The Origin of Interest

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In the last number of this Journal Professor J.B. Clark has given in some detail his views upon the origin of interest, and has there placed in opposition to my theory his own theory of "permanent capital" and its "specific productivity." I have, however, already set forth at such length in my last article the consideration which forbid me to accept as a really scientific explanation of interest his brilliant but somewhat dangerous speculations, that it would be too great a strain upon the reader's patience again to take up that matter. We have each put our views clearly and fully before the public for public approval or disapproval.

Upon a few new points made by Professor Clark, however, I wish to say a few words, not in order to advance opinions, but merely to substantiate facts.

1. Professor Clark seems to assume that I have in my last article "introduced into the problem for the first time" the case of money, representing money as a species of "goods" manifesting the difference in value between present and future goods. In this he is mistaken. For in many, and in some of the most important, passages of my Positive Theory of Capital I have used money as an illustration of the proposition that present are worth more than future goods.

2. Again, Professor Clark seems to regard my theory of interest as a sort of abstinence theory. He believes that, so far as my theory of interest is concerned, production periods are significant, because "there are in society persons who must wait through such intervals in order to have their wants gratified" (p. 259). This waiting for the gratification of wants, this undergoing of a temporary privation, he calls a "time sacrifice" (p. 259); and he believes that in my theory I make interest a payment or compensation for this sacrifice. "In the study of Professor v. Böhm-Bawerk loan interest is the consideration for this. It is a payment for vicarious waiting" (p. 259). "There must be" -- if my theory is true -- "actual persons... who demand and get pay for this waiting" (p. 260). Likewise, on page 265, he speaks of a "sacrifice for which" -- according to my theory -- "a capitalist earns his income." And he urges against me the objection that in a static condition of society no one makes such a sacrifice and "no true abstinence is practised" (p. 260), although there is none the less in such a society an earning of interest.

A total misunderstanding of my theory underlies the above conception of it, -- a misunderstanding which I confess not a little embarrasses me; for, if misunderstanding is possible even here, I do not know how to avoid misunderstanding. In my book on Capital and Interest I have devoted one whole chapter to combatting the idea that interest is a reward for abstinence on the part of the capitalist.

On page 363 of my Positive Theory I have expressly stated that by "the much abused expression, Reward of Abstinence, the existence of interest cannot be theoretically explained' one cannot hope in using it to say anything about the essential nature of interest; every one knows how much interest is simply pocketed without any 'abstinence' that deserves reward!" Furthermore, I have emphatically and repeatedly laid it down that, at a rule, capitalists do not forego any personal indulgence when loaning or investing productively their present goods. For they would not, even in the absence of such an opportunity for investment, consume their capital stock at the present moment, but would in any event preserve it to provide for themselves in the future. In other words, for them the subjective use-value of present goods is no greater than that of future good (for example, pp. 315, 330, 375). Therefore, I do not at all hold -- nor is it a presupposition of my theory -- that any one must suffer want or hunger during the periods of production. My theory, on the contrary, hinges upon the objective fact that certain fruitful methods of production are "time-robbing", or demand a "sacrifice of time" in the sense (as explained on page 82) that "they procure us more or better consumption goods, but only at a later period of time." The remaining steps in the explanation are as follows: Time-robbing, roundabout methods of production, can of course be employed only when one is provided to the very end that one shall not in that interval suffer want). The disposal of present goods becomes thus a condition to the employment of more advantageous methods in production: hence that active and intense demand for present goods, the supply of which is always limited, which finally gives rise to an agio upon them; i.e. to interest. In this exposition it is nowhere presupposed that any one suffers from leaving present wants unsatisfied, or that any one practices

painful abstinence. Nowhere is interest explained as a compensation for a special personal sacrifice undergone by the capitalist or by any one else; but it is explained simply as the result of the objective fact that the commodity "present goods", which the capitalist holds in his hand, has greater value than the commodity "future goods" for which he in any way exchanges the former commodity. Or, as I have expressed the matter on page 336 of my Positive Theory, interest is the "legitimate consequence of the constant fact that present goods are more useful and are more desired than future goods, and that they are never present and offered in unlimited abundance. This agio [i.e. for present goods], thus organically necessary, is given directly on the loan market in the shape of interest, while on the labor market it is given in the form of a price for labor which remains under the amount of the future product of labor."

I agree fully with Professor Clark that interest is a "static income", and that it owes its origin to "static causes"; also that "creating new capital is not a part of the process by which interest is secured." (p. 260). Finally, I can also let pass as true in a certain sense his thesis that "no true abstinence is practised" in the mere preserving of capital unimpaired. But, when Professor Clark wishes to deduce from this case of interest without true abstinence an argument against my theory, I reply: this can be an argument against a theory which makes use of abstinence in its explanation of interest, but not against my theory.

3. The lengthening of the periods of production plays an important part in my theory. Upon this point Professor Clark, on page 270 of his article, expresses himself as follows: "If we try to follow the effect of the action of a tool forward to a point at which consumers' goods, and these only, remain as a result of its action, we shall follow it forever without reaching what we seek," And to this he adds the following remark, evidently expressing an objection to my theory: "Productive periods begin with civilization and never end. It is not possible to lengthen them."

The reader of my Positive Theory will find the same thought expressed in almost the same words on page 88. But he will find also n connection therewith a detailed exposition of the fact that there are two ways of computing the length of production periods. One may have reference to the "absolute period." which is computed "from the moment on which the first hand was laid to the making of its first intermediate product right down to the completion of the good itself." Of the production period in this sense everything holds that Professor Clark has said, and I have anticipated him in remarking this on page 88 of my Positive Theory. But one may also have reference to the period "which elapses on the average between the expenditure of the original productive powers, labor, and uses of land, as successively employed in any work, and the turning out of the finished consumption goods." This second way of counting the length of the production period I have explained very fully on pages 89 and 90 of my Positive Theory; and among other things I have shown that a lengthening or shortening of the period is possible, and how it is so, in this sense. It was for that reason that I expressly added (p. 90): "Where I have spoken above of extension or prolongation of the roundabout process of production, and of degrees of capitalism, I must be understood in the sense just explained. The length or the shortness of the process, its extension or its curtailment, is not to be measured by the absolute duration of the period that lies between the expenditure of the first atom of labor and the last... But it is to be measured by the average period which lies between the successive expenditure in labor and uses of land and the obtaining of the final good." Professor Clark's argument that in a certain other sense a lengthening of the production period is not possible, therefore, again seems to me to be an argument directed against a theory which I do not hold.

That the lengthening of the period in my sense, as a rule, goes hand in hand with an increase of invested capital, is just as evident in the light of my theory to me as it can be to Professor Clark in the light of his theory. That he differs with me as to which is the cause and which the effect in this lengthened production period and increased capital investment is due to the difference in our fundamental views. This difference I will not here again discuss.

4. On pages 273 to 275 Professor Clark cites the case of two mills, a water-mill and a steam-mill, which yield the same rate of interest on capital invested, though their "production periods" are of unequal lengths, the production period of the water-mill being much longer because of the long life of the dam, race, wheel-pit, etc. He finds in this example proof that production periods "may be lengthened or shortened without affecting the productivity of industry" (p. 275), and evidently thinks he has here brought forward an argument against my assertion that lengthening production periods makes productive processes more fruitful.

I shall not discuss the example at length. For the benefit of those who may care to look into the matter more closely, however, I would observe that Professor Clark's argument seems to me to rest upon an ambiguity, which he has evidently overlooked, in the use of the word "productivity". By equally great "productivity of industry" in the case cited he means equally high rates of interest on the capital invested. In my theory, however, the term has reference to an entirely different matter. It there refers to the consideration whether for the expenditure of a unit of original productive powers -- i.e., for each day's or each month's labor -- a man gets equally great products or products greater in some instances than in others. These are two very different matters; and the reader will readily perceive that, in the case of production periods of unequal lengths, equal productivity in the first sense and equal productivity in the second sense, not only need not, but can not coincide with each other.

By way of a simple illustration let us assume that the expenditure of one hundred days' labor, wages being at two dollars a day, will produce at the end of a production period of one year one hundred articles worth each two dollars and ten cents. Upon an invested capital of two hundred dollars this yield a profit of ten dollars in one year or an interest of 5 per cent. Were the production period two years and the technical productivity the same, -- that is to say, were the product of one hundred days' labor and a production period of two years only one hundred pieces of the same commodity, -- then there would be a profit of ten dollars upon a capital to two hundred dollars invested for two years. The capital would therefore bear only 2 1/2 per cent interest; and the "productivity of industry", as Professor Clark understands the phrase, would be lessened. If productivity, in Professor Clark's sense, is to remain undiminished, "technical productivity," as I use the term, must evidently be greater in the process extending over a period of two years. If in the two-year period one produces with one hundred days' labor one hundred and five pieces of the commodity, there is a final return of two hundred and twenty dollars and fifty cents, or an interest upon the capital of 5 per cent per annum.

And this is true of Professor Clark's illustration. If the average production period and period of investment of capital are really greater in the case of the water-mill, then the technical productivity of the labor spent upon the water-mill must also be greater, in order to secure to the capital invested the same rate of interest for the longer time! Equal "productivity of industry" in Professor Clark's sense, therefore, necessarily involves "unequal productivity' in my sense of the term; and the illustration is therefore a substantiation rather than a refutation of my view.

I may add that in my Positive Theory I have anticipated such objections as Professor Clark now brings forward. I was quite aware that in the production of the same article production periods of unequal duration are frequently employed, and that the greater technical productivity of the longer periods may be exactly counterbalanced by heavier interest charges. The reader will find a typical exposition of such a case on page 397 and following, and similar expositions on page 304 and following, and pages 404 to 406. What is said in the last-mentioned passages about "different branches of production" applies in exactly the same way to different methods of producing the same commodity.

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