

A SYNTHETIC THEORY OF INTEREST

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I

It has long been apparent, as it seems to the writer, that there was need for an explanation of interest that would bring together and harmonize the various theories. This synthetic theory should be stated, so far as possible, in non-technical terms. This paper is an attempt to achieve that result.

II

Any satisfactory explanation of interest must answer two questions. First: Why is capital desired? Second: Why is it scarce, that is, why isn't there enough to satisfy the desire for it? Neither answer is sufficient; together they are adequate.

The answer to the first question requires some sort of a productivity theory (of this, more later). The answer to the second question requires an analysis of the cost of producing capital. The two answers bring the discussion under the static theory of the balancing of utility and cost.

As to the productivity of capital, let us not quarrel over the meaning of words. All the term productivity means in this discussion is that equipment, that is, tools, machines, etc., are aids to production. Capital includes engines, stockpiles of raw materials, stores of consumer goods waiting for buyers, the buildings that house them, everything which a business man uses in his business. They enable industries to produce more than could be produced without them.

Here we must repeat the point often made before, that capital consists of tangible things and is not a fund of value. Failure to see this point may account for some of the confusion regarding the word productivity. The value of the things called capital is not the cause but the result of the increases in production that follow the use of equipment. This fund of value is an indication of men's desire for tools and other equipment. If one thinks of capital as a fund of value, and sees that value is not the cause but the result of increased productivity, he may decide that capital is not productive.

No one is likely to deny that a well equipped industry is more productive than one that lacks equipment or lacks good equipment.

If he realizes that equipment is capital he must agree that capital is an aid to production. To deny that is like denying that tools are useful. Useful for what? For production.

When one speaks of the productivity of capital he does not imply that capital can, alone and by itself, produce anything. Neither can anything else. No result ever proceeds from a single cause. By way of illustration, nitrogen is generally regarded as the most productive ingredient in commercial fertilizer, yet alone it can produce nothing. Mixed with a multitude of other things in the right proportions it adds to the farmer's crop. That is a sufficient reason why the farmer should desire nitrogen. Other capital is productive in the same sense as nitrogen, which is one kind of capital. It should be obvious that the reason capital is desired is that industries can produce more with than without it. Call that productivity or not as you like. It is the answer to our first question.

III

This brings us to our second question: Why isn't there enough capital to satisfy all desire for it? The word cost supplies the answer.

But what does the cost of capital include? In the last analysis, cost is disinclination — the disinclination of men to do what is necessary, or enough of what is necessary, to get a thing produced. The money cost is the amount that has to be paid to overcome that disinclination and get the thing produced, or enough of it produced to satisfy the demand for it. That raises the question: What must men do in order to produce the equipment that is called capital?

A self-employed worker, whether mechanic or farmer, must do three things. He must work, he must wait, and he must run risks. If he is disinclined to do as much of any of these as is necessary to supply the demand, he must be paid and that payment is part of the money cost of production.

As to waiting, it must be observed that it has to be done if the process of production is lengthened. The self-employed worker must do his own waiting unless someone else will do it for him. He is relieved in part if someone will pay him for his work before the work is finished and the product sold. But that does not eliminate the necessity to wait. It merely transfers the burden of waiting from one to another.

But is waiting burdensome? Not all of it. Men seem to be endowed with a squirrel-like propensity to collect, to store and to save. Much waiting is done without thought of gain. But that does

not answer the question: Will they do as much voluntary waiting as is necessary to equip our industries as we want them equipped? If not, they must be paid in a free economy. In a coercive economy they may be compelled to wait for their reward by being taxed.

The experience of our government in financing a war may throw some light on this. There is no doubt that the government could have sold a good many bonds even if it only promised to pay back after ten years as much as the buyer paid. But could it have sold as many as was necessary to finance a war? The government didn't think it worth trying. Even with the promise of a return of four dollars for every three invested it had to do a lot of high-pressure salesmanship, supplemented by appeals to patriotism, to sell enough bonds.

Men do not seem any more inclined to finance our industries than to finance our government. In other words, they are disinclined to do as much waiting as is necessary to keep our industries equipped and growing. Therefore they must be paid. That payment is called interest and it is a part of the money cost of producing the *things*, for they are *things*, called capital.

IV

We have now brought the abstinence and the productivity theories of interest into harmony by showing that they are both essential parts of a satisfactory explanation of interest. The acceptance of this synthetic theory will probably depend on the acceptance of the concept of capital as a collection of things rather than as a fund of value.

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