or the stove used to braise, broil or roast the steak—there is much to be said for regarding it as capital, even when it is in the hands of the final owner. It is a tool. It contributes to the preparation of the food, i.e., it contributes to production.

It will help make clear the concept of capital if we here distinguish between "direct" production and "roundabout" production. Let us begin with an illustration. If you go into the woods and pick wild blackberries to eat for lunch, you are engaged in direct production of blackberries. If you plant and cultivate blackberry bushes—because you want to get blackberries later when the bushes bear them—you are still producing berries. But in this latter case you are following a *roundabout* process of production. You are producing well-cultivated and well-watered blackberry bushes because from them you will later get blackberries and more of them from the same work. Similarly, if you catch fish you are engaged in direct production. But if you make a net or build a boat, or both, to be used as equipment for catching fish, you are engaged in roundabout production. For you are producing a tool or tools which themselves aid in later production—in this case, of fish. Still again, if a worker is employed in a factory that manufactures tractors which are used by farmers to help prepare land for blackberry bushes, for wheat or corn, this worker is engaged in production still more roundabout. And so is the factory. And those whose labor built the factory or whose labor and capital produced the brick, lumber and steel used in constructing it, were engaged in production even more roundabout.

Thus capital is something that men produce; it aids in the further production that satisfies men's needs and wants; it is itself something that is intermediate between the beginning of roundabout production and the final consumable goods or service satisfactions which it provides or helps to provide. If it sometimes happens that we are not sure whether a particular article is a consumable good or capital—just as we may hesitate to assert categorically whether a particular person is a boy or man—in most cases we can be certain enough. Freight cars, locomotives, factories, steamships, tunnels, warehouses, trucks, looms, planted fruit trees, fertility put into farm land, fences, cattle—the list might be extended much farther without raising any question of our including anything other than "capital."

Our society has come a long way from the conditions of the pioneer settlers who had to produce for themselves most of the necessities of life. Today we specialize and trade products with each other. Some produce fish. Some produce bread. Some produce meat. Some make cheese. Some dig potatoes. Some make cloth. Some manufacture shoes. Some provide music. Some provide various other things that all or many of us desire. Then, by exchange, using money and/or bank checks, each of us can enjoy a share of the things others are producing. Each sells goods or services of his own production, for money and/or bank checks. Then each spends money or bank checks for goods produced by others.

But when we come to consider, instead of such consumable goods and services as those listed above, the equipment (including buildings, ships, wharves, machinery, etc.) which we must have to make our efforts effective, our analysis needs to be a bit more involved. For such equipment—capital—does not serve us directly but only indirectly. We cannot eat it. We cannot use it as clothing to keep us warm. We do not enjoy it as entertainment. Consequently, those who produce capital are not contributing *directly* to our living and our enjoyment of life.

Nevertheless, they cannot and will not devote themselves to producing this capital unless they, too, can have a share of the food, clothing, and additional consumable goods and services which other are producing. If this is to be possible, those who are producing consumable goods must produce more than they and their families need. This surplus when sold on the market accomplishes two purposes. First, the workers in the factories, etc., who are producing capital, can now buy in the market, the food, clothing, and other consumable goods. If this surplus had not been produced the workers would have to spend a portion of each day raising food, weaving cloth for clothing, and so on, to provide the necessities for their families. Second, as we know, in order that the workers may be able to buy, they must have money or checking accounts. This is made possible because others have saved and invested. In some fashion, the producers of these consumable goods and services must either have a motive ("incentive") to provide for the producers of capital — through saving and investing—or else they must be compelled to do so. If they are to have an incentive, what shall it be—or what is it? And just HOW—by what process—do they provide for the producers of capital?

IV

If, then, capital can come into existence only as there is saving and investing, should saving and investing be discouraged in every possible way? Or should there be incentive?

Is it important for the community that there should be capital? Is it important that there should be a great deal of capital? Is it a fact that men can produce more of the things they need for living and for living comfortably and well, if they are adequately provided with capital than if they are not? If so, is it appropriate and wise that we permit those whose saving and investment bring capital into existence, to enjoy a share of the added output which the capital makes possible? If we permit this, then there *is* an incentive to voluntary, individual saving and investment.

In a free society in which, therefore, economic life is carried on through free markets (where there is competition) and free private enterprise—such a system is commonly referred to as a capitalistic system—an incentive is present and expresses itself through the mediation of the market. Capital yields a return—a net per cent over and above the expense for repairs and depreciation—to the owners of capital. Part of our task must be to explain *how this net per cent return is determined.*

It is easy to say—but would be far from a sufficient explanation — that the rate of interest on capital is determined by demand and supply. Such a statement, with nothing more, would fail to show the relation of the interest rate to the product—or service—that capital yields. There is such a relation and the student of economics needs to understand it, especially in the era of ideological conflict in which our government finds itself.

The analysis is a bit complicated and so may not be easy to follow. But unless we understand it, the case we present *for* the free-market and private-enterprise system and *against* socialism, will be far weaker than it ought to be and could be.

In order that we may understand the theory of interest on capital, we must pay some attention to the so-called law of diminishing returns. We shall do this, here, with particular reference to capital. To do so, we shall suppose the *capital* used in a business to increase while the land used and the number of workers employed continue the same. More or better (and better will ordinarily be more in value) equipment will increase the product turned out. But *continued* increase of equipment in quantity or in quality will not result, indefinitely, in a proportional increase of product. If it would, then on a 160 acre farm operated by a farmer and his son, it would pay to use a million dollars worth of capital or ten million dollars worth of capital or a hundred million dollars worth. Long before even the smallest of the above figures was reached, each added $1,000 or $100 would add so little to the output, that the man in charge of the farm could not afford to pay even one-tenth of one per cent (interest) a year for the use of it or, probably, one hundreth of one per cent (interest).

If capital in the community is scarce, we try to have what there is of it, in the form of the most important instruments. We get along as best we can, without the less important kinds. Or we use instruments of poorer quality, because there has not been enough saving to make possible both enough tools and these of the highest quality. If there had been *more* saving and investment, we could have had both more equipment, including some of secondary importance, and better *quality* of equipment. With this greater amount of capital to use, the annual product of industry would be larger, but larger in a diminishing degree as capital increased.