yet can it be denied that pure theory underlies our greatest technological achievements? If we first assume that risk is non-existent, just as is done with friction in the science of mechanics, though we know that risk and friction are all-pervasive, we can separate the independent forces and set up the theoretical foundation upon which the forces of risk or of friction are superimposed.

First, two of the factors of production, land and labor, are unique and distinct categories, whereas the third factor, capital, is compounded of both land and labor. Parallelism would indicate that rent and wages are unique and distinct channels of distribution of wealth, whereas the share of wealth obtained by capital should be a compound of rent and wages (replacement), leaving nothing over to fall into a third non-correlating unique and distinct category of distribution called economic interest.

Another approach that supports the conclusion that economic interest is zero is George's ethical axiom to the effect that only those who sow, should reap. The existence of interest means that the owners of capital can obtain a share of the wealth produced without labor on their part, that is, without sowing.

A third approach is that the very same reasoning underlying the law of rent is applicable, not only to determining the law of wages but also in determining the law of interest. If the argument is based upon the fact that the holders of land can and do obtain the entire excess of production over the minimum required by least-skilled labor for subsistence (where all valuable land is taken up), then the very same reasoning leads to the conclusion that rent leaves only the minimum necessary to maintain capital, and that minimum is replacement.

Another is that if it is accepted that the pipe lines of production are theoretically always full and overflowing, then the supply of capital relative to demand is such as to permit no extra return to the owners of capital called economic interest.

One of the objections to the conclusion that interest is zero is that it would follow that those in the higher income tax brackets are getting negative interest or losing part of their capital. With this statement I agree, but it does not affect the conclusion. Income taxes are arbi-:ary confiscations based upon changing formuls purporting to represent ability to pay. They re not economic forces. Most of the tax cannot e passed on, just as the tax on land values canot be shifted. Thus, large capitalists are at a efinite, legalized disadvantage. That is why lere is a drying up of venture capital, for lere is no net gain in taking greater risks for igher returns. The sharply increasing tax rate n higher gross income discourages the taking f risk, for the gains after taxes are not comlensurate with the risk.

This is illustrated by the story, perhaps aporyphal, of the head of a large trust company ho is said to have remarked to his close riends, half seriously and half jocularly, that le function of his institution was, with dignity nd grace, slowly to dissipate the funds left in s care.

It is not easy to think in terms of complete bsence of risk, even for those with a highly eveloped theoretical sense. It is not so hard to nagine frictionless conditions in mechanics, specially since there is unanimity among teachrs and the independent forces at work are alrays clearly separated. Even there, some find it ard to believe that there would be perpetual notion if not for friction.

Once risk is fully evaluated and discounted, : becomes apparent that only force enables ome to get wealth for nothing — that only orce prevents the full flowering of produc- :on and its equitable distribution.

The conclusion that economic interest is ero makes a harmonious whole of George's nalysis. In places, George practically confirms ıis conclusion. "For labor and capital are but ifferent forms of the same thing—human ex- rtion. . . . The use of capital in production is, herefore, but a mode of labor." (*Progress and 'overty,* page 198.) And again: "In truth, the rimary division of wealth in distribution is ual, not tripartite. Capital is but a form of ıbor, and its distinction from labor is in reality ut a subdivision, just as the division of labor ıto skilled and unskilled would be." (*Progress nd Poverty,* page 203.)

If economic interest is zero, the third factor f distribution is eliminated, vastly simplify- ıg economic studies and statistics. We rid our- elves of the necessity of reconciling the law f interest, stated in different dimensions, with he laws of rent and of wages. To those who re willing, even tentatively, to accept this con- lusion, I suggest a re-examination of all sorts f economic questions.

Do we raise or lower the gold content of the lollar? De we dilute our credit system? Do we ndulge in deficit financing or in priming the ump? Do we give our substance to others or lump it into the sea? They are all soon dis- ounted and of no permanent avail. The tran- ient effects take from some and give to others ut these are short-lived. Rent adjusts itself as uickly as commitments expire. Where only ubsistence land is available without the pay- nent of rent, wages are at subsistence plus or ninus the transient or risk effects.

Vast superstructures of economic reasoning, uch as investment propensities, monetary olicy, surplus value arguments, would be elim- nated once it was demonstrated that economic nterest is zero.

Fortunately, the causation of interest does not affect the soundness of George's remedy. But there is a weak spot in our armor of logic if we cannot resolve the question of interest. And every weapon in our arsenal must be true if we are to make any headway in fighting the proposals of planners, which lead to stultification of production, and servitude to the ogre-state. —M. S. Lurio

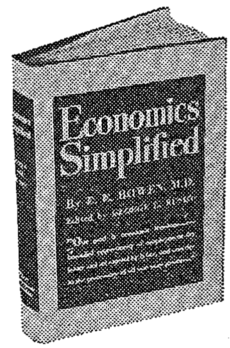
Comments from the Co-author of *Economics Simplified*

Professor Harry G. Brown, in the aforementioned article, accepts the basic premise that capital is wealth used (to mean anything definite, this must mean "*being* used") in the production of wealth. But his concept of the term "used," in this connection, is palpably such as to render the reasoning based on it wholly erroneous and self-contradictory. He included as capital both the plane and the plank being shaped by the plane; both the pruning knife and the orchard tree that is being pruned.

This erroneous position results from failure to recognize that the verb "use" can be employed in two very different senses, to fail to recognize the radical difference between which is to make clear thinking not difficult, but quite out of the question.

Whether, in the production of wealth labor does or does not employ capital, it is obvious that in either case labor must apply itself *to* something that is *not* capital—to land or some form of mere wealth. In any given wealth producing operation it is *prima facia* that labor cannot apply itself *to* capital. . . .

The basic trouble resides in failure to recognize that the term "use" can be employed in two senses, the economic and the non-economic, and in the resulting failure to differentiate accordingly. The plank that has been fashioned into a plank by labor using capital (the plane), is mere wealth — until, when? Until, having been fashioned into a carpenter's bench, for example, and being used in production, it becomes capital. The orchard can never become capital, unless, for instance, it is cut down and made part of some wealth producing bridge.



When the carpenter "uses" hammer and lumber in erecting a building the hammer is "used" in an economic sense and is capital; the lumber is "used" in a strictly non-economic sense and is *not* capital. To regard it as capital would necessitate the formulation of an entirely new science of economics.

In commerce, where any kind of loose language is permissible, the orchard could be classed as capital; but economically (to which field the present discussion must be confined) the trees are but wealth, the product of labor applied to other wealth, or to land. The orchard may pay an income to its owner, but that is irrelevant. To include as capital anything paying an income, merely because it does so, would be to directly contradict the author's own premise and to convert political economy into a hopeless hodge-podge.

Another staggering misconception is that labor produces, or ever can produce capital. Labor can produce but one thing, *wealth,* which in turn can be *converted* into capital solely by the act of labor in using it to assist in production. The shovel does not take on the property of being capital till it strikes the ground, in the hand of the laborer, in the process of production. "All the King's horses and all the King's men" could not produce an iota of capital.

Fortunately, though apparently unintentionally, Professor Brown furnished a clue for the correct approach to the subject. He says quite correctly that the user of capital can borrow it and the lender receive interest for its loan—for permission to use it; well, if capital is something that is capable of being borrowed, and interest is what is received for the privilege of using it, how is it possible for his other contentions concerning the subject to be correct?

Here we have the key to the whole subject—an extremely simple subject notwithstanding so many labored efforts, by as many authorities, to make it complex, involved and incomprehensible. The contention that interest is simply what is received for the loan of capital, nothing more or less, is in full accord with the basic premise laid down by Henry George (however unfortunately he may have so directly contradicted himself in his discussion of interest per se), that interest is one of the portions or shares into which product naturally divides itself, the shares going, respectively to him who performed the labor, to him who permitted use of the land, and to him who permitted use of the capital.

That is all there is to the interest question, a subject the gross misunderstanding of which is chiefly due to the fact that the one using the term has consistently failed to think his concept through and adequately express it in a definition capable of standing every test. If we are to have a concept of interest that accords with the rest of our economic concepts, instead of contradicting them and subjecting us to the deserved ridicule of the analytical minded oppositionist, that concept must be just this, that interest "is the capital owner's share of product (wealth) for granting permission to use (i.e. for lending) the wealth used (as capital) in producing it."

As to the claim that saving is the cause, or even *a* cause, of interest, one is reminded of the Lime Kiln Club's Agricultural Committee Report, after several weeks' deliberation, that the cause of the poor apple crop last year was that the trees didn't seem to bear as well as usual. So many fail to differentiate between a cause (that which operates to produce a given result) and a *pre-requisite* (that which must be, in order that a given cause *can* operate to bring about a given result). Obviously there must be saving, or there would be no accumulated product for labor to devote to use as capital. But what has that to do with the *cause* of interest? The cause of the price of *anything* is, that there is demand for more of that thing than can be had free of cost; interest is the price that the loan of capital (or wealth wanted as capital) commands: therefore the cause, and the only cause of interest is, must be, that there is a demand for more loanable capital than can be had free.

The law of interest: "Interest is that part of product (wealth) distributed to the owner (as such) of capital, and is fixed by the prevailing relation, at any given time and place, between the demand for, and the supply of capital, or wealth wanted for use as capital."

—George L. Rusby