CHAPTER II — NON-WORKING CAPITALISTS

I. THE POSITION OF THE *RENTIER*

Man has been defined as "an idle animal" — a definition which is unfair to him, since he is no more idle than any other animal, nor even as idle as some. But all the same he has displayed extraordinary ingenuity in evading the law of work: slavery, parasitism, begging, theft, and gambling, have all originated in this way. But the best way to avoid work, because it is at the same time the surest and the most respected, is *to have a private income.*

Although *rentiers* — persons of independent means — do not work, that does not prevent their living, and in very many cases living well. Not only are their incomes often larger than those produced by labour, but they possess the special advantage of being more regular: whether it snows or blows, whether the *rentier* be in health or confined to his bed by sickness, whether he be young or aged and infirm, a stay-at-home or a globe-trotter, still his income follows him everywhere and never fails him. Thus the fact of having a private income ensures, first of all, those two good things, security and independence, that are better than all the pleasures that other kinds of fortune can procure. That indeed is a privileged position, and we may well ask these lucky mortals what god has bestowed this leisured life upon them — *deus vobis haec otia fecit.*

They will reply that it is labour itself: that they are living upon *the produce of past labour.*

What is the worth of this reply? If this past labour is *his own* labour — if the *rentier* is a retired official in receipt of a pension, or one who has saved up for his old age, — then no one can raise any objection. Man cannot be doomed to compulsory toil for ever: if he has worked during the productive part of his life it is only fair that he should be able to rest during the unproductive part.

But if this past labour is the labour of *somebody else* — his father, grandfather, great-grandfather, or even some stranger who at some time or other made a fortune and left it to the *rentier* with the right to consume it in idleness, — then the question becomes more difficult.

Why should it be so? it will be said. We have compared pieces of money to orders or tickets conferring the right to consume a given amount of wealth at one's own choice, up to their total value (p.

212). Well, a man has earned a large number of these tickets by his labour: if he does not want to use them himself, now or later, he will hand them on to someone who will use them instead.

From the economic point of view that is all very well; but from the moral standpoint we may be more exacting. Has the idle *rentier* done his duty towards society by the mere fact that he has paid for what he receives with money that represents — even putting it at the best — only past labour — the labour of those who are now dead? Ought he not to pay in present, personal services the equivalent of the income he receives? Notice that the *rentier* does not live at all on his past labour, as he thinks he does, but on *the present labour of somebody else*. The things he consumes every day are the produce of living and not of dead labour — new bread, early vegetables, new clothes, the daily paper, and so forth. Now does not justice demand that in exchange for what his fellows produce every day for him, he should himself produce something for them? The economist Augustin Cochin — a catholic, and by no means a socialist — said, "The *rentier* is a wage-earner who has been paid in advance." If he has been paid *in advance*, there must be some labour *remaining due* from him. What he owes, in fact, is to "make himself useful," as we say. If he is of no use, he will meet the fate of parasites, and will sooner or later be abolished, and it will be in vain for economists to point out that he has provided in good money the exact equivalent of all that he has consumed.

But *idleness* must not be confounded with *leisure*. Idleness is a state of revolt against the law of work. Leisure means intermission of work in the course of a life that may otherwise be very active and laborious, and that is even more so, the more it is interspersed with periods of leisure. These periods are like infrequent clearings in a gloomy forest, where the sunlight can penetrate: there is the evening leisure after the day's work is done; the weekly day of rest; the leisure of the holidays, which will not always remain the privilege of brain-workers but will become a possibility and a right for hand-workers as well; and finally there is the leisure of retirement after a well-filled life. Leisure, in the form of recreation, is not only useful for the smooth working of labour itself; it is indispensable to the development of the internal and external life; to meditation, which should not be reserved for sages alone; and to the performance of many duties besides that of earning one's daily bread — family duties, social relations, participation in good works, committee work, trade union or co-operative society meetings, political gatherings, religious worship, and so forth.

It is true that it is not very easy to determine where leisure ends and idleness begins. It is easy, of course, to class a man who lives by begging or gambling; but the case of the *rentier* we have been discussing is more difficult. Is he an idler, or simply a man of leisure?

It must be acknowledged that from the historical point of view the *rentier* in the past performed a real social function, and even the most important of functions — that of creating the arts, letters, sciences, politics, culture, and civilization in general. We owe all these good things, in which the poorest have their share, to the idle *rentiers* of Greece, Rome, and Judæa — all those ancient societies where idleness none the less appeared in a particularly odious form, because it rested entirely upon force — upon robbery and slavery. In all civilized societies to-day the *rentier* is not necessarily a parasite, though he may happen too often to be so as a matter of fact. But generally, and to an increasing extent under the pressure of public opinion, it is upon the *rentiers* that the task devolves of performing what we might call the gratuitous functions — those which bring no reward, such as charity in its numberless forms, politics, and literature, and which can only be performed by men who have other means of subsistence. That is how things are done in democratic societies like the United States.

But must we conclude that it will always be so? For the proper conduct of great social interests, for unravelling the delicate threads of politics and diplomacy, and for worthily holding the sceptre of taste in the world of letters and of art, must we always require white hands that labour has not hardened, and leisured brains that have never been oppressed by the anxiety of performing an allotted task and earning the daily bread? Perhaps not. These lofty functions are not necessarily incompatible with labour — even manual labour. The existence of a *rentier* class would cease to be indispensable to the intellectual, artistic, and moral life of society as soon as sufficient leisure was assured to all workers.

II. HISTORY OF MONEY-LENDING: USURY AND THE REGULATION OF INTEREST

Money-lending at interest was practised throughout ancient times and in terribly harsh forms; yet it was stigmatized by many great men, like Moses, Aristotle, and Cato, who was himself a usurer, and was condemned by almost all religions. On the coming of Christianity the attack upon it was renewed with redoubled energy in

the writings of the Church Fathers, and when the Church had firmly established its power it succeeded in getting loans at interest formally prohibited, in civil as well as in canon law. The law of Mahomet did the same: "God has permitted sale but forbidden usury," says the Koran. The true Moslem receives no interest for money lent, not even from the Christian banker with whom he has deposited it.[1]

Although this doctrine has been treated in more modern times with profound contempt, and regarded as a mark of ignorance of all the laws of economics, yet it admits of a very easy historical explanation.

We have already observed (p. 280) that credit in the shape of loans of money could only lead to ruin if it was not productive in character. Now in former times it could only serve, and did only serve, for consumption. So the ancients and the canonists were not so utterly wrong as they are thought to have been. On the contrary, they had a very clear idea of the economic state of the times in which they lived when they declared that lending was barren.

The borrowers were the poor plebeians of Rome, who borrowed from the patricians to obtain food, and the impecunious knights of the Middle Ages, who borrowed from the Jews and Lombards to equip themselves for the Crusades. All borrowing, therefore, was for personal and consequently unproductive consumption. Naturally, when the day for repayment arrived the borrowers could pay neither the interest nor even the capital, so they had to pay with their bodies and their labour as slaves of their creditors.[2] In these circumstances money-lending appeared to the lender as an abuse of the right of property, and to the borrower as an instrument of exploitation and destruction, which is sufficient to explain such long-standing and persistent condemnation.

In those days capital was scarcely known, even by name. Yet then as now there were many people who had great need of money, and since there was no one then, any more than now, who was inclined to lend it for nothing, some kind of compromise had to be discovered. So people set their wits to work, and the many ingenious methods devised by medieval casuistry make one of the most inter-

[1] The Christian bankers of Cairo know very well how to take advantage of this form of Moslem piety

[2] The houses of the Roman patricians were equipped with cellars used as prisons, *ergastula*, for insolvent debtors. In the Middle Ages debtors were less harshly treated, in spite of the example of Shylock. A powerful insolvent debtor had merely to furnish hostages to his creditors and pay for their food, which must, however, have been very burdensome. For this reason the canonists said: *Jus usurae, jus belli.*

esting chapters in the history of economic doctrines. The principal devices were these:

(1) In all cases where it was recognized that the borrower could make a profit — for instance, by commercial undertakings, and especially by maritime commerce, the most hazardous of all — it was considered that interest was no longer usurious, but became legitimate on account of the risk incurred by the lender.[1]

(2) If the lender definitely transferred to the borrower the ownership of the capital sum lent — that is to say, if he gave up all claim to repayment — then in this case also the legitimacy of interest was easily admitted; for the lender could not be asked to give up both capital and income. The loan took the form of an *income-yielding investment.*

(3) If the interest was stipulated for in the form of a penalty in case of non-payment of the capital on the appointed day, this also was valid. And since there was nothing to prevent the fixing of the date for repayment on *the day after the loan was made,* it is obvious that the rule could be easily evaded in this manner.

The Reformation naturally caused a reaction against the canonist doctrine, not only through the spirit of opposition, but through the same foreshadowing of modern notions as was visible also in its political and democratic ideas. At the same time this is true only of Calvinism, for Luther himself continued to condemn interest. Calvin, however, showed himself disposed to tolerate money-lending under certain conditions, and in the sixteenth and seventeenth centuries the scholastic arguments against usury were refuted by two great French huguenot lawyers, Dumoulin and Saumaise,[2] the latter an exile in Holland. It is interesting to notice, however, that the Jesuits as well as the Reformers contributed to the admission of money-lending into practice, by inventing ingenious arrangements for evading the economic law: for instance, the *contractus trinus*, or threefold contract, by which the lender was held to associate himself with the risks and profits of the undertaking, but at the same time insured himself against the risks and gave up his claim to the profits in exchange for a fixed annual sum.

But to find economic doctrine declaring itself in favour of money-lending at interest we must come to the economists — to Turgot, the author of *Mémoire sur les prêts d'argent* (1769), and Bentham,

[1] The Lateran Council (1515) defined the situation perfectly: "There is usury wherever there is profit which does not arise from anything productive, and which involves neither labour, nor expense, nor risk, on the part of the lender."

[2] [Better known as Salmasius, the celebrated opponent of Milton.]

who wrote *A Defence of Usury* (1787). From that time forth all economists have been agreed. And this time they are right. Why is this? Because the position of things has entirely changed.

On the one hand, the parts have been inverted. It is no longer the impecunious now who borrow from the rich — the plebeians from the patricians. On the contrary, it is generally the rich, the powerful, the speculators, the great companies, the bankers, the owners of gold-mines, and the great States in particular, who borrow from the public, from small folk — who draw upon the people's savings and the peasant's stocking. The result is this: that it is most often the lender rather than the borrower whose fate is deserving of commiseration. It is no longer the weak and defenceless borrower who must be protected by law and public opinion against the rapacity of the lender; it is the ignorant lender who must be protected by law and public opinion against the exploitation of the great borrowers of whom modern financial history offers many scandalous examples.

On the other hand — and these two changes were simultaneous — the object of the loan contract has changed. Men have almost given up borrowing for consumption; they borrow now to make their fortunes. Although loans are still described by lawyers as consumption loans, they have now assumed their true economic character as a mode of production. It is, as we have seen (p. 116), the *entrepreneur* — the actual agent of production — who hires the capital and pays interest for it, and this interest appears among his expenses of production just like the wages of labour and the rent of the factory. It would be foolish, therefore, to wish this *entrepreneur* to be exempted from paying interest, from humanitarian motives, for the only result would be to increase his profits.

Of course this process of development is not yet everywhere complete. In the agricultural parts of the East, in Russia, the Danubian countries, Italy, and Algeria, credit still retains its earlier form, and there as of old it is the borrower — the peasant — who is eventually expropriated by the lender. It is in those countries, too, that the movement known as anti-semitism has arisen. For this reason, old laws against usury may still be perfectly appropriate in some lands and in some circumstances.

Moreover, even in more advanced countries the old dislike of interest has left some traces upon legislation, if not in the form of prohibition, yet in that of *limitation* of the rate of interest.[1]

[1] [We omit the author's instance from French legislation. In England the legal maximum rate of interest was fixed in the sixteenth century at 10%; thence it was lowered to 8% and 6%, and in 1714 it was fixed at 5%. It was not till the nineteenth century that all restrictions were removed.]

Economists, however, protest against all limitation. It is certain that the fixing of a maximum price for the hiring of money is an altogether exceptional measure, since it is not practised in the case of house hire or the hiring of land. We believe, too, that it could be abolished without any inconvenience.

None the less, the act of lending *habitually* above the current rate of interest, even if there is no limit placed upon this rate, constitutes a punishable offence — the offence of usury.

There is no real contradiction, although there may appear to be, in allowing freedom in settling the rate of interest and yet punishing those who make a trade of lending at excessive rates, any more than there is in allowing consumers liberty to drink and yet punishing the publican who supplies drink to a drunken man.

III. THE CAUSE OF INTEREST

The question of the legitimacy of interest is the oldest question in political economy, having been debated more than two thousand years before that science really existed. We have sketched its main features in the last section. But a distinction must be drawn between two aspects of the question that are commonly confounded.

What used to be discussed was more especially the *legitimacy* of interest — that is to say, its legal cause: whether the lender has the right to receive anything beyond the capital that he has lent.

What is discussed nowadays is more particularly the *explanation* of interest: what is its economic cause? Does it represent a real surplus value of capital, and if so, whence does this surplus value arise?

1. *The Legal Cause of Interest*

This cause is the fact that all capital is private property, for the right of property necessarily implies that no one can be compelled to hand over his goods without receiving anything in return: a gratuitous loan would be as unintelligible as a gratuitous sale. In fact, what makes this discussion obsolete and scholastic, is that none of those who denied the legitimacy of interest — neither Aristotle nor the legists and canonists — *disputed the legitimacy of the appropriation of capital.* They were not by any means socialists. They never contested the right of the owner to receive rent for the hire of house or land; why, then, deny him the right to receive interest?

However, we will recall their arguments.

(1) It was said that a distinction must be made according to

whether the borrower had or had not made a *productive use* of the borrowed capital. But what does this matter? Even in cases where the capital has not been put to productive use, and where it could not be, owing to circumstances — in other words, in cases where it is not really capital, but merely an object of consumption — why should the owner of this kind of wealth be obliged to lend it for nothing? It is not his fault if the borrower squanders the capital he has received instead of making proper use of it. The command of Christ "Lend, hoping for nothing again," relates solely to the Gospel order of things and not to the economic order, exactly like the command to him that has two coats to give one of them away. From the legal point of view there is obviously sufficient justification for interest in the mere principle that no one can be robbed of his wealth, and that whoever consents to dispossess himself for the benefit of another has the right to do so only on such conditions as he chooses to lay down.

(2) It was said, in the second place, that a distinction must be made, on the side of the lender, according as he had or had not *suffered privation*. But what does this matter, either? Since when has the remuneration that I claim — whether profit or wages — been in proportion to the privations that I experience? On what principle should I be obliged to put freely at the disposal of my fellows the wealth that I cannot or do not wish to make use of myself? Must I let other people establish themselves in my house because I am compelled to be absent, or allow them to eat my dinner because I am not hungry? This thesis could only be maintained on the principle that in this world man *has a right only to the amount of wealth that is strictly necessary for his personal consumption*, and that any excess belongs rightfully to the community — which means the adoption of pure communism.

(3) Thirdly, it was said that interest on capital must not be confused with the rent of land or houses, because land yields a periodical harvest and houses, if they do not yield fruit in the literal sense, at least provide numerous utilities — such as shelter from the weather, a comfortable family home, and a legal domicile — which are all perpetual, or which at any rate last as long as the house itself. The rent paid is the price of these harvests or these amenities, and, like them, should be perpetual or at least periodical. Of course the money paid by the tenant as rent has come out of his pocket, but he has received an equal value in exchange, just as when he pays for his daily bread.

Capital that has been lent, on the other hand, and that always

takes the form of circulating capital and particularly the typical form of money-capital, is not a durable kind of wealth like a house: it is destroyed by the very act of production. The coal that is cast into the furnace disappears in smoke, the raw material is transformed, the money is expended in wages. How, then, can interest pay for the use of a thing whose very nature it is *to be consumed by its first employment?*

Besides, houses and lands, simply because they are durable, remain the property of the lessor, even when they are let, whereas borrowed money is necessarily consumed, because it is what the lawyers call "fungible." That is the very meaning of the words used to denote loans of money in legal language: in Roman law the word is *mutuum* (*ex meo tuum*, mine becomes thine), and in French law, *consumption* loan — the lender definitely alienates his money and the borrower becomes the definite owner thereof. Would it not, then, be contradictory to admit that the borrower may become at once the owner and the hirer of the same thing?

This last objection is no better founded than the rest. For if house-rent or land-rent is legitimate, how can the rent of capital not be so, since capital can always be used to purchase a house or land? Calvin himself remarked on this. When two kinds of wealth are interchangeable, one cannot be worth less than the other.

As for the legal argument that rent cannot be received for goods that one no longer owns, it is easy to reply that the capital lent is neither coal nor money but capital in the abstract — pure value. Now that is a permanent form of wealth, that retains its identity as well as, and even much better than, a house which sooner or later perishes and falls into ruin. Capital value remains for ever, like the Proteus of mythology in all his transformations. As for the borrower, too, he becomes the owner of the *coins*, certainly, and will definitely keep them; but he does not become the owner of the *value:* that is why he will have to return them, in the shape of other coins. The conception of hire is therefore quite applicable to the case of loans of money.[1]

The question is quite different, however, if we consider the legitimacy of the private appropriation of capital, as is done by socialists

[1] Another argument that we do not include here, though it has held an important place in the history of this question, is the one that justifies interest by the *abstinence* required for the creation of capital. We have already rejected the notion of abstinence as a factor in the formation of capital (see p. 113); still more do we set it aside as a justification of interest. Even if we admit that saving involves sacrifice, this sacrifice is sufficiently rewarded by the acquisition of the capital itself, without any necessity for adding a premium in the shape of interest.

to-day, instead of the legitimacy of interest. It is obvious, indeed, that if the appropriation of capital is robbery, the levying of interest must be so too. But this is quite a different matter.

We have seen (p. 23) that capitalist appropriation has been vigorously attacked by socialists. The precise aim of Karl Marx's famous book on *Capital* was to prove that this appropriation was the result of a historic process of spoliation, and that it remains the means of continuing this spoliation and indefinitely increasing it. Collectivists, it is true, admit that capital may be the object of a legitimate property right when it takes the humble form that economists like to give it — the canoe dug out by Robinson Crusoe, the plane that Bastiat's carpenter made, or the coins packed away in an old stocking or placed in the savings-bank by the peasant. But the real capital, they say — the capital that brings riches and power — is not that. It is never the produce of personal labour, or savings effected out of the product of personal labour. On the contrary, it consists of *savings effected out of the produce of the labour of someone else* — the labour of wage-earning workers, — savings which can only increase in so far as they are used to set other workers to work, so as to draw fresh profits from their labour. No great fortune, they say, has been created in any other way than this.

We should have to conclude from this argument, then, that there are two kinds of capital: the small, whose appropriation is legitimate because it is the fruit of honest and individual labour; and the great — a kind of vampire capital — whose appropriation is illegitimate because it involves the appropriation of the produce of other people's labour. Now since all great capital obviously began by being small, it must follow that the appropriation of capital is legitimate at its birth and up to a certain stage of development, after which it becomes improper. Capital, on this theory, is like those animals that are good when they are young, but become wicked when they grow up. But where is the critical point to be placed? It will be the point where capital has become too large to serve simply as an instrument for its owner's labour, and is used by him to set others to work in sufficient numbers to enable him and his heirs for ever to live on their income. Here we get back to the collectivist doctrine, and must refer ther eader to our previous discussion (pp. 355–361).

We need only recall this point: that we cannot lay it down as a principle that all capital, even on a very large scale, is necessarily and by its very nature an instrument of exploitation, and that it can only increase by draining the life-blood of labour. Vampire capital is by no means the normal form: on the contrary, it is a

monstrous perversion of true capital, whose real function is to serve as the instrument and the handmaid of labour. We can say of capital what has been said of money: that it is a bad master, but a good servant; it is merely a matter of keeping it in its right place. That is what co-operative societies do: they know quite well that they cannot do without it, but they do not allow it to rule, or to take possession of the profit.

We must remember also that if we admit the existence of much capital to be an indispensable condition of economic progress — a postulate that no socialist disputes, — and if we believe that the development of production imperatively demands a stock of accumulated wealth, then we ought to regard the function of those who accumulate this wealth and put it on the market as a very important one. And the most effective way of encouraging these makers of new capital — these social treasurers — certainly seems to be to assign to them the ownership of the wealth that they have capitalized, with the right to make a profit on it. If private property in capital were abolished, and a collectivist system established in its place, it would certainly be necessary to establish and remunerate a personnel for the performance of this service.

Nevertheless we have the right to ask whether these "treasurers" are not paid too highly for the function they perform, and whether their services could not be obtained at a cheaper rate. That is another question. We are assured by economists that competition keeps their remuneration down by means of the unavoidable fall of the rate of interest. That seems to us very doubtful (see below); but more confidence can be placed in the good organization of credit, and especially of mutual credit.

2. *The Economic Cause of Interest.*

Having done with the justification of interest, it remains for us to explain its nature and its origin. This is no longer a legal question — whether the lender has the right to demand interest — but an economic question — whether capital really yields a surplus value, which is interest. The question goes beyond that of loans, or even the appropriation of capital. For instance, we may discuss whether the rent paid for land is really due to the landowner or whether it ought not rather to be nationalized; but in any case there is no doubt that it represents a real value, and a new one — the harvest yielded by the earth. Is it the same with interest? Does it represent an

equal value received by the borrower, as in all cases of exchange?[1] Or is it merely a kind of tax that the borrower has to deduct from his own income, making himself by so much the poorer?

This question is not out-of-date, like the one we have just dealt with: it is of the greatest present interest, and a question that is very far from being settled. For the last thirty years it has been the subject of huge books and innumerable articles in journals. The explanations that have been proposed may be reduced to two typical ones, as follows.

(1) The oldest explanation is that of the *productiveness* of capital: interest exists because it is the nature of capital to produce a value greater than its own; and interest is precisely this increase or surplus value.

We are not dealing here with productiveness in the material sense of the term — productiveness by way of generation, as when a cow produces calves; nor even by way of fructification, as the *rentier* thinks when he tears off his dividend coupons as they fall due, just as he gathers his fruit when it is ripe. It is understood (see above, p. 62) that capital acts in production only as an assistant to labour; but by the productiveness of capital is meant the extra produce due to labour when it is assisted by capital. Thanks to his net, the fisherman will catch ten times as many fish; thanks to his saw and his plane, the carpenter will make ten times as many boards. It is in this sense that the term was understood by Bastiat, and that is the argument that he repeated with such wearisome iteration in his controversy with Proudhon. Economists have long been satisfied with this explanation, and it will no doubt seem an adequate one to the reader: it is clear and simple. But the more modern economists describe it as "naïve," and have subjected it to a pitiless analysis.[2] It has suffered the same fate as the law of supply and demand (p. 193) and the quantity theory of money (p. 212).

To begin with, it is remarked that if interest is due to the productiveness of capital, this explanation fails utterly in the case of loans for consumption. In this case, then, it must be inferred that interest has no cause, which means that it is merely a tax levied on the

[1] There certainly seems to be something fictitious about interest, to judge from the fantastic results that may accrue from compound interest, and which obviously cannot correspond to anything in actual existence.

[2] In the front rank must be placed the Austrian economist Boehm-Bawerk, who criticized the theory of productiveness, as well as all the other explanations of interest that had been proposed, in a book that marks an epoch in the history of economic doctrines (1884). In a second volume (1889) he expounded his own theory, of which we are about to speak.

borrower's purse — a legitimate one, if you like, since it results from a contract, but one which corresponds to no value that has been exchanged.

Even in the case of capital employed productively (*e.g.* a plane) the notion of productiveness is said to be equivocal, for it implies material productiveness (*e.g.* boards). Now though it is obvious that the employment of capital enables labour to produce more, both in quantity and in utility, it is by no means proved that it enables it to produce more in *value*. To create abundance is not to create value (p. 42). *Technical* productiveness must not be confounded with *economic* productiveness. Does machinery confer upon the products it makes a greater value than that of hand-made products? Yes, if there is a monopoly; no, if there is competition. In the latter case the products whose price is reduced to the cost of production acquire no extra value beyond that represented by the cost and depreciation of the machinery. It is intelligible that the price of boards must include the value necessary to repair the machine or the plane — the allowance for depreciation; — but it is impossible to understand by what natural law it ought to include an extra value that would be the *income* of the machine or the plane.

Finally, if productiveness were the actual, or at least the sole cause of interest, then the rate of interest ought to be determined by the degree of productiveness of the capital. How then should we explain the general tendency of interest to fall, when capital continues to grow more and more powerful and productive?

(2) A more modern explanation is this: that interest is *the price of time*, or in the ingenious phrase of the American economist Irving Fisher, its cause and its measure is *impatience* to enjoy. Strictly speaking this explanation is not a new one, for the idea that interest is the price of time did not escape the canonists,[1] and was forcibly expressed by Turgot in his defence of interest. But only with Boehm-Bawerk and the psychological school did the notion find scientific expression, thanks to their admirable ingenuity of analysis. This very abstract theory has filled volumes and could not be described here in any detail.

This explanation has the very great advantage of being just as applicable (and perhaps even better applicable) to consumption loans as to production loans. Indeed the man who borrows for

[1] But the canonists, while aware of the argument that *interest is the price of time*, refuted it nobly by saying that time cannot be sold and has no price because it belongs only to God. That is a very different conception from the American one, that *time is money*.

consumption is generally more "impatient" to receive the money than the man who borrows with a view to production.

It has also this further superiority: that it does not apply only to loans, but has a far wider sphere of application. It applies even when capital remains in the hands of its owner instead of being lent. If I own a thousand pounds and prefer to make use of it myself, by putting it into the ground or into the furnace of an engine, in the shape of seed, fertilizer, or coal, or if I have it consumed by workmen in the shape of a food allowance or money wages — in all these cases I sacrifice a present good to obtain a future good in the form of crops or manufactured articles. I lend the money to myself, as it were. So there is always an exchange of the present against the future, and I should not make it if I were not to get back at the end of the year the money I had spent *plus something more.* That is what the capitalist unconsciously means when he says that his capital *ought* to bring him interest.

If this surplus value is not realized, he will say rightly that he has incurred a loss. If his accounts are properly kept he will only count as net profit the excess over the interest on the capital employed.

In short, as it is well expressed in everyday speech, every loan is an *advance;* and what does "advance" mean, if not the gaining of *time?*

Yet this theory, after a period of striking success, is beginning nowadays to be somewhat discredited.

Indeed, we may well ask ourselves on reflexion whether it is quite certain that man always prefers a present good to a future good. It is indisputable whenever we are dealing with a present want, but it is not the same in the case of *a future want:* here, on the contrary, the situation may be reversed. A sack of seed wheat will be worth far more to me at sowing time, nine months hence, than to-day in January, since I shall only have the trouble of keeping it from now till then. If a man insures his life or his children's education, paying a single or a graduated premium, is he not sacrificing a present good to one that is to come? And why does he do this, if not because he thinks the future good preferable? But we may go still further. Whoever lends his money, surely does so precisely because he has no use for it at present, and because he thinks it will be more useful to him at the time of repayment than now. Now since there are necessarily as many lenders as borrowers, it cannot be said that there are always more people who prefer a present good than there are who prefer a future good.

A future good, though identical with a present good, has always a

lower value: that is a psychological law, confirmed by everyday experience. To have something for dinner to-day is a very different thing from having something for dinner in a year's time, or ten or a hundred years'! The value of a good thing diminishes in proportion to its distance from us in time, exactly as the size of an object diminishes when it is far away; and just as an object getting more and more distant becomes finally invisible, so value ends by becoming negligible or even disappearing altogether if the time is very far off.[1] If it were not so — if a future good had the same value as a present one — the most astonishing results would follow. For instance, the value of any piece of land, even the smallest, would be infinite, or at any rate would amount to millions of pounds; for its value would be the sum of all the crops expected from it as long as the earth endures, or at least as long as there are men to cultivate it! Now we know quite well that it is nothing of the kind: the value of a piece of land is not more than twenty or thirty times the value of its present crop, because the value of each future crop is only reckoned at a figure that diminishes rapidly until it reaches zero.[2]

This being admitted, let us consider what happens in the case of lending. The lending of money is not a hiring contract, as in the case of a house or land: it is an exchange contract. But an exchange of what, since all capitals in the form of money are identical? It is an exchange of a present good for a future good. I hand you a present good in the shape of a bag of money containing £100, or a bank-note of the same value, and I receive in exchange a future good in the shape of a promise to pay £100 in a year's time. But if the exchange were made on these terms the values would not be equal, for £100 payable in a year is not worth £100 to-day. If I put the present £100 in one scale of the exchange balance and the future £100 in the other, the latter will be the lighter: so a little extra weight must be added to the scale containing the future value — say £5 — in order to restore the balance. This supplementary amount is precisely interest. Or else, what comes to the same thing, we must remove a portion from the heavier scale — say £5, leaving only £95 — and this deduction is what is called discount

[1] This law seems merely a scientific translation of such popular sayings as, "A bird in the hand is worth two in the bush." But all that these proverbs convey is the fact that every future satisfaction is always uncertain, whereas the theory described in the text has a deeper signification, namely, that the future satisfaction, even when certain, *is not worth as much as* the present satisfaction.

[2] Thus the public has learned, not without surprise, from the discussions about German reparations, that the present value of 8,000 million pounds to be paid in 42 annual instalments is only about 2,400 or 3,200 millions.

The only difference between a loan in the strict sense of the word and discount, is of course that in one case the interest is added to the capital when it is repaid, while in the other case it is deducted from the capital at the time of borrowing.

Is there not a vicious circle in this explanation also? If present capital is generally preferred to future capital, is it not simply because the possession of present capital enables us to invest it at interest? Is not the preference for present money determined by the existence of interest, and not the other way about?

Between these two explanations one may make one's choice. Yet they are not incompatible: they may even be presented as complementary to each other — and that not by a convenient process of eclecticism but for the same reason as we gave in dealing with value. Just as value seems to be determined not by a single force but by two opposing forces, one on the seller's side, and one on the buyer's — the two propping each other up, like the two sides of an arch, — so, in the case of interest, we must look at both the lender's and the borrower's side of the transaction. On the borrower's side, in the case of a production loan, it is the degree of productiveness of the capital to be borrowed; on the lender's side, it is his degree of preference for the anticipated future good over the present good that he gives up. And it is the rate of interest that reconciles these opposing claims, by its rise or fall, assuming, of course, that there is competition between borrowers on the one hand and lenders on the other.

IV. THE DETERMINATION OF THE RATE OF INTEREST

We have seen that the rate of interest[1] was for a long time settled by law, and was so in France for non-commercial loans until quite recently. But such legislative limitation can only give legal sanction to what is approximately the current rate; otherwise it would be useless. What matters, then, is to ascertain the economic and natural laws that determine the rate of interest, like those which determine the rate of wages or the prices of goods.

If capital were borrowed in kind, in the shape of factories, ma-

[1] The *rate* of interest is the ratio between the amount of the income and that of the capital. To express it most conveniently, the capital is represented by the conventional figure 100, and the rate of interest as a percentage — 3%, 4%, 5% etc. It used to be calculated differently: the interest was expressed as a fraction of the capital. Thus money lent at 5% was said to be a loan of *the twentieth penny*, because the interest was one-twentieth of the capital; 4% was called the twenty-fifth penny, and so forth.

chinery, or any sort of instruments of production, there would be set up for each of these a *different hiring price*, according to their respective qualities, durability, and productiveness, just as the rent of houses varies according to their degree of comfortableness and their situation, and as the rent of land varies according to its fertility.

But capital always takes the shape of money (or its equivalent in credit instruments). This is, first, because the borrower always prefers to receive money rather than capital in kind, having thus more liberty to adapt the loan to the purposes he has in view; and, secondly, because it is necessarily in this form that capital is put on the market by all those who have saved and are seeking to invest their savings. In fact, capital in kind could not be created by saving, but only money capital.

Now this substitution, which transforms a hire into a loan, has certain remarkable results.

On the one hand it tends to eliminate all causes of variation and to *equalize* the hiring price of all capital; for all capital must be of the same value if it is lent and borrowed in the same form, as money. Henceforth it has differences of quantity only, and not of quality. Moreover, capital in this form is essentially mobile, and therefore moves almost instantaneously to any point where it is attracted by a higher rate of interest; and the result of this is that any differences are rapidly smoothed out. Therefore at any given moment there is only one rate of interest in the national, and even in the international market.

But, on the other hand, this substitution of money introduces into the determination of the hiring price of capital a differentiating cause which assumes very great importance: the degree of *solvency* of the borrower. In fact, as we have already observed, the borrower is not really a hirer: he acquires the definite ownership of the money, and can do what he pleases with it. It is possible, therefore, that he may be unable to return it; thence arises a risk for the lender, which will cause him to demand higher interest as *compensation for the possible loss* of his capital. The high interest is a premium of insurance, which the lender naturally requires the borrower to pay.

Interest should therefore be divided into two parts: (1) *Interest properly so called*, representing the price paid for the right of disposing of the capital. This is the same for all loans (on the same market and at the same time); (2) An *insurance premium* against the risk of loss. This varies for each loan, and it is this which de-

termines almost entirely the differences between the rates of interest of all investments in public funds or Stock Exchange securities.[1]

What, then, are the causes determining this general rate of interest, or, in other words, the price of hiring money capital? We must not imagine that we can discover a single cause, any more than we can in the case of the value of commodities or the price of labour. There are many causes, but they may be summed up under the old formula of supply and demand.

The supply of capital in the shape of money or credit instruments depends in the first place (1) upon the *saving power* of the country, aided by good credit and savings institutions to facilitate this saving and provide outlets for it. But (2) it is not enough for capital to be abundant in the country: it must also be abundant in the market, and must be offered for loan. This implies the existence of a numerous class of persons *unable or unwilling to utilize their capital by their own personal industry*, for in a society where everyone made use of his own capital, it is plain that, however abundant it might be, it would not be offered. Lastly, (3) the supply of capital depends on the *security* of the investments. Without this, as has happened in the past and as still happens in countries exposed to the inroads of enemies or of their own governments, capital will be uselessly hoarded instead of being offered on loan.

The demand for capital is determined by its *productiveness* — not exactly the average productiveness of the business undertakings in a given country at a given moment, but more precisely the productiveness of the *least productive* businesses among those to which capital is offered; for it is they that command the market for capital, simply because they cannot give more. If these businesses can only give 3% interest, more remunerative ones, which could pay more if necessary, will be careful not to do so.

In a new country, endowed with all manner of natural resources — virgin land to be cleared, mines to be exploited, and roads to be made — the rate of interest will be very high: firstly, because capital is scarce, and the more so since those who possess it are keeping it to make use of it and not putting it on the market; and also because in such a country there are no undertakings bringing in small returns — they are despised.

[1] To these two elements we ought to add a third: the *premium for depreciation*, representing the annual payment necessary to repair the capital that has been used once, in the case of capital in kind, or to reconstitute the money capital after it has been spent. But this is not really interest: it is a portion of the future capital coming to replace past capital.

In an old country, on the other hand, the converse causes will operate: capital accumulated by long saving will be offered in abundance; and as modes of employment with a high degree of productiveness will all be already supplied, this capital will be driven into less productive businesses, thus keeping down the general rate of interest.

Loans at interest, like wages and rent, are speculative contracts — that is to say, the lender forgoes all claim to the profits of the undertaking in return for a fixed annual payment. We have seen, however (p. 412), that when lenders prefer the chances of gain or loss to the security of a fixed income, the borrower promises them only a share of the profits if there are any, and nothing if there are none; and if there is a loss, it is on the capital provided by the shareholders that it falls first. But then this is not, legally speaking, a loan at all, but a *partnership:* the credit instruments of these lenders are called *shares* instead of *bonds*, and their income, instead of being called *interest*, is called a *dividend*. The rate of dividend must naturally be higher than the rate of interest, as it represents a more uncertain income: it must include a premium of insurance against the risk of bad years. Generally, too, the dividend also includes, besides interest and insurance premium, what is called profit. But we shall recur to this question when we come to deal with profits.

V. WHETHER THE RATE OF INTEREST TENDS TO FALL

If we must desire a rise in wages from the social point of view, we must conversely desire a fall in the case of interest.

It must be desired in the first place from the point of view of distributive justice; for by the very fact of reducing the share deducted from the total production by the capitalist, a fall in the rate of interest must (other things being equal) increase by so much the share available for labour; and the more so because the rate of interest determines not only the income of the capitalist, but also, indirectly, the rate of profits and of rent, and consequently of the whole income of the possessing classes.

It must be desired also as a stimulus to production; for by continually lowering the hiring price of capital, and consequently the expenses of production, it must facilitate the execution of undertakings that were formerly impossible. Here are lands to be cleared, and houses that one would like to build to house the workmen, but it is well known that land and houses will not bring in more than 3%. If, then, the current rate of interest is 5% it will be impossible

to get capital for these undertakings, for they could only be undertaken at a loss. So they will be left alone. But suppose that the rate of interest falls to 2%: there will immediately be a rush to execute them. Turgot compared a fall in the rate of interest, in a celebrated simile, to the gradual fall of waters that allows cultivation to extend over new lands.

But it is not enough that this fall should be desirable. Is it probable? Has it a permanent character? Is it to be regarded as a true economic and natural law, like that of the increasing value of land or the fall in the value of money?

The law has always been affirmed by political economy, and especially by the French optimist school, from Turgot to Paul Leroy-Beaulieu; and Bastiat included it among his most beautiful "harmonies."

The theory rests both on reasoning and on facts.

As far as facts are concerned, the great fall of the rate of interest is one of the most characteristic economic phenomena of the second half of the nineteenth century: from 5% in the middle of the century it fell to 3% in 1897, the year that marked the lowest point.

As a matter of theory, most of the causes already enumerated as determining the rate of interest seem bound to operate in the direction of a fall. It seems reasonable to think that in every progressive society capital must become more and more *abundant*, like all wealth that is produced, and that consequently its final utility and its value must go on diminishing. *Security*, also, ought to go on increasing, at any rate if we admit that civilization implies more fidelity to their engagements on the part of individuals and States, or more effective means of control on the part of creditors. And alongside of these optimistic forecasts we can even place a pessimistic one, which nevertheless will operate in the same direction — namely, that capital will in future become *less productive*, and that profits will diminish, alike in agriculture, owing to the law of diminishing return, and even in industry and transport, because opportunities for employment in these directions are limited. It seems indisputable, for instance, that the railways which may yet be constructed in France will be far less productive than the great lines already built.

It even seems that there is scarcely any assignable limit to this decrease, for here there is no limit set by the cost of production, as in the case of commodities, or by the cost of subsistence, as in the case of the wages of the workman. The only limit is the point below which the capitalist will give up lending and prefer to hoard or to consume his capital. But what is the rate below which he will

rather spend or lock up his money than lend it? Will it be 1% — or 1 per thousand?

Bastiat declared that interest might fall below any assignable figure, yet without ever reaching zero, like those well-known curves in mathematics which approach nearer and nearer to a straight line called an *asymptote,* without ever touching it, except at infinity. Some economists would go further still and believe that the rate of interest may fall to zero, which would mean the disappearance of interest and free credit.

Those are the arguments for the indefinite diminution of the rate of interest. None of them, however, seems to us decisive.

In economic history, in fact, the fall of the rate of interest never appears as a regularly descending line — like the fall in the value of money which has continued almost without intermission for more than a thousand years — but as a broken line without any well-marked direction, either upward or downward. The fall during the second half of the nineteenth century was very striking; but what are fifty years in the whole course of history? Under the Roman Empire the rate of interest was no higher than it is to-day, and in Holland in the eighteenth century it had already fallen as low as at the end of last century. It is quite possible, therefore, that in the future the rate of interest may rise; and a very marked rise was indeed observed, even before the war, in the rate of interest for public funds and the chief Stock Exchange securities.

It was in 1897 that the fall in the rate ceased and a period of rise began, showing itself in the form of a fall in the price of all fixed-income securities. Thus the price of 2½% Consols, which in 1898 was nearly 111, had fallen by 1913 to below 74, which represented a rate of interest of nearly 3½%.

But since the war it has been a very different matter. The upward movement of interest and the fall in the price of securities have been greatly accelerated, so that the rate has risen above 6%. This rise is only too easily explained by the enormous need of the belligerent States for money, and the immeasurable destruction of capital. The rise in interest would have been greater still if the belligerent States had not resorted to the issue of paper money on a large scale, with the double result, on the one hand, of reducing to that extent the issue of government loans, and on the other hand, of providing the public with the funds necessary for subscribing to these loans.

There is every reason to believe that the rise in interest will definitely continue long after the war, since the same causes will remain

in operation.[1] Given the urgent necessity for reconstruction everywhere, the world will experience a veritable famine of capital; and if, as Mr. Irving Fisher says, the real cause of interest is "impatience," it will surely never have operated with such intensity as now! Moreover, since the supply of capital will be at a minimum, owing to the terrible extent to which it has been consumed, and since the productiveness of businesses after the war will undoubtedly be greater than it has ever been before, on account of the rise of prices, we certainly cannot see a single reason for believing that the rate of interest will fall for some time yet.

But this time, too, will pass, and if we look beyond it and try to forecast the fluctuations of the various factors that influence the rate of interest, we can but find them quite uncertain. The increasing abundance of capital is indeed probable; but it may very well be counterbalanced by an increasing demand. Does not every business undertaking require a greater and greater amount of capital? And so far as risk is concerned, does anyone imagine that there are fewer insolvent debtors now than there used to be, or fewer bankruptcies, fewer gigantic swindles, or less capital swallowed up in hazardous enterprises and, above all, in the bottomless gulf of armaments? Certainly not! Why, then, should anyone feel justified in concluding that it will be different in the future?

In the matter of productiveness, if we look only at a given industry, such as railways or gas lighting, there is undoubtedly a limit to their development; but if we look at production in general, we can see that old industries are continually being replaced by new ones. Now there is no ground for asserting that motor transport, for example, will be less remunerative than rail transport, or electric lighting less remunerative than gas.

In short, what seems most likely is that the rate of interest will pass through the same long periods of alternate rise and fall in the future as in the past.[2] It does not appear to us to be established, therefore, that belief in an indefinite fall in the rate of interest can be erected into a law, or that there is any foundation for regarding it

[1] For many arguments in support of this view see an article on "The Rate of Interest after the War," by Mr. Irving Fisher, in the *Annals* of the Academy of Philadelphia (November, 1916). The contrary view has also been maintained, however.

[2] This forecast, which we made in the first edition of this book in 1883, did not agree with that of M. Paul Leroy-Beaulieu, who, like almost all economists of the liberal school, has always predicted a fall. This prediction was fulfilled down to 1897, when the fall was succeeded by a rise.

as one of the factors tending to bring about the equalization of human conditions.

This is not to say, however, that we may not be right in expecting the share of wealth accruing to capital to be reduced in the future; but this reduction will take place in profits rather than in interest (see below, Chapter IV). Nor would such a result be due to the operation of some natural law, but to purposive and persevering human action, operating probably through co-operative credit associations and similar consumers' societies.

With regard to the hypothesis that the rate of interest might fall to zero, or even lower, this is by no means such an absurdity as it would be to see all wealth becoming free on account of its superabundance. For the production of wealth necessarily involves labour, and is therefore burdensome, whereas the transformation of wealth into capital is only a change of destination, not necessarily involving labour, or even hardship. Of course purely gratuitous lending will always be an act of generosity and, as such, outside the sphere of political economy. But it is conceivable that, in cases of abundance of capital, the lender might be satisfied with the certainty of recovering his capital at the right time, and with being exempted meanwhile from the trouble of looking after it. That is exactly what sometimes takes place in the case of loans in the shape of deposits.