What We're (Still) Talking About

It's not often that our readers respond as thoroughly as did Mr. David Byrnes, Executive Secretary of the Sequoyah Institute of Civil Values in Riverside, California, in the thoughtful letter that follows:

I read with interest about the problems of educating students on the proper definition of wealth in political science terms, and the habitual thought-patterns of students who revert back to error as soon as they go out of the classroom. One problem is semantics. "Wealth" is an ambiguous term. Even "friends" and "good health" can and should be called a legitimate form of wealth by poets and philosophers. The same is true of "property." We Georgists must be careful not to use the term "property" when we are talking about taxes because the word can refer to either land or structures, or both. It is not a safe word and should be avoided in economic discussions.

On the other hand, you might be able to clarify the problem with your students if you used the relationship which Harry Gunnison Brown employed when teaching at Missouri. Brown referred to money as "tickets" or "claim checks" on real wealth, readily exchangeable (in a market society) for the real thing. Money could also be compared to a title of ownership – which has "value" and represents wealth, but is not the real thing, only its paper representation designating certain legal rights and obligations.

But most importantly, I wish to help you define "profits" as something much more than an awkward component of the three factors of production. Profits are closely related to the market economy. This is because an entrepreneur will (if legitimate) procure varying amounts of land, labor and capital, paying the going market price for each factor. Using managerial and innovative skills in combining those three factors, the entrepreneur will produce a product or service which is so desirable that consumers will willingly buy the output for a market price that is greater than the sum of the input factor costs. The amount of the sales price remaining after paying for all input factors is the true economic "profit."

The entrepreneur has increased the total wealth of the community, for consumers are willing to pay more for the entrepreneur's output than for the raw factors that went into it. If there are no profits, there will be no economic progress; the outputs of production will be worth no more to consumers than were the raw materials that were combined to form the outputs. Entrepreneurs will have labored at management – yet no one will be better off.

The entrepreneur can increase his or her profits by means legitimate and illegitimate. He can procure any factor for less cost by skillful shopping – or be deceitful negotiations or theft. He can use less of the factors by managerial skill – or by reducing quality. He can obtain a higher sales price from the demand of eager consumers, or by means of deceitful advertising and merchandising. And of course, he can enjoy the use of land or resources without paying for them because he owns them, in which case he is only cheating himself.

The definitions of profit that are employed by accountants, the IRS, corporate promoters and small businessmen are all imperfect. Only the definition I cited above, in which factors of production are acquired at a true market value, and the output is sold at a legitimate market price, allows the true expression of profit. And obviously the realization of profits is a highly precarious task. Properly calculated, the average profit of the Fortune 500 might average 3 to 4% even today, because they should be charging themselves for the interest costs of stockholder equity and for the replacement cost of capital goods. Almost all farmers would lose money each year because the imputed rent on their land would be greater than the net profits they report through their accountant.

Profits will never sink to zero even in a state of perfect competition – because when they do, there is no point in operating a business. Even at 1 or 2% profit, the entrepreneur is better off working for someone else.

Apparently, most of the public has a gross misconception of the size of corporate profits. Sometimes they confuse gross profit with net profit. Other times, they read that a corporation's profits are "up 33% for the year" when in reality they are only 4% compared to last year's 3% – thereby doing a great disservice to the principle of free enterprise. Ignorant laborers, activists and liberals who seize upon that 33% figure can never be dissuaded of this error.

David McClelland noted (in *The Achieving Society)* that at the peak of the industrial revolution in England, average profits were about 5% and the highest profit record he could find was a temporary 15%. These figures came from data that managers and owners reported to their bankers, whom they presumably wanted to impress. And, as always, profits then and now are never large enough to fund the expansion of a business which is doing well.

Lindy Davies replies:

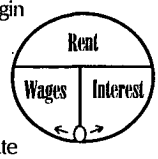
Mr. Byrnes reminds us that "wealth" is an ambiguous term. Indeed it is, for poets, philosophers and most economists – and one of our most important missions is to clarify its meaning. His reminder of Harry Gunnison Brown's treatment of money is appreciated. But strangely, most students have an easy enough time grasping that money is not wealth. Burn a hundred-dollar bill: is there less wealth in our economy? The most persistent confusion, though, is one that seems equally clear at the outset: the fact that **land** is not wealth.

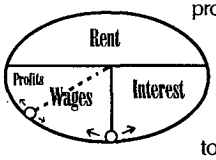
If I understand Mr. Byrnes correctly, the entire return that he calls "legitimate" profit for the entrepreneur – the payment for management and risk-taking – would go in the category of wages, in our three-factor model. Labor is the active factor in production; clearly management and risk-taking are not undertaken by land or capital. But for Mr. Byrnes, and most contemporary economists, the inputs of entrepreneurs are different enough from those of the laboring masses to place them in a separate *(continued on back page)*

TEACHERS' CORNER

Entrepreneurship and Input-Balancing

Henry George argued that the essential distribution of wealth is between land and labor. Capital is merely a special class of labor, in a way: labor that has congealed into labor-saving material. So, the returns to labor and to capital tend to seek an equilibrium; both are called for in production. (And, since both need land to produce, the returns to both Labor and Capital rise and fall with the margin of production.) The classic HGS lesson materials illustrate this notion like this. The pendulum between Wages and Interest swings back and forth as the returns to labor and capital move toward equilibrium. If we consider profits as a separate category, we must remember that what Mr. Byrnes calls "legitimate" profit imputes away the returns to land, capital and monopoly. What's left is what Henry George referred to as "wages of superintendence." Low-risk production labor and high-risk entrepreneurial labor also tend toward an equilibrium. Both are needed for progress; therefore, one will not long prosper at the other's expense.





Teacher's Corner

(continued from page 7) category. That division makes a certain amount of sense – as long as we realize that it is a sub-categorization. Labor and entrepreneurship are far more similar than, say, labor and land.

Mr. Byrnes is careful to stress that he is referring only to "legitimate" profits in competitive markets. Now, if "property" is an unsafe word that we ought to shun, what can we say of "legitimate"? For Mr. Byrnes, it appears that legitimacy is a function of honesty. How, though, is one to judge whether (or to what degree) a manufacturer has "deceitfully" lowered quality or advertised falsely? Is there an objective standard for such things? For Henry George (and other market-oriented economists), beyond a reasonable public interest in truthful labeling, advertising and marketing add to a product's value and the buyer should beware. Legitimate profit is any return from production; it is illegitimate to collect what has been produced by others, whether by individuals or by the whole community. For George the boundary of legitimacy is hardly ambiguous at all.

It has been clearly shown that a great deal of today's economic inquiry makes the mistake of ignoring or obscuring the difference between land and wealth. Once that fundamental distinction is lost, it is easy to consider land simply as one input to production, among the many inputs that entrepreneurs manage, in order to realize those profits which are so essential to progress. This tendency leads, as my article noted, to the specious (but frequent) claims that land rent is negligible in a modern economy. What else could be happening to it? It doesn't show up as wages or interest; it must be masked as profits.

Will profits never sink to zero even in a state of perfect competition? Well, most agree that "prefect competition" is a theoretical ideal that real economies can never reach. But remember that in our three-factor conception of things, profit is a subset of wages. If, let's say, the land monopoly were eliminated, thus enhancing competition, return to labor in general would rise, as would the return to capital. Risk, in new enterprises, would be lower – as would the rate of profit – but fewer businesses would fail.

Mr. Byrnes is wary that do-gooder types will miss the vital contribution that entrepreneurs make to a dynamic market economy. His concern is well-founded and Henry George certainly shared it. Nevertheless, I'll stick with the three-factor model in my *Fundamental Economics* class. We need the clarity of George's analysis before we tackle the muck of modern economics.