

## LESSON

### II

#### DISTRIBUTION THE LAWS OF RENT, WAGES AND INTEREST

*"Most writers pay too exclusive an attention to the production of wealth and neglect the laws of distribution."*—BUCKLE in "History of Civilization."

WHAT IS IT THAT ACTUATES OUR EFFORTS? ALWAYS we are trying to satisfy our desires. Every conscious move man makes has this for its purpose. To satisfy our desires for material things, three steps are necessary: 1—wealth must be produced; 2—it must be distributed, and then, 3—consumed.

With consumption (the use one makes of wealth after receiving it, which use lessens its capacity to satisfy one's desires), political economy has nothing to do; but it may be well to answer here a question which often arises. In our last lesson reference was made to the many people in society, such as doctors, lawyers, teachers, musicians, etc., who do not produce wealth, but who serve by giving personal service—by helping us satisfy our desires for other than material things (or material things that have no exchange value and therefore do not come within the scope of economics). Are these people parasites? No, by no means. The only ones in society who are

parasites are those who consume without giving a commensurate return for what they consume.

Few of us would be content merely to have satisfied our desires for material things. Most of mankind is reaching out constantly for those other satisfactions which are often referred to as "the higher things of life." Since no individual has the time, or the energy, or the ability to do, or to make, or to discover everything needed to satisfy his own desires, he employs others to help him to satisfy his desires for those things he cannot do, or make, or investigate for himself.

The musician helps us satisfy our desire for beauty of sound; the teacher helps us satisfy our desire for knowledge; the lawyer, our desire for equity and justice; the doctor, our desire for health; the insurance man, our desire for security, and so on.

Would anyone contend that beauty, knowledge, equity, justice, a sense of health, or security are useless things? Far from it. It is satisfactions such as these that make life worth living. To secure as many of these satisfactions as possible is the chief reason why most people strive to get wealth. If these desires are normal and healthy, then those who help us satisfy them cannot be performing useless tasks. They cannot be parasites because they do give a commensurate return for what they receive. ("Personal Service," defined p. 24.)

The fact that these occupations do not come within the province of political economy does not make them of any less importance; they simply belong in another field (consumption). The laws of physics and chemistry are not a part of political economy, but the men who search out and acquaint us with these laws are not useless members of society—nor are they who give personal service

of any kind. The higher the degree of civilization, the greater will be the portion of the population which is employed to give purely personal service.

There is a class of people in society who can truly be called social parasites, because they do take from others without giving anything in return. This class will be discussed in later lessons.

But to return to political economy. We have seen that there must be land before labor can be exerted; labor must be exerted on the land before wealth can be produced; wealth must be produced before a part of it can be saved to use (as capital) in producing other wealth. When and as wealth is produced, it is distributed among the factors which aid in its production. By "distribution of wealth," we mean assignment of ownership. The laws of distribution are those which determine who properly can claim title to the things produced; they indicate what it is that determines how large a portion of the wealth produced shall go as rent, how much as wages, and how much as interest.

Many have a vague idea that the land-owner can compel his tenant to pay any price he may set for the use of his land; that Labor can fix its own wages, and that the capitalist sets the interest rate he will accept. Second thought will show that none of these can be true, for each group would quite willingly take 100% of the wealth produced if it could. The truth is that the portion each receives is fixed by a natural law, over which man has no control.

Sometimes Labor feels it is being exploited by Capital, and sometimes Capital feels that Labor is getting an unfair share of the product. Then the class which feels abused, if it be strong enough, may get laws passed fix-

ing maximum or minimum interest or wage rates. But of what effect are such laws? For a little while, and to a slight extent, they may affect the condition it was hoped they would improve, but that is all. If the legal rate of interest or wages does not correspond to the natural rate for that time, place and condition, the legal rate will be ignored or evaded by premiums, discounts, bonuses or in some other way.

For instance: the legal rate of commercial interest in New Jersey is 6%. In 1940, the savings banks were paying 1% or less, and the government itself was borrowing huge sums for brief periods without paying any interest at all. Yet in 1928, those who wished to borrow often needed to pay a bonus of 10% or more in order to get a loan. This means that in conditions such as existed in 1940, 6% was too high, while in conditions such as existed in 1928, 6% was too low; and the natural rate tends to prevail in spite of human laws to the contrary.

Minimum wage laws will be similarly evaded. If they are not, they will cause unemployment and suffering among the very people they are intended to benefit. If the minimum wage rate is fixed higher than the natural rate for any given time, or place, or kind of work, the result will be that those who cannot produce enough to justify the payment of this wage will not be employed at all; or, if they are employed, prices must be increased to such an amount as will cover these wages. But when prices are increased, consumption is decreased. Decreased consumption inevitably leads to decreased production, which means decreased employment, and of course the poorer workers will be the first ones dropped. If the business man cannot raise his price, yet must pay a higher wage, he will fail, if he be in a competitive field,

and his men will find themselves out of jobs. There is no way to prevent an enforcement of a minimum wage law from causing unemployment of the poorer workers if its wage rate is higher than the natural rate would be.

If legal interest or wage rates are too low, they may be evaded by Capital or Labor (whichever happens to be the "underdog" at the time) moving out of the district or refusing to function. Or, if these rates are too high, then Capital or Labor will come into the district from outside, and by competition tend to bring interest, or wages, back to where natural laws would set them.

Generally, though mistakenly, land is regarded as either wealth or capital; therefore seldom are laws passed attempting to regulate economic rent, but if such laws were passed, they also would be evaded. Human laws cannot regulate these things; efforts to make them do so only make conditions worse.

Of course, it is not contended that wages should be no higher than they are now. Wages of both employers and employees should be immensely greater than now; but we cannot increase wages by laws passed for that purpose. Wages can be increased only by removing the artificial cause which keeps them low; and when this is done, the natural law of wages will keep them high.

We can make natural laws work for us if we understand them and make our statutes conform to them, but any attempt to prevent their operation must end in failure. It is as though a man, wishing to change the course of a stream, were to lie upon its bank and try to blow it in the direction he wants it to go. He could turn a few drops for a short distance, but others would immediately take their place; even the drops he turned would start downhill again immediately, and the great

body of the stream would go on as though he did not exist.

Human laws attempting to regulate rent, wages or interest are just as ineffective as this man's attempt to change the course of the stream. Gravitation pulls water downhill in spite of man's efforts to restrain it, and the natural laws of distribution work just as surely in determining how much of the wealth produced shall go to each of the factors which aid in its production.

One of the well recognized natural laws governing the physical world is this: "Motion seeks the line of least resistance." This same law governs also the acts of men, for always "Men seek to gratify their desires with the least possible exertion." Once this truth is recognized, the laws of distribution become axiomatic. Though the average person does not suspect the existence of these laws, it is not difficult to demonstrate what they are and how they operate.

Though usually capital is necessary for the production of wealth in our modern world, it is sometimes possible for Labor to produce wealth from land without using capital; therefore, the laws which determine what portion of the wealth produced shall go as rent and what portion shall go as wages must correlate with each other and form a perfect whole of themselves without any reference to the law governing interest, else these laws will not fit those exceptional cases where no capital is used in production.

Therefore, we will study first the Law of Rent and the Law of Wages and demonstrate by diagrams how the former determines what the land-owner can get from his tenant, and the latter what the laborer can get in return for his labor.

The land of every country varies in productivity. Some agricultural lands will yield large crops, others but small crops; some mines are very rich, others very poor; much more business can be done in the center of a large city than in a small town, etc. Let diagram 2 represent the

100	75	50	25
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No. 2

land of this, or any, country divided into different grades. On the best land, labor of a given efficiency can produce 100 (bushels of wheat, tons of steel rails, bales of cotton, suits of clothes, or any other kind of wealth), while labor of the same efficiency, working the same length of time, can produce but 75 from the second grade land, and 50 and 25 respectively from the third and fourth grades. (For simplification, in this diagram the land of each grade is grouped all together, though actually, of course, each grade is found widely scattered, and the different grades shade gradually into each other, instead of being sharply defined, as here shown.)

The first comers, A and his colony, will settle on the best grade of land, where they can satisfy their desires with the least exertion. No one needs to buy the land he takes, nor does he need to rent it, and, whether it be possible to produce much or little, each can keep for himself all he produces—wages are 100.

Now other settlers come with B. They also want, and take up, some of the best land (as in diagram 3). Can any of the people of A's colony sell or rent any land to the people of B's colony? Certainly not. Even if this land be fabulously productive, no one will give even one cent an acre for any of it, so long as he can get what he wants

of it free of charge. It may be that someone will wish to save the time and energy necessary to clear land and build a cabin, and so will purchase a home site from someone in A's colony who has already done this work.

Wages	100				
	A	100	75	50	25
	B				
Rent	0				

No. 3

All that will be purchased in this case, however, will be these improvements; no one will pay anything for land itself, when equally good land can be had free. Land can neither be sold nor rented until the holding of a particular spot will confer an advantage of some kind which cannot be obtained from other land to be gotten free. Therefore the rent of this 100 land is 0 so long as any of it is to be had free of charge. (The same law applies to all kinds of land, regardless of time, place or condition. If today one wished to go into business, one would pay nothing for any site, however well situated it might be, if he could get another site, equally good, without cost.)

What will wages be in this condition? If a man works his own land, he has no rent to pay and can keep for himself all he produces, which is 100. If he hires someone to work for him, he will find that he cannot compel another to work for him for less than that other can get working for himself—100. All wages will be 100; not only the wages of the man who works for himself, but also the wages of the men who work for others. No employer or group of employers can enforce a lower rate. In primitive



days people often exchanged work with each other—help with plowing would be exchanged for help with reaping; a woman invited to a quilting bee would invite her hostess to an applebutter bee, etc. This exchange of work was equivalent to paying 100 in wages.

Now other colonists come with C and D. C with his colony arrives first and takes up all the remaining 100 land. What will D's colony do when it arrives? These people also would like to have the best land, but there is no more of it free. There are five courses open to them from which to choose.

First: They may bring guns, battleships and other means of warfare and drive away some of those now on the 100 land to make room for themselves. Not that this would better conditions, because those driven off the 100 land would need to solve the same problem which had faced those who drove them off; but, if one analyzes the causes behind wars, one finds that practically every war can be traced, directly or indirectly, to a desire for land.

But we will suppose that D and his people are peaceable folk who will try to adjust themselves to conditions as they exist. A second choice, and probably the one most of the colonists will make, is to settle on the second grade land which is still free to them but where their labor will produce less. Here they need pay no rent and can keep for themselves all they produce, which is 75 (as in diagram 4).

A third choice: some may wish to live on the 100 land (they may wish to be near relatives, or by the seashore where they can be fishermen, or by a waterfall where power is available). Yesterday this land had no rental value, but now men will offer to pay for its use since it

can be had in no other way. How much can they be charged as rent? The land is no more productive than it was yesterday, but now it does offer an advantage over land which can be gotten free—labor can produce more from it; and the value of this advantage will be the difference between what can be produced from this land

Wages	75	75			
	A	C	D	50	25
	100	75			
	B				
Rent	25	0			

No. 4

(100) and what the same labor can produce from the best free land (75), which is 25. Therefore 25 can be charged as rent—no more. The land-owner does not fix this rent, nor does his tenant; it is fixed by a natural law. This Law of Rent, as old as man, was formulated by Ricardo in 1815 thus: "*The rent of any given piece of land equals the excess of its productivity over what the same labor can produce from the least productive land in use.*" Rent is what is paid for an opportunity to work on more productive lands.

A fourth choice open to D's colonists is to buy some of the best grade land. What will be its purchase price? Yesterday this land had no selling value, but now that there is no more of it free, now that its use offers an advantage over that offered by the best free land, now that it has a renting price, it can be sold; and its selling price will be determined by how much rent it will bring its owner (or by what the owner hopes it will bring him in the future). If there are no taxes, when the rental value

of land is 25 the selling value will be such an amount as will yield 25 to its owner at the prevailing rate of interest. If this be 5%, then the sale price of the best grade land will be 500; since 500, invested at 5% will yield 25.

The fifth choice: if some of those who came with D do not care for agriculture, and do not have the capital or the inclination to start in some other business for themselves, they may decide to get their living by working for others. What wages can they charge? On the second grade land they can get but 75, but workers on the 100 land have been getting 100 in wages, and D's people, rather than work for themselves for 75, will gladly offer to work for 95 in order to get these better paying jobs on the 100 land. The employers of course will be glad to pay 95 instead of 100 if the men will do as much and as good work as their present workmen. The displaced men can take up some of the still free 75 land if they wish, but naturally, instead, will offer to work for enough less than 95 to get their old or similar jobs. Thus men competing with one another for jobs will bring all wages down—down to 75; but below this, basic wages cannot be driven, because here is free land to which men can go, where they can make 75 working for themselves, and no one, unless enslaved, can be forced to work for another for less than he can make working for himself on the best land free to him. The men working on the best land must agree to accept a wage of 75, else the employers will hire men from the 75 land who are looking for jobs. When 75 is the productivity of the best free land, it will be, also, the basic wage on all grades of land in use. (Of course, he who performs his work more efficiently than those men earning the basic wage can command a proportionately higher wage.)

Thus, wages, like rent, are fixed by a natural law. This Law of Wages was formulated in 1879 by Henry George: "*Basic wages are determined by the productivity of the best free land,*" or, stated in another way: "No man can successfully demand from his employer more than he can make working for himself on the best land free to him."

So far as wages are concerned, it will make no difference to those in D's colony whether they take up the second grade land, where their labor will produce 75; whether they work for another, in which case their wages will be 75; whether they rent some of the 100 land, paying 25 for the privilege and keeping 75 for themselves; or whether they buy some of the 100 land for a purchase price sufficient to yield a return of 25, leaving their own net income 75. The Laws of Rent and Wages will fix their return in any case.

To carry the illustration further: suppose a lumber mill which would employ 200 men were to be built on a stream running through the 100 land. The wages in this mill must be 75, so long as the 75 land is still the best free land. Regardless of how large the mill, or how greedy its owner might be, basic wages could not be forced below 75. If the attempt were made, men would leave the mill and take up the 75 land for themselves. And regardless of how numerous the employees, or how greedy they might be, basic wages could not be forced above 75 so long as there was no free land better than the 75. Any attempt to raise wages above 75 would be an invitation to others to rush in to get these jobs paying more than the average wage, and by bidding against one another, in time, they would force wages back to 75.

Suppose the land taken by A's colony should prove to

be over an oil field where the same labor could produce five times as much as before the oil was discovered, would wages rise in the oil field? No. Wages would be the same, 75, that a man could make on the best land free to him; the change would be in the rent (as in diagram 5), which would increase to 425, with, of course, a corresponding increase in the selling price of the land. This is verified by conditions in oil fields everywhere. Wages there are no higher than for the same work elsewhere; but the price of land, both to rent and to buy, has risen enormously.

Wages	75	75	75		
	A	B	C	D	
	500	100	75	50	25
Rent	425	25	0		

No. 5

Or, suppose the land were used mostly for agriculture and a drought of many years' duration should occur. This probably would reduce the productivity of the poorer lands more than it would the productivity of the better grade. In this condition, labor of a given efficiency might produce 90 from the better land, but only 50 from

Wages	50	50	
	90	50	
Rent	40	0	

No. 6

the second grade land, instead of 75 as formerly. Though the drought might be a calamity to the community as a whole, with wages reduced to 50 (as in diagram 6), the

owner of the better grade land would profit by the calamity, because the rent of his land would rise from 25 to 40. When the rains came again and the former productivity returned, the rent of the better land would drop to 25, its old level, and wages would return to 75.

Now suppose other colonists came, took up all the remaining 75 land and overflowed into the 50 grade; the rent of the 75 land, which before was 0, would rise to 25, and basic wages drop to 50. As this process continued and it became necessary to use the 25 land, basic wages on all grades of land would drop to 25 and rents would rise correspondingly (as in No. 7).

Wages	25	25	25	25
	100	75	50	25
Rent	75	50	25	0

No. 7

These simple illustrations show that the rent of any given piece of land is not determined by its productivity alone, but by how much more Labor can produce from it than from the poorest land in use. In the drought illustration above, rent increased, though productivity declined. Similarly, wages are not determined by what Labor can produce from any given land, but rather by how much rent must be subtracted from the product. In most of these illustrations the product from each grade of land remained the same, but wages decreased and rents increased as poorer land was brought into use.

As it is sometimes stated: wages and rent are determined by the position of "the rent line," which divides all the wealth produced into two parts. All of the product

on one side of this line will go as rent; all on the other side, as wages. When rent is relatively low, wages must be relatively high; when rent is relatively high, wages must be relatively low.

$$\frac{\text{Product}}{\text{rent} \mid \text{wages}}$$

The laws of rent and wages supplement each other perfectly. Where one stops the other begins. Each is but the other part of the same thing. The rent of any given piece of land is fixed by the excess of its productivity over that of *the poorest land in use*. Basic wages are determined by the productivity of *the best free land*. It is just a case of a thing being equal to the sum of its parts. One part of the whole (product) goes as rent, the other as wages. Obviously, what falls on one side of the line cannot fall on the other.

That wages depend on the productivity of the best free land has been noted by many. In 1751, Benjamin Franklin wrote:

“Notwithstanding the increase in population, so vast is the territory of North America, that it will require many ages to settle it fully; and until it is settled fully, labor will never be cheap here, where no man continues long a laborer for another, but gets a plantation of his own; no man continues long a journeyman at a trade, but goes among these new settlers and sets up for himself.”

An illustration showing the application of this same principle elsewhere, is that of the Swan River settlement in West Australia. About 1800, a certain Mr. Peel took to West Australia for colonization purposes 3,000 people “of the working class,” and seeds, implements and cattle

valued at £50,000. When the ships arrived at their destination, the people immediately scattered and took up land for themselves and Mr. Peel "was left without even a servant to make his bed or to fetch him water from the river." Learning from this experience of Mr. Peel's, Edward G. Wakefield worked out a plan of colonization intended to prevent what was viewed as a calamity in the Peel case. He said: "Let the government put upon the virgin soil an artificial price, independent of the law of supply and demand, that compels the immigrant to work for a long time for wages before he can turn himself into an independent peasant. In this way the supply of cheap and subservient labor can be maintained." It was the adoption of this Wakefield plan for West Australia and other colonies, which diverted a large stream of immigration to the United States, where land was free and wages relatively high.

But if wages are fixed by the productivity of the best free land, the question arises: "what will fix wages when free land is no longer available?" Labor then has no point at which it can stand and successfully say it will not accept less. Wages then will be fixed by what the average man is willing to live on and reproduce; and competition among men, bidding against one another for jobs, which they must have in order to live, will cause wages to decline surely, however slowly, to the point of bare subsistence.

Now, what is the law governing interest, and how does it accord with the Laws of Rent and Wages?

In order to consider interest intelligently we must always distinguish with certainty between what is and what is not capital. Land is never capital though it is often mistakenly regarded as such. Man's abilities and



skills are not capital, though sometimes they, also, are so called. Stocks, bonds, mortgages, notes, and things of this kind are not capital, though when the money invested in them has been exchanged for wealth used in productive work, they will represent ownership of capital. Money is not capital; it is but a certificate which can be exchanged for capital. Nor should capital be confused with "capitalization." One might own a toll bridge costing \$1,000 with a monopoly privilege that would yield the owner \$20,000 a year. He could "capitalize" the business for \$400,000, and 5% annual dividends could be earned. But total *capital* is only \$1,000; to be even that much the bridge must be used solely for production.

True capital is but one thing—that part of wealth being used by Labor to produce other wealth. If everyone consumed all of the wealth he received as fast as he received it there never could be any capital. Wealth to be used as capital can be accumulated only by some saving a part of the wealth they receive. The chief reason men have for saving wealth is that they may have it to use at some future time.

Usually there are many who would like to have more wealth to use as capital than they have the ability, inclination, time or opportunity to save for themselves. Those who want capital are *always* laborers—because to use capital one must become a laborer. It often becomes advantageous for a laborer, who has not been able to save his own capital, to borrow wealth for his own use as capital from someone who has been able to save it, and to pay the market price for the hire of this wealth until he can return it. That which Labor pays (out of increased product made possible by borrowing) for the hire of wealth used as capital is true economic interest.

Labor will pay no more for the hire of capital than a rate at which it is profitable to borrow. In a free market the rate will be fixed by the higgling of the market, as is the price of everything else.\*

We have seen that land has no rental value so long as other land of equal value can be had free; but when the demand for any grade of land becomes greater than the supply of the same grade of land that can be gotten free, then rent arises and that land has a price. The same is true of capital. When, in relation to demand, there is little wealth in the market loanable as capital, interest rates will be correspondingly high. When the supply of wealth offered as capital is greater than the demand, interest rates will be correspondingly low or interest might disappear entirely. But capital is not a fixed quantity as is land; the amount available can be increased or decreased at the will of man. When rates are low, less capital is offered, which is quite natural. This lessens

\*It is well to understand clearly the *cause* of interest: the reason why anything commands price is that the demand for that thing exceeds the supply that can be gotten for nothing; interest is the price that is paid for the loan of capital; therefore, the cause of interest is that the demand for loanable capital exceeds the supply that can be gotten for nothing.

As to the justice or injustice of interest: if A makes a tool which B wishes to borrow, it would be *unjust* to prevent the transaction, on any terms mutually and freely agreed on. To deny to A the right so to loan his property would be to deny, to that extent, property rights.

There is a tendency to regard interest as unjust, due, largely, to failure to realize what true interest is. It is payment for the loan, not of money, but of some form of actual, material wealth that Labor is using to increase its product—its wages. It is what one pays for the loan of a boat used to increase one's catch of fish. It is what is often defined as "what is received for the 'use' of capital." This must mean for "using" or for "permission" to use. As it cannot mean the former, it must mean the latter—the loaning of.

the supply of available capital and tends to cause interest rates to rise. Then when interest rates are high, wealth will be saved and converted into capital in order to take advantage of these high rates; and this increased amount of wealth in the market, which can be used as capital, will tend to bring interest rates down again.

Thus, as stated, the prevailing rate of interest will be fixed by the relation between the demand for and the supply of wealth to be used as capital. The rate will not be determined by the amount of extra wealth which can be gotten *by* the use of capital. If it were, interest rates would increase with the march of invention, and we know this does not occur. If it did occur, practically all the wealth produced would be interest, since men can produce so much more with the aid of capital than they can without it.

Since it is always, and only, Labor which uses capital, it is always, and only, Labor which pays for the loan of wealth used as capital; therefore interest must be paid out of that part of the wealth produced which is on the

Product	
rent	wages
	interest

wage side of "the rent line." This means that out of the wealth produced, that which the Law of Rent determines shall go as rent must always be the land-owner's share; but from that which payment of rent leaves must come not only the portion Labor can keep for itself, but also the interest which Labor must pay for the hire of the capital it uses.

But though Labor pays for hire of capital, the borrowing of capital is advantageous to Labor, because

the use of capital enables Labor to produce much more than it could otherwise. Therefore, Labor's wages and standard of living are very much higher than they would be if it did not use capital. In order for capital to get a return, or even in order for it to be maintained, it must have Labor use it. Labor will not use capital unless it benefits thereby. Therefore, capital can get no return unless and until Labor has benefited by its use, notwithstanding so much current opinion to the contrary.

### RECAPITULATION

When all land is free and no capital is used, all the wealth produced goes as wages;

When all land is free and capital is used, all the wealth produced goes as wages; but out of these wages Labor must pay interest for the hire of the wealth it uses as capital;

When the best land is taken up and more is needed for use, basic wages will be fixed by what Labor can make working for itself on the best land free to it; the rent of each piece of land being determined by its productivity over the productivity of the poorest land in use; interest will be fixed by the relation between the supply of and the demand for capital;

When land is all taken up, competition for jobs among laborers will force all wages down to the point of bare subsistence. Rent will take most of the product.

### QUESTIONS FOR DISCUSSION

- 1—Does the man who owns land, and uses it for his business, receive any rent for it? Does the man who owns the land under his residence receive any rent? Is there any difference between the two? If so, explain why.