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SOME CONSIDERATIONS ABOUT INTEREST.

IN an essay recently published by the present writer the attempt was made to show that the general assumption that saving depended upon the rate of interest, increasing with its rise and diminishing with its fall, was, to say the least, *unproved*. The argument, indeed, went further. Certain reasons were adduced which undoubtedly tend, so far as they go, to a contrary conclusion; and to this extent it was contended that interest, though not without effect upon saving, operated in such a way, or rather in such different ways, that saving might well proceed undeterred by alterations in the rate, or even in the absence of any rate. Of course, in this argument there is no suggestion that interest is a dispensable factor in the economy of a society regulated as our society is regulated; its existence depending, as it does, on circumstances involved in the demand for and the distribution of capital, as distinct from those relating to saving or the supply of capital.

Owing to the fact that this essay had been written some time ago, one form of the argument as to the social utility of interest, namely, that revived and so admirably stated by Dr. Cassel, received inadequate attention. The position taken by Dr. Cassel was indeed stated and subjected to some examination; but not to an examination so careful or methodical as it deserved. It is proposed in this paper to attempt some supplement to the essay in question.

The position to be considered can be briefly stated. Wholly independent of the argument by Böhm Bawerk, which attributes the need of interest to a difference in magnitude or utility, and so in incentive force between things in the present and things in the future, a need which may be modified or even neutralised by apprehension and anxiety as to the future, it is necessary to recognise that the life of man is limited, and that therefore he cannot go on postponing indefinitely, that some time the future for which provision has been made arrives, when the period of consumption will replace that of postponement. Saving, that is, takes

place in view of needs which occur within fairly definite limits, and which are not capable of indefinite and continuous postponement. Consequently, it is urged, the particular method of saving adopted is of importance. Of methods of saving there are two under consideration. By one, that largely in use at the present time, whereby saving takes place chiefly in view of the income derived in interest, the provision for future wants is made in terms of interest; and so when the time for future satisfaction comes, needs are met without a withdrawal of the sum accumulated, from its use as productive capital. Under the alternative system, saving is governed by the consideration of the satisfaction to be obtained by the gradual consumption of the sum thus accumulated, and so when the needs provided against present themselves, that sum is necessarily and proportionately diminished, with, as a result, a corresponding decrease in the total productive capital. The conclusion drawn is that the former method is advantageous to society in general, and that therefore such a rate of interest is required as will secure its fairly general adoption. This rate has been stated as something under two per cent., having regard to the duration of life and to what may be called the period of anticipated needs. But the actual rate itself is not a matter of great consequence for our purpose, the main importance lying in the existence of some minimum rate sufficient to prevent the substitution of one method of securing the future for another method, which is held to be more advantageous to the productive interests not of the individual but of the community. The point at issue is whether the former method is necessarily less advantageous; whether, in other words, its adoption can be said to lead necessarily to such an alteration in accumulation as will diminish the amount of capital in industrial use. Saving, it will be generally admitted, will proceed, provided, that is, that the desire to provide for the future remains in undiminished force, but it will necessarily be more widespread, each succeeding generation being forced to provide for its future instead of relying upon the inheritance of the savings of the past, which are now reconverted into the form of immediate commodities to meet the actual needs, in view of which they have been specifically put aside. That new saving will take place cannot be doubted, but it may be doubted if it will take place in sufficient quantity to replace as capital that which is withdrawn.

With regard to this, certain considerations present themselves which may be dealt with under two headings.

In the first place, there are considerations which touch directly the point at issue.

Firstly, in this connection it may be questioned whether provision made by the two methods already sketched is in view of the same needs and embodies itself in equal satisfactions. In the one case a series of different wants extending over a specific number of years is provided for; but, in the other case, while equal provision is made for these, there remains over the total sum at the end of the period. But if this be so, the two cases are not analogous. Either certain possible satisfactions have been operating as incentives to saving in the latter case, or else, if not, a singularly foolish and uneconomical method has been adopted, those who save effecting provision for needs which they do not feel or anticipate. To put the cases on a level, it must be assumed that in each case provision is made for the same quantity of satisfactions and for no more. But if this be done, it seems clear that greater accumulations will be required in a system without interest than in a system with interest. Of course, it is not denied that long usage of a particular method may lead to the practical subordination of these further or, so to speak, *incidental* ends, so that they rest in many instances as unconscious results, or exist in others as sub-conscious incentives; but illusions of this kind are not a very stable basis. Indeed, it is quite clear that in many cases the bubble has been pricked. On the other hand, if these *incidental* satisfactions, which are secured by the survival of the total accumulation after the more immediate advantages definitely anticipated have been satisfied, are real and at all substantial, some effort will be made to provide for them, even if a method of saving be adopted which does not involve them so simply. Such provision, however, will necessitate greater accumulation than has previously been the case, and hence the provision of a new amount of capital which would go far to compensate or even more than compensate for the gradual withdrawals which take place.

It will not do, however, to overlook the possibility that postponement may suffer because of the less result ensuing. But this is a feature which takes place with every reduction in interest, though no doubt particularly accentuated here. For the present it may be reserved, with this remark, that it depends on the degree of apprehension and anxiety as to the future. If that be great, it seems difficult to assume that further savings would not be made, should such be necessary to the end in view.

Secondly, one general difference between the two methods

under review requires to be noted. In the case where interest exists, the uncertainty which attends on the wants of the future is naturally and simply provided for. If life be prolonged, the income from interest still continues. But in the other case it would seem probable that, in many instances, at any rate, some species of insurance will be required. Possibly, if the period over which consumption of the corpus is to be spread extend over sixty or seventy years, insurance would not be necessary; but it may be assumed that even then in some instances insurance will be adopted. If this be so, a definite diminution in the amount saved would seem probable, since provision by insurance for contingencies requires a smaller amount of accumulation than when provision is made separately by each individual. Still, after all, two things must be remembered. Insurance under a system of interest requires a smaller amount of accumulation than if there be no interest, granted that the ends contemplated be the same. Again, even under existing conditions insurance is an increasing means of providing for the future. During the last few years a great development has taken place in the benefits offered, policies providing for annuities and lump sums on death prior to the date of such annuities enabling provision to be made by the same act for various possible needs. From all accounts a considerable increase in this method of providing for the future has occurred. With this in view, the effect of a system of saving without interest would be to accelerate rather than to occasion the adoption of insurance, while at the same time, owing to it, a larger accumulation of wealth would be required than were interest in existence, granted, of course, that provision be made for approximately the same needs.

With regard to the difference between the two systems, one thing must be added. If insurance be involved, the great advantage of the interest-bearing system in early times is obvious. The uncertainty besetting the future until definitely calculated could not be provided against except by permanent annual income. Only with the growth of accuracy, both in the actual appreciation of specific wants and in the estimate of their probability, can any other system bear comparison with it. Even so, it is clearly open to discussion whether any other system, carefully elaborated though it may be, can offer a means of provision so far-reaching in the objects combined and so satisfactory from the standpoint of permanence. But this point, like that mentioned above, may stand over for the time.

In the second place, we must turn to the consequences ensuing

from a system under which the burden of providing for future wants would be imposed mainly upon the generation concerned.

Firstly, one result of such a change would be a considerable increase in the industrial efficiency of a class which is now largely supported by wealth saved by others and inherited from them. There would be more productive labour. Though this has no direct concern with saving, in one way it may affect it indirectly through the general increase taking place in the production of the community. For a time no doubt there would be even greater competition for capital, but with the growing power of the community itself a larger revenue would accrue, out of which savings might be made, if only the need for them by an appreciation of the wants of the future be adequately realised. Ultimate results such as this may possibly be deemed too hypothetical to be taken into account in this narrower consideration. It is well, however, to notice them, and to remember that so far as this aspect is concerned the absence of interest would have advantageous rather than detrimental results.

Secondly, the consequences on saving of a greater distribution of wealth among those in receipt of wages, salaries, and all forms of direct earnings must be borne in view. The reduction or the withdrawal of interest will be accompanied by an increase in the direct earnings of those engaged in work, including under this all payments made for personal service. It is difficult to determine how far this would affect saving, just because the grounds for an estimate as to the classes contributing to saving even in the past and present seem wanting. But if it is difficult to determine at all certainly the classes which, given their wealth, contribute proportionally the most to the capital of the country at the present time, it is far more difficult to say what classes would contribute the most under a new order of things. Probably the general result would be for a wide distribution among the population, with a consequent rise in the earnings of the less well off classes out of proportion to those of the more highly paid few. According to generally accepted statistical estimates, this has been a feature, so far as this country is concerned, of the last half-century or so; but if this has been so, it has not had any detrimental effect upon accumulation. That has grown. So far as it goes, it would seem fair to conclude that an alteration in distribution would be unattended by detrimental effects upon saving. Possibly it might be safe to go further and to substitute a more positive conclusion.

Thirdly, a more definite result would seem to be the prevention

of a good deal of the waste of past savings which now takes place. Though the main object of this paper is to investigate the influence on saving of a particular system, it must be remembered that the suggested defect in this system is not that saving would not exist, but that the amount saved would be converted to the satisfaction of the wants of those who have saved it. Consequently it is by no means impertinent to inquire how far some process of gradual and wasteful attrition takes place at the present time. Here again so far as quantities are concerned we are involved in surmises, and no estimate is possible. But so far as the main matter is concerned there is little room for doubt. Unfortunately not only is the capital sum thus withdrawn from use, but it is often wastefully withdrawn, and when this occurs usually by those who are the least likely persons in the world to assist in its replacement. Now under the one system withdrawal from capital use for consumption use takes place in normal course, and is met equally normally by replacement. Even were it proved that a somewhat smaller amount would at any given time be in capital use, savings would be applied to the satisfaction of definite wants for which specific provision is required, and replacement would take place systematically. Over against this we must reckon what occurs at the present time, when the sum saved is withdrawn, being either through extravagance or carelessness applied to anything but wants specifically in view when provision was made, and without any probability of concurrent replacement. Putting aside the nature of the consumption, whether wasteful or extravagant—which, after all, is beside the mark so far as the present inquiry is concerned—there remains withdrawal without replacement, a process which undoubtedly tends to a diminution of the active productive capital of the country. This occurs at the hands not, as a rule, of those who have saved, who after all have some object in view during their calculated abstention, but at the hands of those who inherit, who, it is suggested, think of anything rather than subsequent replacement.

It must, however, be remembered that this would not take place in a society, were all persons, those who inherit savings equally with those who inherit nothing but personal qualities, compelled to work; but it seems undoubted that inherited wealth as an institution tends somewhat in the opposite direction, and under its *régime* we may expect in consequence a certain amount of withdrawal to occur. The only question is how this, occurring as it does without replacement, stands as compared with any alleged diminution due to a system of continuous con-

sumption use of the sum saved, accompanied as that is by systematic replacement.

Under the foregoing headings certain considerations have been adduced with the object of showing that the suggestion that under a system of saving without interest there would be less capital at the disposal of a community is less certain than it may seem at first sight; that on the contrary and owing to the action of forces, some indeed problematic but some very fairly certain, the very opposite may take place; that under certain conditions the impulse to save may be enforced and new opportunities for accumulation may be occasioned, while at the same time a definite and uncompensated withdrawal from use may be avoided. But much of what has been said on these points depends on matters which after mention were reserved for fuller discussion. Before turning to these the case may be restated.

The assumption that under a system with interest saving would result in a larger provision of capital than if there were no interest appears initially to be tenable only if the existence of the capital sum at the end of the period saved for, or after the range of satisfactions sought and attained, is ignored. Its possession and continuance after these has either served as an incentive, in which case a like incentive under the alternative system might result in more accumulation, or is a mere incident without stimulus or result, in which case it may be assumed the increase of intelligence will lead to the consumption of capital as well as interest within the period or area covered by anticipation. But in this case saving, if it fulfil the same purpose, will result in a larger provision of capital when there is no interest than when such is paid. Again, the very alteration in method to which attention is directed develops conditions likely to be favourable rather than unfavourable to the supply of such capital.

But this, if put otherwise than tentatively, assumes certain conclusions in respect of these questions.

First of all, custom at any rate lends some warrant to the view that under existing circumstances the survival of the total sum set aside may itself be an object so long as it be linked with the possibility of some not inadequate personal benefit; but that if severed from such it would cease to stimulate postponement. Pride and a species of indefinite apprehension have invested the capital as distinct from the income with sanctity. Despite the fact that in many cases living on capital is the most sensible thing to do, prudent people shrink from such a course. Nor is their intention likely to be attacked by the younger generation surrounding them.

Again, there is the undoubted fact that the existence of interest enables a given amount of saving to achieve greater satisfactions, a feature which presents itself in this instance just as it does when a rise in the rate is contemplated. The position is a perfectly simple one. Granted an increase without effort in the amount saved, what, it may be asked, will be the result? This has been discussed elsewhere so far as alterations in the rate of interest are concerned. Here the form is different, but the principle the same. It is a case of eating the cake and yet having it, no doubt much pleasanter in many ways; but the only point to be considered in this connection is whether this possibility leads to a larger or a smaller cake. In both instances it must be remembered there is a comparison to be made as between the present and the future, and, on the whole, what is required in the future depends on what is being enjoyed in the present. The mere fact that it is more agreeable to save when something is done to transform what is saved into some larger sum does not determine the matter, since it is quite possible that the ultimate result will be something more in the present, and so a less provision of productive capital. After all, people do not spend their lives saving as much as they can, but as much as they are willing to spare from the present, and the standard of present wants is fairly elastic. On the other hand, it is equally true that given the degree of apprehension and anticipation existing at the time, saving must be made to seem worth while.

Thirdly, however, when the position which would occur in the absence of interest is discussed, a special turn is given to the matters considered above. Under early conditions, and possibly under conditions prevailing in some instances at the present time, an interest-bearing system offers particular guarantees alike as to permanence, and so security, and as to the possibility of combining a large reserve against special contingencies with an annual income till such be needed or in its continued absence. Before the development of insurance, and especially of the more varied methods to which allusion has been made, the superiority of such a system could not be contested; and even now in some respects it continues to offer special advantages, and so to present to some the best means of effecting provision sufficiently adapted to their circumstances to tempt them to save. In some instances, on the other hand, the absence of interest will tend to increase the amount accumulated.

The considerations suggested in these last paragraphs, though they may modify the conclusions previously stated so far as their immediate applicability is concerned, do not invalidate them. It

may be true that unreasoned prejudice still leads to the desire to die possessed of a fortune, be it large or small, and so to achieve an exit from the world irradiated by a thrifty splendour; but there are signs that this is less forcible than it once was. It is also true that the more elaborate methods of insurance are of comparative recent date; but there is every sign that insurance for the various needs of the future is continually more resorted to. The point at issue is not whether at the present moment interest is influential in securing a larger provision of capital than would otherwise be in use, but whether, taking things as they are and tendencies as they present themselves, it is *essential* for such a purpose. This does not seem to be the case. At any rate, much more proof is required in support of any such position.

Undoubtedly it might hold good under one set of circumstances, namely, if the inheritance of wealth did not hinder the action of those who inherit either in work or in the desire to make further provision for the future. In this case larger accumulations of wealth to be used as capital would be insured, since with energy in labour undiminished the standard of living in the present, and so in respect of what is wanted for the future, would be raised.

A few words as to the general problem of interest will not be out of place. The point raised here and elsewhere is not the position of interest as existing in a competitive society conditioned as at present. That is secured, if in no other way, by the circumstances of the demand for capital and the manner in which it is distributed among those who use it. Still less is the effect of interest in certain social phases doubted. The question at issue is whether interest is or is not essential to accumulation in an age keenly alive to the vicissitudes of the future and anxious as to what it may bring forth. The answer in the affirmative rests on two grounds.

On the one hand there is Böhm Bawerk's theory, which treats interest as necessary, because it adds enough to make the prospect of future enjoyment equal to that foregone or postponed. The conception is individualistic. The future is emphasised to incite the individual to save. On the other hand, we have the view now under consideration which treats the matter from the point of view of the community rather than of the individual. The need is not so much of leading the individual to postpone as of securing that provision for the future be made in one rather than another way.

Now with regard to the first it is recognised by many, as indeed by Böhm Bawerk, that given a certain degree of anxiety

interest might not be required. But there are certain factors which have been inadequately recognised, if indeed recognised at all. One is the difference of motive among those saving; the other, the restriction placed upon the amount required in the future by the present standard.

With regard to the second ground, the considerations raised in this paper must be taken into account. They are wider than those previously dealt with; but then the position is itself less defined, affecting, as it does, the general advantage of the community rather than the specific inducements required to make an individual realise the future.

In conclusion, the factors which underlie the problem of saving, and so affect interest, may be enumerated. The following considerations appear to be permanent :—

(a) Postponement is determined by a comparison between present and future satisfactions.

(b) The wants to be satisfied in the future are in the main determined by those satisfied under the present standard of living.

(c) Future wants are not capable of indefinite postponement, the anticipation of the future being conditioned by the duration of life.

(d) The possibility of complete provision is in many cases necessary to induce saving.

(e) The motives of saving are not uniform, and so not subject to the same laws.

But operating among these conditions there are other factors or influences which may be termed variable, altering with time, and so exerting greater or less effect as the case may be. Such are :—

1. The degree of anxiety or apprehension as to the future.
2. The desire for the possession of a lump sum of wealth in itself, and apart from considerations of its definite use.
3. The growth of insurance, which is independent of interest.

Taking account of these, it would seem obvious that the problem of saving and interest, so far from being statical, is essentially dynamical. With different phases of society different methods of providing for the future present themselves. What is wanted most is not a history of the theories held about interest or saving, but a history of these as they have presented themselves in the past and operated under different conditions.

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