

Three Theories of Rent

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[The following article challenges the orthodox conception of rent and sets forth a new theory that, in the author's words, "represents a sharp break from the Ricardian concept." The first part of the article is presented herewith; the second and concluding part will appear in our next issue, following which appropriate comment will be made.—Ed.]

IN these days of economic depression, wars and political confusion, the rent question assumes a position of paramount importance. Current literature dealing with governmental regulation of industry and so-called rugged individualism, democracy and dictatorship, statism and individual rights, is, for the most part, merely a repetition of what has been written in the past and indicates no awareness whatsoever of the real significance of the phenomenon of rent* in modern society. It is my firm belief that a clear understanding of this phenomenon would throw a brilliant light on all the economic and political problems that are plaguing mankind today and would eventually lead to their solution.

I do not believe that it is claiming too much to say that those who have been engaged in serious, scientific investigations on this subject, may be classed among the advanced thinkers of this age. A great deal of progress has been achieved, but, as is inevitable in all such investigations, different opinions and different conclusions are bound to arise when a certain stage of development has been reached and lines of thought diverge in the shape of definite and mutually opposing theories. Therefore, it seems to me appropriate at this time to reappraise these various theories with a view to eradicating those beliefs that are based on mere opinion or assumption and to retaining those that have been tested by the facts of life. Naturally, I am addressing this to those readers who are scientifically-minded, and who, therefore, knowing that they do not possess the whole truth, are eager and fearless enough to tread unfamiliar paths in order to gain, if possible, more enlightenment on this very important matter. Now, as lack of space is the controlling factor, the following examination cannot possibly be an exhaustive one. I shall only offer the highlights of each theory and hope that the reader will be inspired by my few deductions and conclusions to develop them further himself.

Broadly speaking, there are three schools of thought relating to the nature of rent. The first frankly supports the Ricardian concept and numerically is the strongest of

the three. I shall call this school the Ricardian. The second formally rejects the Ricardian theory; but while it represents an advance in some respects over the old theory, it nevertheless contains certain Ricardian characteristics. This school, therefore, I shall refer to as the neo-Ricardian. The third advances a theory that represents a sharp break from the Ricardian concept and differs also from the neo-Ricardian in that it insists upon an accurate description of economic life *as it is today*. It contains the seed of a revolution in economic and political thought. I shall call this the Realistic School.

The Ricardians

The Ricardian theory is accepted by most academic economists with varying qualifications. Briefly, it is this: Rent is the excess of wealth that is produced on land over that which an equivalent amount of labor can produce on the poorest land in use—i. e., on free land at the margin. According to this theory, the best land is cultivated, first, but interpreted broadly, the superiority of land is determined, not only by its fertility as compared with that of land at the margin, but also by its proximity to the markets and to governmental and cultural advantages. It is assumed that the landowner is a non-productive individual and is in no way responsible for either the existence of these advantages or their availability.

The favorite example that is offered to prove that rent is determined by the difference between the products of different grades of land is this: A goes to an island and makes a good living by using a portion of the land. B follows and finds with the same degree of exertion that he can only make a poor living as compared with A by using the other land available to him. The difference between these two standards of living is regarded as rent. In this illustration, nothing is said about government services, and so we must assume that no such services exist. In other words, as there are no policemen to protect A from the encroachments of B, A could not prevent B from sharing the better land if the latter were envious of his favorable location, unless he devoted part of his time and labor to standing guard. While he stood guard, he could not produce any wealth, so that in all probability, he would not be able to profit from his use of the better land. Thus the products of the two grades of land would tend to an equality and no rent would arise. A could only enjoy a higher standard of living if he were stronger and more skilled than B, but in that case the difference would be wages, not rent.

* Ground rent, as distinguished from the payment that is made for the use of a building, a machine or any other article.

But let us assume now that A enjoys the benefit of police protection. In one week, he can produce 10 bushels of corn. In the same time with an equal amount of labor and skill, B can only produce five bushels of corn. As A's excess of five bushels was made possible only by the police protection, he is compelled to turn it over to the policemen as their compensation. Thus his superior location avails him nothing, and he finds that he is living in a fool's paradise.

Looking at the matter from another angle, let us suppose that no policemen are necessary, that B recognizes A's absolute right to his land and makes no attempt to disturb him. In this case, A would certainly enjoy a decided advantage and the excess of his product over that of B the Ricardians would term rent. But is the question as simple as all that? Where in civilized society does such a situation as this exist or ever did exist? Not by the wildest stretch of the imagination can we tie it up with economic life as we know it. Such a situation represents a purely primitive economy—in other words, an individual economy—whereas we are living in an exchange economy. If the Ricardians are to prove their case, their theory must be applicable to an exchange society. They might try to make such an application by claiming that B would be willing to pay A five bushels for the use of the better land. It is doubtful if B would do this, for after such a payment his standard of living would be no higher than he enjoyed when he used the poorer land. If he paid only four bushels, then rent would not be the excess product but only *part* of the excess product. And if B were willing to pay four bushels for a one-bushel advantage, it is just as reasonable to expect that A would be willing to accept only one bushel as rent in exchange for a four-bushel advantage. In other words, rent might be anything from one bushel to five bushels, but this would be inconsistent with the original Ricardian assumption that rent is the excess product.

In order to give this theory as fair a test as possible, let us assume that instead of A and B exchanging products for land, they perceive the advantage of exchanging products for products. In order to be on a par with A, B would produce something else besides corn—say potatoes. They sell them or part of them in the open market. The same amount of labor and skill has produced twice as much corn as potatoes. Thus B would receive in exchange twice as much wealth for a bushel of potatoes as A would for a bushel of corn. Ten bushels of corn then would be equal in value to five bushels of potatoes, and as A would enjoy no excess, no rent would arise.

The conclusion that we must draw, therefore, is that no one can profit from the natural advantages attaching to land, whether he be a farmer, a manufacturer, a banker or a landowner. No rent is paid for such advantages. They are equalized through the process of exchange. The law

of the market is that nothing can demand a return that has not been brought into existence, either directly or through exchange, by the labor of the seller himself. If A did not own the land but rented it from someone, he could not afford to pay any rent without risking bankruptcy. He could only pay rent if he enjoyed some advantage or service at his location which could not be dissipated by exchange, and if at the same time he were a better laborer than B and produced more wealth. Such service could not withstand dissipation unless it were the result of human exertion. The Ricardians, however, claim that men of equal ability use different grades of land, and it is this false assumption that prevents them from adequately explaining the phenomenon of rent. In actual life, only the ablest men use the best land. As we cannot compare the products of men of different abilities, we cannot logically say that rent is determined by the excess of wealth produced on land over that which is produced on the poorest land in use. Rent is not a differential except in the sense that the price of anything is a differential, for if the foregoing reasoning is correct, the margin cannot be considered as a factor in determining rent.

The Neo-Ricardians

This school seems to recognize the law of the market so far as it concerns the cooperation of nature, i. e., they insist that rent cannot be charged for the free gifts of nature. According to them, rent is payment for governmental and social services. The social services consist of transportation systems, theatres, churches, commercial and professional establishments and private museums, art galleries, schools and hospitals. It is admitted by the neo-Ricardians that the direct services of these agencies are compensated for in the prices that individuals pay for them. Thus, a person who benefits from the service rendered by a theatre pays the price at the box office, the person who attends a school pays the tuition fee and so on. But it is contended that in addition to the direct services rendered by these agencies, they render an indirect or "stand-by" service for which they are not compensated. By establishing themselves near certain locations and holding themselves ready to satisfy the demands of the occupants of sites, they make these sites more valuable. This "stand-by" service is paid for in the rent that goes into the pockets of landowners, according to the neo-Ricardians. They admit, however, that these enterprisers must carry the overhead cost of this "stand-by" service.

Now it is a matter of business practice that *all* the costs of a business concern are included in the price of the article or service it sells, for otherwise it would be forced to discontinue operations. In fact, a large part of the service rendered by business or professional men consists of "stand-by" services, and there is no valid reason for drawing a

distinction between "actual" services and "stand-by" services. The owner of a retail store, for instance, carries goods on his shelves for a long period before selling them and he employs salesmen to wait for customers to come in at their convenience. The cost of carrying these goods consists of depreciation, obsolescence and interest on his own or borrowed capital, and the cost of waiting for customers consists of the rent he pays for his store and the salaries of his salesmen. All these costs are included in the prices he charges. It is claimed that because the occupant of the site must pay more rent due to these "stand-by" services, he has less in hand with which to buy the "actual" services of these private enterprises and so these enterprises suffer. If he paid less rent, he could buy additional "actual" services, and this, it is said, would compensate for the cost of the "stand-by" services. How some men stay in business a long time and show profits without being compensated for these "stand-by" services, the neo-Ricardians fail to explain. The assertions they have made in this connection are mere assumptions not verified by observed facts. They have no place in a scientific investigation.

We have eliminated the natural advantages of land (including proximity to the markets) and social services as elements in the determination of rent and have left now only the governmental or public services. But while the first two do not give any value to sites, they do give the sites utility. Value and utility, however, are not the same thing, and I believe that it is the failure to distinguish between them that leads to erroneous conclusions. The neo-Ricardians correctly state that a man is free to purchase public services such as highways, police and fire protection, sewerage systems, libraries, sanitation, parks, etc., in the open market. He decides for himself the quality and quantity he desires. All is a matter of exchange in which efforts of one kind are exchanged for efforts of another kind. They state definitely that this natural payment *always exists* wherever these services are provided and they designate it as rent. But then, surprisingly, they contend that this process of exchange is *not* permitted to operate today, because rent is paid to a private landowner instead of into the public treasury. This payment, therefore, they claim, is a one-sided transaction and not an exchange. But if this process of exchange by which a man pays rent for public services does not operate today, how then could they have been able to describe it? Has it *ever* existed? Apparently they do not believe so, for they do not tell us where we might find it.

Now a payment that is not the result of an exchange but is a one-sided transaction is the same as a tax, i. e., it represents a seizure of one's private wealth. Thus the neo-Ricardians apparently believe that there are two kinds of rent—one a *compulsory* payment which they say is actually made today, and the other a *voluntary* payment which exists

only in some utopian realm created out of their own imaginations. How a single term can be applied to two entirely antithetical phenomena and still give one a clear picture of a certain phase of economic life they fail utterly to explain. Their assertion that rent is a voluntary payment but that it is non-existent today reads more like a normal precept of what rent *ought* to be rather than like a scientific description of what rent *actually is*.

The question naturally arises: Why does rent constitute a compulsory payment when it is made to a landowner and a voluntary payment when it is made to government officials? The neo-Ricardians answer it by saying that in the first case men are not free to refuse to pay rent because it is not possible for them to get off the earth. Now we know that men are land animals and that they cannot leave the earth unless they become disembodied spirits, but this fact has nothing to do with the economic question. Men do not pay rent for land as such, and no one knows this better than the neo-Ricardians themselves. To claim that the private collection of rent leaves men no alternative but to get off the earth (something which by their very nature they cannot do) is to assume that there is a scarcity of land in the aggregate, either natural or artificial. The neo-Ricardians vigorously and repeatedly denounce the Ricardians for making this matter a land question, but apparently not perceiving the cause of this error, they have fallen into the same trap themselves. While we know that there is a scarcity of certain kinds of land, i. e., of particular locations, no evidence has ever been produced to show that a scarcity of land in the general sense exists. The neo-Ricardians assume that men have no alternative but to get off the earth because they make the mistake of viewing rent in the general sense rather than in the specific or relative, sense.

Of course, civilized men cannot refuse to pay rent any more than they can refuse to pay for the food they eat or the clothes they wear, but they *can* and frequently *do* refuse to pay the rent that a *particular* landowner demands for a *particular* location by going to some *other* location. If we view economic life objectively without bias, we observe that landowners are constantly competing with one another for tenants. Even the owners of the poorest sites, if they possess good business judgment, are deterred from demanding too high a rent by the fear of losing their tenants or prospective tenants to the owners of better sites. Men are *absolutely free* to refuse to occupy a particular location, for no landowner threatens them with violence or coerces them in any way. The rent is not fixed by the will or caprice of the landowner but by the market. Therefore, we are left with no other conclusion but that rent is *not* a compulsory payment today but a voluntary one. The tenant pays his rent after he has entered into a free contract with the landowner. To claim, as the neo-Ricardians do, that the market is not free is equivalent to saying that there is no market

at all. Unless we believe that landowners are not constituted like every one else, it is reasonable to assume that, as a class, they are just as anxious to receive an income as other people are, and they cannot receive an income unless their land is occupied.

The curious lack of realism in the reasoning of the neo-Ricardians is even more in evidence in their attempt to show why rent would constitute a voluntary payment if it were made to government officials. Rent would be fixed by the market, they say, but apparently it would be a different kind of market than the one that now fixes the value of private services. The market that we know is one in which buyers and sellers bargain with one another in order to determine the prices of things and in which landowners and tenants bargain with one another in order to determine the rental value of sites; but the market that they envision for the fixing of rent would consist only of buyers. The public services would be provided by the public through its so-called agent, the government, but the public officials would not bargain with the users of land. They would not make assessments, or "nominate" or "fix" the rent in any way. They would merely collect it. Just how the officials would know the exact amount of rent they should collect is not explained. We are told that there would be no auctions. This means then that there would be no bidders and no sellers and thus no bargaining. Rent would be determined, it is said, by "public opinion." How this "public opinion" is to be expressed, the neo-Ricardians fail to divulge. As a matter of fact, the public today has opinions about rental value, but these opinions are influenced by real estate interests who are in actual contact with the market. But opinions frequently are wrong. The fact that one site brings a certain rent does not guarantee that a similar site will rent for the same amount. In fact, it would not be rented at all if there was no demand for it. Witness the difficulties of conscientious public assessors who assess land today by comparing one site with another. A subsequent sale or rental shows how wide of the true value their assessment was.

The "public opinion" that the neo-Ricardians have in mind would be even more nebulous. The real estate interests, in the situation that this school imagines, would be interested only in buildings and other improvements, not in land, and so would have no opinion to express that was based on actual *contracts* between landowners and tenants. Such opinion, to be effective, would have to be founded on facts of some kind. It would have to fix "rent" according to the site-users' ability to pay or according to the needs of the government. If the former, it is natural to assume that the site-users would tend to conceal such ability. But here the neo-Ricardians abandon economics (if indeed they have not already done so) and assume the role of psychologists.

They say that in order to understand this question of "public opinion" it must be realized that "the psychology of the situation would have been completely reversed by the consciousness that rent is a debt due the public." The user of the site would gladly pay whatever "public opinion" decided because it would be the "patriotic thing" to do, like "saluting the flag." Whether or not they believe that the site-user would be expected to pay in rent all that he produces above a bare subsistence we do not know, for they do not commit themselves. If this was expected of the site-user, then we would have a situation akin to early Christian communism. It is fair to assume, however, that the neo-Ricardians do not favor anything like communism, Christian or otherwise; but that leaves "public opinion" in a dilemma. Exactly how much wealth would it permit the producer to keep for himself? In order to find something definite on which to base its opinion, the public would be forced to ascertain the actual needs of government. That would mean appealing to the government officials who could safely be relied upon to fix the "rent" at "all the traffic will bear." But the man who has to pay the "rent" would not protest, for we are assured that once people understood what rent was, it would be looked upon as a "preferred debt." The reader can decide for himself whether or not this psychology is sound. The majority of the people today believe that taxes are paid for public services and that they are a "preferred debt," but yet they do all in their power to avoid paying them. Unless we are to ascertain some miraculous power to the word "rent," it is reasonable to assume that they would react in exactly the same way toward the payment of "rent" if it had to be made to public officials. Now as rent is a *voluntary* payment (and this is admitted by the neo-Ricardians), a payment made to public officials under compulsion would not be rent at all. It would be a tax. Land nationalization would be the result with all of the corruption and inefficiency which that would entail. Private industry would be even more at the mercy of the state than it is today, and the trend toward state socialism would be greatly accelerated.

In spite of the efforts of the neo-Ricardians to avoid the fixing of the "rent" by public officials, they have, through their repudiation of the democratic process of the market, played right into the hands of the bureaucrats. I do not mean to say that this repudiation is deliberate, but I mean that like the Marxist they fail to understand the market or exchange system as it operates today. This is the real cause of their confusion. They might have avoided this confusion if they had applied to the rent question their favorite dictum that opinion has no place in economic science. I shall discuss the true nature of the market, when I consider the third theory of rent, in more detail than I have thus far done.

(To be concluded in the next issue)