A HISTORY OF THE THEORY OF LAND-VALUE TAXATION

A thesis presented

by

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to

The Department of Economics

in partial fulfillment of the requirements

for the degree of

Doctor of Philosophy

in the subject of

Economics

Harvard University

Cambridge, Massachusetts

May, 1980

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TO

MY MOTHER AND FATHER

ACKNOWLEDGMENTS

While accepting sole responsibility for the contents of this thesis I would like to thank the following persons for their help and encouragement in its writing: Professors Richard A. Musgrave, Arthur Smithies and Malcolm Gillis; the Commonwealth Fund of New York and Mrs. Priscilla Van de Workeen; Betsey Cogswell, Graduate Secretary to the Economics Department; Nancy and Ross Scott of WordPro Inc.; and, always, my dearest Deborah.

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ABSTRACT

This thesis surveys the history of the theory of land value taxation from John Locke to the present day. The history of the rent concept is first explored, with particular attention to the classical view that rent as the return to land, the non-produced factor of production, is uniquely a costless income. The argument that a tax on rent cannot be shifted is examined as is the argument that all other taxes must reduce aggregate rent. A less well-known set of arguments is then explored: that not only can land values be taxed without excess burden but they *must* be taxed if market failure and economic inefficiency are to be avoided. Finally, the ethical argument that land values *ought* to be taxed as a matter of justice is surveyed together with ethical objections. The Appendices briefly discuss aspects of the revenue adequacy and administrative feasibility of land value taxation, drawing on Australasian experience.

Economic administration opens up the sources of wealth; wealth attracts men; men and wealth make agriculture prosper; expand trade, give new life to industry, and increase and perpetuate wealth. Economic administration forestalls a decline in the affluence and strength of the nation. Upon the means which it abundantly provides, the success of the other branches of the king's government depends. Economic administration strengthens the power of the state, attracts the respect of other nations, and safeguards the glory of the monarch and the happiness of the people. It includes in its scope all the essential principles of a perfect system of government, in which authority is always a benevolent protectress and a beloved guardian, which can never be diverted from its course, which will not spread its influence too far, and which cannot cause anxiety. It maintains everywhere the interests of the nation, good order, the rights of the public, and the power and dominion of the sovereign.

Francois Quesnay (1759)[1]

TABLE OF CONTENTS

		Page
	INTRODUCTION	1
PART I	HISTORY OF THE RENT CONCEPT	4
Chapter 1	Rent as the bounty or labour of nature	5
Chapter 2	Rent as payment for the use of land	8
Chapter 3	Rent as the result of diminishing returns	10
Chapter 4	Rent as a demand-determined factor price	13
Chapter 5	Rent as the unique surplus	16
Chapter 6	Rent "does not enter" into price	19
Chapter 7	Rent as any surplus	25
Chapter 8	Rent in the marginal productivity theory of distribution	28
Chapter 9	Paretian rent—disequilibrium and heterogeneity . .	31
Chapter 10	Consumer's surplus as a rent	34
Chapter 11	Rent and quasi-rent	35
Chapter 12	Rent as a reward for risk	40
Chapter 13	Rent as rental	48
Chapter 14	Exhaustible resources and their rent	59
Chapter 15	Rent as a monopoly return	65
Chapter 16	Externality as a cause of rent	76
Chapter 17	Rent as a payment for location	86
Chapter 18	Conclusion to Part I—land rent as the only long-run surplus over real cost	91

		Page
PART II	THE TERMINOLOGY OF CLASSICAL TAX ANALYSIS	99
Chapter 19	Funded versus unfunded state revenues	100
Chapter 20	The "ability to pay" principle of taxation	104
Chapter 21	The "benefit" principle of taxation	107
Chapter 22	Excess burden of taxation	111
Chapter 23	The incidence of taxation	119
Chapter 24	Neutrality and superneutrality	128
PART III	GENERAL ECONOMIC ARGUMENTS IN FAVOR OF LAND VALUE TAXATION	135
Chapter 25	The doctrine that a tax on rent cannot be shifted .	136
Chapter 26	The argument that all taxes fall on land	163
PART IV	SPECIFIC ARGUMENTS ABOUT THE ECONOMIC EFFICIENCY OF LAND VALUE TAXATION	176
Chapter 27	Superneutrality of land value taxation	177
Chapter 28	The idea of "highest and best use"	181
Chapter 29	"Unsound" versus "sound" speculation in land	186
Chapter 30	The "unearned increment" as a subsidy to capital or labour	205
Chapter 31	Land value taxation and resource control as a barrier to entry	210
Chapter 32	Tax cost versus interest cost as holding costs to land users	214
Chapter 33	The effect of land value taxation on land settlement	216
Chapter 34	Urban congestion	221
Chapter 35	Land value taxation and the internalization of externalities	232

		Page
Chapter 36	Land rents and the optimal supply of spatial public goods	238
Chapter 37	Land speculation and the link between the present and the future	243
Chapter 38	The intertemporal neutrality of ad valorem property taxation with respect to the choice of investment asset life	245
Chapter 39	The effect of land value taxation on the discovery of natural resources	246
Chapter 40	Land value taxation and the depletion of natural resources	249
Chapter 41	The taxation of rental versus capitalized land values	256
Chapter 42	Land and its taxation in relation to capital formation	259
PART V	EQUITY ARGUMENTS IN RESPECT OF LAND VALUE TAXATION.	271
Chapter 43	Equity arguments and their philosophical assumptions	272
Chapter 44	The justice of land-value taxation in terms of positive law	275
Chapter 45	The justice of land-value taxation in terms of natural law	278
Chapter 46	Objections against land-value taxation in terms of justice	287
Chapter 47	Land-value taxation: theoretical versus practical compensation	314
PART VI	CONCLUSION	322
Chapter 48	A theory unchallenged yet unexplored and unimplemented	323

		Page
PART VII	APPENDICES	328
Appendix 1	The revenue adequacy of land value taxation	329
Appendix 2	Comparative administrative difficulties of land value taxation and income taxation	333
Appendix 3	The assessment of leasehold interests under land value taxation	338
Appendix 4	The operation of land value taxation under inflation	340
NOTES TO THE TEXT		342
BIBLIOGRAPHY		450

INTRODUCTION

"To Australasia," wrote Yetta Scheftel in 1916, "the Western world owes, among numerous experiments in social science, the system of taxation on the unimproved value of land."[1] Yet, as the writer can testify, the theory and practice of land value taxation is today almost as neglected in Australasia as in the rest of the world, a neglect which appears peculiar when one reflects how intimately the subject is connected with contemporary problems such as urban development and the taxation of natural resources.

This neglect cannot, therefore, be explained by arguments that land value taxation is of no significance for public policy: instead, the explanation would seem to lie in the academic conviction that the theory of land value taxation is an exhausted orebody and economic theory can find nothing further of interest in this area.

The purpose of this thesis is to show that such a conviction is mistaken, that a historical survey of the arguments put forward in favor of land value taxation will show that, while some have been accepted as standard economic theory, others have scarcely received the attention of economists and others again have been rejected on the basis of semantic redefinitions. This thesis is not, therefore, a chronological study of the ideas of one author or group of authors but rather of the development of ideas in themselves.

T.R. Malthus once expressed concern that much of what is disputed in political economy could be settled by the careful definition

of words. Few words have gone through such metamorphoses of meaning as the word "rent"; consequently, I begin with the nature and causes of economic rent as they have been perceived by writers since the Physiocrats and I shall argue that the classical notion of rent as a surplus over real cost of production is essentially a valid and useful concept.

Next follows a discussion of the terminology of classical tax analysis, in which I suggest that the origins of economic arguments for land value taxation may be found in the way arguments about "ability to pay," "benefit taxation" and "incidence of taxation" were sometimes formulated.

We then trace the history of the doctrines that "a tax on rent cannot be shifted" and "all taxes fall on land," doctrines which form the basis of economic arguments in favor of land value taxation. Various specific arguments about particular effects of land value taxation are then surveyed; the general conclusion is that land value taxation is essentially innocent of charges that it will distort the allocation of resources (e.g., urban congestion, premature land development). It also emerges that there are ways in which land value taxation may correct various types of market failure--such a tax may be better than neutral.

Taxation is not, however, judged by economic efficiency alone: equity has figured prominently in all writings on the subject, particularly so in the case of land value taxation. An attempt has been made to isolate the different concepts of distributive justice which have been at the root of economists' disagreements about the equity of special or exclusive taxation of land values.

Since, as Edwin Cannan once remarked, "A theory of taxation which cannot be applied is a bad theory,"[2] the appendices briefly discuss the practical questions of the revenue adequacy and the administrative difficulties of land value taxation. Practical questions, after all, cannot be scorned in what Adam Smith described as that "branch of the science of a statesman or legislator" which "proposes to enrich both the people and the sovereign."[3]

PART I

HISTORY OF THE RENT CONCEPT

"What remains is that independent and disposable part which the land gives as a pure gift to the one who cultivates it, over and above his advances and the wages of his toil; and this is the share of the Proprietor, or the revenue, with which the latter is able to live without working . . ."

A.R.J. Turgot (1770)[1]

". . . there is this difference between land and other agents of production, that from a social point of view land yields a permanent surplus, while perishable things made by man do not."

Alfred Marshall (1895)[2]

CHAPTER 1

RENT AS THE BOUNTY OR LABOUR OF NATURE

The first concept of rent which appears in economic literature is that of rent as the free gift of Nature. As Turgot puts it:[1]

> "The land, independently of any other man and of any agreement, pays him [the husbandman] directly the price of his labour. Nature never bargains with him in order to oblige him to content himself with what is absolutely necessary. What she grants is proportionate neither to his needs nor to a contractual evaluation of the price of his working day. It is the physical result of the fertility of the soil, and of the correctness, much more than of the difficulty, of the means he has employed to render it fruitful."

Rent (that is, net product or revenue) is "that independent and disposable part which the land gives as a pure gift to the one who cultivates it," and once land is privately owned, "is the share of the Proprietor."[2]

Adam Smith, although rejecting the Physiocratic doctrine of the sole productivity of Nature, also remarked that "In agriculture too nature labours along with man; and though her labour costs no expense its produce has value, as well as that of the most expensive workman . . . rent may be considered as the produce of those powers of nature, the use of which the landlord lends to the farmer."[3]

Ever since Ricardo declared that Malthus was in error "in

supposing rent to be a clear gain and a new creation of riches"[4] whereas in fact "rent is a creation of value . . . but not a creation of wealth,"[5] the notion that rent is the gift of Nature has been regarded as obsolete. Thus J.S. Mill remarks that the French Economists and even Adam Smith were mistaken in supposing that rent was due to the productive services of Nature, rather than the scarcity of those services.[6] Marshall repeats the criticism, stating that the "producer's surplus from land is not evidence of the greatness of the bounty of nature, as was held by the Physiocrats and in a more modified form by Adam Smith: it is evidence of the limitations of that bounty."[7]

We may agree with Cannan that "it does not really make much difference whether we choose to attribute the existence of rent to the bounty of nature in providing a certain amount of good land or to her niggardliness in not providing more of it"[8] but in justice to Cantillon, the Physiocrats and Smith we ought to go further and concede that a profound insight had been gained—land yields a rent because, though costless, it is a productive as well as a scarce factor.[9]

In this view of rent, the Physiocrats and Smith were ahead of H.C. Carey, Frederic Bastiat and Frank Knight,[10] who were later to deny that rent was other than a return to capital. Land was clearly recognized as a factor of production, separate from labour and capital. Moreover, this concept of rent was embodied in a functional analysis of factor incomes and, not as commonly asserted, an analysis growing out of the incomes of social classes. Turgot's discussion of landed property[11] and Smith's observations on cases of the confounding of rent, wages and profit[12] show this clearly.

The deficiency of the idea that rent is due to the bounty of Nature is that it tended to concentrate attention solely on rent as an agricultural phenomenon, to which we now turn.

CHAPTER 2

RENT AS PAYMENT FOR THE USE OF LAND

The notion that rent was due to the bounty of Nature went hand in hand with the idea that it was a payment for the use of the inherent fertility of the soil, which was the cause of the distinction between agriculture and manufacturing. Urban rent was at first not considered.

Quesnay in his discussion of the maxims of Sully explicitly states that house rent, like interest, is a transfer from one person to another of a part of the national income and does not represent an original revenue.[1] Ricardo, in turn, was to stress rent as an agricultural phenomenon when he asserted that "Rent is that portion of the produce of the earth which is paid to the landlord for the use of the original and indestructible powers of the soil"[2]--a definition as famous as it is ambiguous. Ricardo himself tacitly denied that rent was a payment for "original" powers when he suggested that the quasi-rent earned by capital sunk in the land was rent[3] while the destructibility of mines makes one wonder how he could have headed his next chapter "On the Rent of Mines," having announced in the previous chapter the Marshallian view that a royalty is not a rent.[4]

Adam Smith, while leaning towards Cantillon and the Physiocrats in regarding food as "the original source of rent"[5] since the fertility of the soil raised up a population and markets, nonetheless showed superior insight to Ricardo when he stated that "rent . . . is regulated . . . partly by the general circumstances of the society or

neighbourhood in which the land is situated, and partly by the natural or improved fertility of the land."[6] Although Cannan says that Smith includes the quasi-rent of sunk capital in his notion of the rent of land,[7] Smith's discussion of the gross and net rent of land,[8] together with his stress on a functional analysis of incomes[9] suggest this is not so. In any case, whereas Ricardo takes situation as exogenous, Smith fully grasps that physical fertility is not value fertility[10] because location is endogenous and rent can thereby reflect man-made external economies. Thus Smith was to avoid the identification by Ricardo, J.S. Mill, and others, of rent and diminishing returns, together with the naive Malthusianism which resulted. Was it perhaps then Smith's awareness of these other causes of rent which led him to ignore the discovery of diminishing returns by Stewart and Turgot before him?[11]

CHAPTER 3

RENT AS THE RESULT OF DIMINISHING RETURNS

Although Schumpeter remarks that we need "nothing beyond the productiveness and scarcity of land to explain why there is such a thing as rent. Neither the fact to be explained nor the explaining facts have anything to do with decreasing returns,"[1] nonetheless the two phenomena were inseparable after Ricardo.

Ignoring location rent,[2] Ricardo builds his analysis by generalizing from an a-spatial form,[3] so as to concentrate on the distribution into relative shares among classes of the "value" (not "riches") created. Ricardo clearly established the intensive and extensive margins and showed that the non-existence of no-rent land was irrelevant to the question of whether rent would arise.[4] The conclusion Ricardo drew from this was that rent would naturally tend to rise as a percentage of national income as population grew and land had to be cultivated under worse circumstances. Moreover, as J.S. Mill was to emphasize, the growth of rent was the sign of resource exhaustion, the ever-present reminder of the niggardliness of Nature, and man had no choice but to avoid the multiplication of his numbers if he wished to maintain his standard of living. Diminishing returns partook "of the character of physical truths . . . Whether they like it or not, a double quantity of labour will not raise, on the same land, a double quantity of food . . ."[5]

Fortunately, Mill's fact, while correct, does not support his

dismal conclusions and the reasons are indicated in the work he considered somewhat "obsolete"[6]--the Wealth of Nations, as we shall see.

Now, Mill had admitted that rent was due to location[7] as well as fertility. But location in relation to what? Markets, of course, and Smith would have promptly remarked that the division of labour is limited by the extent of the market, hence greater markets and greater population mean greater productivity which can offset diminishing returns indefinitely. Or as Henry George was to put it,

> "while the increase of population thus increases rent by lowering the margin of cultivation, it is a mistake to look upon this as the only mode by which rent advances as population grows. Increasing population increases rent, without reducing the margin of cultivation; and not withstanding the dicta of such writers as McCulloch, who assert that rent would not arise were there an unbounded extent of equally good land, increases it without reference to the natural qualities of land, for the increased powers of co-operation and exchange which come with increased population are equivalent to--nay, I think we can say without metaphor, that they give--an increased capacity to land."[8]

Thus Smith, who was more concerned about absolute levels of national income than distributive shares, regarded economic progress as a rent-maximizing process[9] for the "land constitutes by far the greatest, the most important, and the most durable part of the wealth of every extensive country. It may surely . . . give some satisfaction to the

public, to have so decisive a proof of [its] increasing value . . ."[10]

Marshall saw the problem of confounding "the amount of the produce raised, to increasing applications of capital and labour in the cultivation of land" with "the value of the produce"[11] but his loyalty to Ricardo[12] seems to leave him inclined to think that diminishing returns due to Nature might, in agriculture, still overcome increasing returns due to man's specialization.[13]

In summarizing the relationship between rent and diminishing returns, we can see that the "great classical Law of Diminishing Returns"[14] represented a logical deduction from a model which was, however, much too narrow in its treatment of the causes of rent.

Associated with the idea of diminishing returns was the notion that rent does not enter into price; and from it was to emerge the law of variable proportions and the theory of marginal productivity, which formalized the view that rent was a payment for differential advantage.

CHAPTER 4

RENT AS A DEMAND-DETERMINED FACTOR PRICE

It was realized by the Physiocrats that the rent of land, and its capitalized value, were not dependent on the conditions of supply of land, which was a naturally given factor. Turgot clearly saw that the rent of land was therefore fixed by the derived demand of would-be users of land:

> "The competition of wealthy agricultural entrepreneurs establishes the current price of leases in proportion to the fertility of the land and the price at which its produce is sold, always in accordance with the calculation which the farmers make of their costs and [illegible] profits which they ought to draw from their advances: they are unable to give the proprietor more than the surplus. But when the competition is very keen, they give him the whole of this surplus, since the proprietor will let his land only to the man who offers the highest rent."[1]

Given the rent thus determined, the value of land was obtained by capitalization at the rate of time preference.[2]

This view of rent was adopted by Adam Smith when he stated that the

> "rent of land, therefore, considered as the price paid for the use of land, is naturally a monopoly price. It is not at all proportioned to what the landlord may have laid out upon the

improvement of the land, or to what he can afford to take; but to what the farmer can afford to give."[3]

Where Smith had been content to let value from scarcity and value from cost of production both stand together in his anticipation of the Walrasian general equilibrium theory of value, Ricardo was not.

Ricardo clearly saw that

"There are some commodities, the value of which is determined by their scarcity alone. No labour can increase the quantity of such goods, and therefore their value cannot be lowered by an increased supply. Some rare statues and pictures, scarce books and coins, wines of a peculiar quality, which can be made only from grapes grown on a particular soil, of which there is a very limited quantity, are all of this description. Their value is wholly independent of the quantity of labour originally necessary to produce them . . ."[4]

Land, of course, fitted this description and Ricardo had to "get rid of rent" from his cost-of-production theory of value. He did so by invoking diminishing returns and going to the intensive and extensive margins. Value was <u>determined</u> (not "measured" or "equal to") by marginal cost of production. Nonetheless, in spite of his different approach to value theory, Ricardo also would have agreed that rent is a demand-determined factor price, a payment for infra-marginal surplus.

Marshall, in his synthesis of Ricardian and general-equilibrium analysis, saw this clearly and, in his parable of the rent of meteoric stones, commented that the

"owners of them would have a differential advantage in produc-

> tion, that would afford a large producer's surplus. This surplus would be governed wholly by the urgency and volume of the demand for their services on the one hand and the number of stones on the other hand: it could not be affected by the cost of obtaining a further supply, because none could be had at any price."[5]

Rent, of course, could be affected by the cost of production of substitute factors.

The significance of the notion that rent is a demand-determined price becomes apparent in the analogy drawn between rent and monopoly pricing[6] and the parallel between the incidence of taxes upon rent and taxes upon monopolies. It also figures in the argument, familiar to accountants, that the distinction between land and capital can be seen in the fact that the

> "value of land, like that of bonds or of a secure monopoly, bears no relation to cost of duplication. It is arrived at solely by a process of discounting or capitalizing the prospective income from it at the current interest rate. Capital value, however, depends not only indirectly, but also directly, on present cost of production (or of duplication)."[7]

CHAPTER 5

RENT AS THE UNIQUE SURPLUS

The Physiocrats are alleged to have held that only agriculture was productive and that manufacture was sterile. So stated, their doctrines have been regarded as self-evidently foolish. However, before dismissing the opinions of obviously intelligent men, it is perhaps well to ask ourselves: what did they mean?

The answer, I would suggest, lies in asking oneself what ought to be net national income. The obvious modern answer is that it is the value of goods and services provided in a year less costs of production, which means that one deducts depreciation and cancels out intermediate sales and is left with wages plus net operating surplus or, in Adam Smith's terms, wages plus profits and rents.

Now the Physiocrats went further; they held that wages were but the cost of production of labour supply[1] and that interest was the cost of keeping capital in the country[2] "for monetary fortunes are a clandestine form of wealth which knows neither king nor country."[3] Hence, they argued net national income was simply rent, i.e., the net product of land. The Physiocratic view was thus that, although labour produced its own wages[4] and capital raised the productivity of land,[5] these two factors of production were not productive of a surplus over their supply cost. Thus, just as Adam Smith's "unproductive labourers" could be necessary to a nation's productive activities, so the Physiocrats conceded the necessity of labour and capital in production,

but were still adamant that rent alone was the true net national income or "revenue" of a nation.

Adam Smith's criticisms of the Physiocratic concept of "productive" are well known:[6] what tends to be forgotten is that Smith considered the Physiocratic system "the nearest approximation to the truth that has yet been published upon the subject of political economy, and is upon that account well worth the consideration of every man who wishes to examine with attention the principles of that very important science."[7] Consequently, it is not surprising to discover that Smith, in fact, agreed with the Physiocrats in their definition of rent as the unique surplus. Smith first links factor pricing and distribution: "The whole annual produce of the land and labour of every country . . . naturally divides itself . . . into three parts; the rent of land, the wages of labour, and the profits of stock; and constitutes a revenue to three different orders of people . . . These are the three great, original and constituent orders of every civilized society, from whose revenue that of every other order is ultimately derived."[8] Then he immediately states of landowners: "They are the only one of the three orders whose revenue costs them neither labour nor care, but comes to them, as it were, of its own accord, and independent of any plan or project of their own."[9] That Smith virtually agreed with the Physiocrats in depicting rent as the unique surplus is reinforced by the reasons he gives for not taxing wages or profits, viz., that they are costs of production.[10]

Ricardo accepts the idea that it is "obvious that the power of paying taxes is in proportion to the net, and not in proportion to the

gross revenue,"[11] and he identifies net revenue with profits plus rent, arguing that wages "if moderate, constituting always the necessary expenses of production"[12]—an idea still vestigially honoured today in all income tax systems of the British Commonwealth which exempt a subsistence income.

Obviously, the admission that certain incomes other than rent contained a surplus element opened up a line of reasoning which was to be perfected by J.A. Hobson, but for the moment we may sum up the idea that land rent was the unique surplus by expressing it in Marshallian terms: land represents the only income which in the long run is a surplus over the real (i.e., labour and capital) costs of its production. Or as Marshall himself put it:

> ". . . in the long run the earnings of each agent are, as a rule, sufficient only to recompense at their marginal rates the sum total of the efforts and sacrifices required to produce them. If less than these marginal rates had been forthcoming the supplies would have been diminished; and on the whole there is in general no extra surplus in this direction . . . But there is this difference between land and other agents of production, that from a social point of view land yields a permanent surplus, while perishable things made by man do not."[13]

The concept of real cost and rent as a social surplus now lead us naturally into the question of whether or not "rent enters into price."

CHAPTER 6

RENT "DOES NOT ENTER" INTO PRICE

The controversy over the question of whether rent does or does not enter into price is surely one of the most important in the history of economic thought. I think it accurate to state that from this debate has come the marginal productivity theory of distribution, the theory of quasi-rents and ultimately, the neoclassical concept of capital formulated by J.B. Clark which has recently come under renewed attack. Unfortunately much of the controversy has been unnecessary because the question of whether rent does or does not enter into price was ably analyzed by Adam Smith.

It "has been common to pronounce Adam Smith inconsistent in his treatment of rent and price. He stated both that rent was and that it was not an element in determining the price of commodities"[1], a charge levied by David Buchanan in 1817,[2] repeated by Edgeworth in 1900 ("It being universally admitted that in McCulloch's words, 'there are few chapters in Dr. Smith's great work more unsatisfactory than his chapter on rent,' it will not appear particularly impious to dispute a formula which involves Adam Smith's obsolete conception of rent forming a part of price")[3] and still to be found in histories of economic thought.[4] Hence, it would seem wise to comment on the views taken by Ricardo, J.S. Mill, Jevons and Marshall on rent and price before looking at Adam Smith's doctrines.

Ricardo's doctrine on rent and price is admirably clear: "Corn

is not high because a rent is paid, but a rent is paid because corn is high . . . rent does not and cannot enter in the least degree as a component part of its price."[5] The underlying basis of this assertion was the implicit assumption that land had one use (growing corn);[6] the motive for the assumption was both to obtain a cost of production theory of value by going to the extensive or intensive margin and to determine the rate of profit by comparing homogeneous input and output.[7]

John Stuart Mill attempted to restate the Ricardian doctrine but, in doing so, gave a somewhat different and modified version of the theorem that "rent does not enter into price." His first reason is that rent is not a real cost of factor supply: "In the case of the implement (a thing produced by labour) a price of some sort is the necessary condition of its existence:[8] but the land exists by nature. The payment for it, therefore, is not one of the expenses of production . . ."[9] This statement is obviously correct and is conceded by the most strenuous advocates of the concept of opportunity cost.[10] The second reason Mill advances is that rent is not a cost to the individual producer because it pays for itself: "whoever cultivates land, paying a rent for it, gets in return for his rent an instrument of superior power to other instruments of the same kind for which no rent is paid. The superiority of the instrument is in exact proportion to the rent paid for it."[11] This argument, however, is not peculiar to land as Mill recognizes,[12] but he did not pursue this—it was left to J.B. Clark and J.A. Hobson.

The most important statement on this subject by Mill is given

in his "Summary of the Theory of Value":

"Rent is not an element in the cost of production of the commodity which yields it; except in the cases (rather conceivable than actually existing) in which it results from, and represents, a scarcity value. But when land capable of yielding rent in agriculture is applied to some other purpose, the rent which it would have yielded is an element in the cost of production of the commodity which it is employed to produce."[13]

This concession was seized upon by Jevons and the other neo-classical economists to attack the doctrine that rent does not enter into price.[14] But, as Bladen notes,

"in the classical system land was treated differently from the other factors of production because its supply was taken as given, as independent of price. Once the supply of labour, or capital, is taken as given, the distinction disappears and the concept of rent applies to all. The stage is set for the development of a new position, that the prices of products no more determines the prices of factors, than prices of factors determine the prices of products . . ."[15]

The neoclassical criticism was based on the notion of alternative uses of land and the rent paid in one use as being an opportunity cost when land was employed in another use.

Marshall was not happy with the contention that the notions of opportunity cost and alternative uses of land were sufficient to dispose of the Ricardian doctrine that rent does not enter into price. He

remarked

"I hold that the point of Ricardo's doctrine is to be sought in the fact that the cost of production of the marginal produce can be ascertained (theoretically at least) from the circumstances of the margin, without reasoning in a circle, and that the cost of production of other parts of the produce cannot. For other parts yield a rent or a quasi-rent, or both: and these are determined not by the circumstances of production of the parts in question, but by the price of the whole produce."[16]

Marshall wanted to interpret cost of production in the sense of real cost of production and hence, following Ricardo, he invoked the intensive margin to get rid of rent. His objection to the opportunity cost approach to rent was based on the observation that the rentals bid for land in alternative uses depended logically on the surpluses over real costs which could be made in each use. Thus if a farmer "reckoned that he could get a surplus of 30 pounds above his expenses (other than rent) . . . and a surplus of only 20 pounds above similar expenses by growing any other crop, it could not truly be said that the rent which the field could be made to yield by growing other crops 'entered into' the marginal price of hops."[17]

It has been objected by D.H. Buchanan that Marshall's argument here depends upon an implicit assumption of disequilibrium: that land will shift from one use to another so as to equalize its returns[18] and on the assumption that land is homogeneous this is true. However, the assumption is heroic.[19]

At this stage it is worthwhile to return to Adam Smith, whose

"comprehensive mind"[20] seems to have formulated as correct a view of the relation of rent to price as can even now be given.

Smith discusses the relationship of rent to price under three circumstances:

(1) When considering rent in the aggregate Smith recognized that rent was not a real cost of production to society, being no recompense for "labour or care."[21] In the aggregate, therefore, rent was not a cost of production.

(2) In dealing with particular commodities Smith takes the view that rent may or may not be a cost of production depending on whether other uses compete for the land: the normal rent of land which formed part of the natural price of a commodity was the competitive rent determined by alternative uses;[22] however when land was uniquely suitable for a specialized use (e.g., vineyards for rare wines) its rent would be a special monopoly rent.[23] But in both of these cases what was bid for the land would depend on the surplus it yielded.

Smith's statements on the relation of rent to price are thus able to reconcile the Ricardian and Jevonian positions without committing the errors of assuming land is restricted to one use or is homogeneous. If we want to translate Smith into modern jargon his position may be summed up as:

(1) Rent is a surplus of factor price over the real cost of production of the unproduced factor, land (which cost was zero).

(2) Rent is a cost of production of a particular commodity only in the sense that it must cover the transfer earnings (opportunity cost) of the land.

(3) The surplus, if any, of rent paid for a piece of land over its transfer earnings is indicative of a special monopoly rent. This may arise because land is not homogeneous.[24]

It is remarkable that the controversy over the relationship between rent and price should have persisted for so long when a close perusal of Adam Smith would have shown the different hypotheses underlying the opposing positions. For our purposes, however, the significance of this controversy is that it led to the identification of rent with any producer's surplus, an identification which meant that land ceased to have the importance classical writers had assigned to it.

CHAPTER 7

RENT AS ANY SURPLUS

As we have seen, the controversy over the question of whether rent does or does not enter into price fostered the notion that land rent was only a specific kind of surplus, a representative, as Marshall puts it, of a "large genus."[1]

This development in thought was not sudden. Turgot had seen that wage-earners might earn a surplus over subsistence wages due to energy, skill, economy or special ability and yet rejected the temptation to classify such a surplus as a species of rent because he argued that such a surplus was necessary for capital formation.[2]

David Buchanan, in his observations on the Wealth of Nations, clearly raised the question of identifying rent as a surplus of price over real cost. He argued

> "Rent being a surplus above wages and profit, whatever yields this surplus may be said to pay a rent. The inventor of a machine for abridging labour, were he to keep his secret, might sell his goods for such a price as would yield a rent or surplus above wages and profit . . . When Dr. Smith considers the extraordinary profit derived from secrets in manufacturers as the high price of the manufacturer's private labour, he clearly mistakes the nature of this profit, which is in no respect different from the rent of land."[3]

We see here the germ of the idea that rent may also be viewed as a

surplus due to factor heterogeneity.

Ricardo acknowledged this point: if machinery were to become worse "a rent would be paid to all those who possessed the most productive machinery."[4] Yet while thus foreshadowing the theory of quasi-rent and the application of the principle of differential advantage to other factors than land, Ricardo did not pursue the idea. Rent remained as land rent.

John Stuart Mill repeated Buchanan's point when he stated that there were cases of extra profit analogous to rent: "Wages and profits represent the universal elements in production, while rent may be taken to represent the differential and peculiar"[5]—a clear lead into theories of monopolistic competition and "rents" due to heterogeneity.

However, what really altered the notion of rent was the formulation of the marginal productivity theory by J.A. Hobson and J.B. Clark, who set out to show that the law of variable proportions meant that increments of any homogeneous factor would generate an infra-marginal producer's surplus attributable to the whole of that factor.

In the next few sections we shall see how:

(1) Rent was identified with infra-marginal producer's surplus generated by homogeneous factors (the marginal productivity theory).

(2) Rent was seen as a surplus of factor price over transfer earnings which, in the case of homogeneous factors, is essentially a disequilibrium phenomenon—supranormal profit.

(3) Rent was due to differential advantage arising from heterogeneity of factor inputs.

(4) The word "rent" was applied even to consumers' subjective

infra-marginal surplus.

(5) Rent was to be distinguished from quasi-rent by the effluxion of time.

CHAPTER 8

RENT IN THE MARGINAL PRODUCTIVITY THEORY OF DISTRIBUTION

In the Quarterly Journal of Economics of 1890-91 appeared two articles; "Distribution as Determined by a Law of Rent" by J.B. Clark and "The Law of the Three Rents" by J.A. Hobson. These authors present the marginal productivity theory as a generalization of Ricardo's law of rent to all three factors of production. Diminishing returns is reformulated as the law of variable proportions and land rent ceases to be distinctive.

> "Labour and capital, in current theories, are the antithesis of the typical rent-producer, land. Yet wages in the aggregate constitute the income derived by society from its entire fund of pure labour energy; and interest is, in like manner, the product of a fund of pure capital. Both are differential gains, and are completely amenable to the Ricardian law."[1]

There are several criticisms which can be made of Clark's version of the marginal productivity theory: the confounding of the rate of interest with the rents and quasi-rents received by land and capital,[2] the attempt to find pure capital by aggregating capital values which depend on the rate of interest that quasi-physical fund is supposed to determine,[3] but for our purposes the identification of the rent concept with infra-marginal surplus received by a factor has to be questioned.

Clark states that "each earlier worker creates a surplus over and above the amount created by the last one, and the sum of all these surpluses is the rent of the fund."[4] The problem is that labour is assumed a homogeneous input; there is therefore no "earlier" and no "later" man—we must talk of the marginal product of ten men, not the marginal product of the tenth man. Every man, every unit of capital is "marginal." Clark admits this[5] yet insists on calling this surplus a "rent" analogous to Ricardo's land rent.

However, in Ricardo's theory land inputs are not homogeneous, we can isolate the surplus and talk of the rent of the third acre, say, of land brought under cultivation—rent is a surplus due to heterogeneous qualities of land whether of fertility or location and _is assignable to individual units of land in a way that aggregate infra-marginal surplus of labour or capital is not_:[6] each unit of these homogeneous factors must be paid the same factor price. Moreover, if the aggregation of capital goods raises problems, the aggregation of heterogeneous land raises more.[7]

Marshall was wise to assert that in the reaction against Ricardo,

> "too much insistence has been laid on the fact that the earnings of every agent of production come from, and are for the time mainly governed by the value of the product which it takes part in producing; its earnings being so far governed on the same principle as the rent of land; and some have even thought it possible to constitute a complete theory of Distribution out of multifold applications of the law of rent. But they will not reach that end."[8]

The marginal productivity theory accounts well enough for the allocation of a given supply of factors to their most productive uses but it stops short of explaining how the aggregate supply of factors is determined in the first place, which was the very question which prompted the classical writers to distinguish land rent as the payment to a non-produced factor of production.[9] For them population was endogenous, not exogenous, and capital could not be treated on the same basis as land, because the capital stock was endogenously determined whereas land was given gratis by Nature.

CHAPTER 9

PARETIAN RENT--DISEQUILIBRIUM AND HETEROGENEITY

As we have seen, the marginal productivity theory is an outgrowth of Ricardo's reasoning in regard to the intensive margin wherein successive doses of one homogeneous factor (labour cum capital) are applied to a fixed quantity of another (land), raising its marginal product. The law of variable proportions simply put all three homogeneous factors on this same basis and thus determined distribution by the rent law.

However, Ricardo's reasoning with regard to the extensive margin implied that rent arose because land was not homogeneous (i.e., of different qualities). This view was echoed in J.S. Mill's remark that

> "Wages and profits represent the universal elements in production, while rent may be taken to represent the differential and peculiar: any difference in favour of certain producers, or in favour of production in certain circumstances, being the source of a gain, which, though not called rent unless paid periodically by one person to another, is governed by laws entirely the same with it. The price paid for a differential advantage in producing a commodity, cannot enter into the general cost of production of the commodity."[1]

The importance of this identification of rent with differential advantage is that it points to the two causes which can occasion

Paretian rent—heterogeneity and disequilibrium.

One of the results of the controversy over whether or not rent enters into price was the Paretian concept of rent which defines rent as the surplus rewards a factor earns over its transfer earnings (opportunity cost).[2] Now, if all the factors of production are homogeneous and the system is in equilibrium, Paretian rent cannot arise, since all units of each factor will have the same transfer earnings[3] at the level of the firm. Only if we extend our view to the industry or the economy generally do the Paretian rents appear. However, this is no advance on Adam Smith's insights into rent—it is simply another way of stating that whether or not rent enters into price depends on the alternatives open to the factor.

Worcester recognizes that the Paretian concept of rent "seriously impairs the meaning of the word"[4] and suggests that "Paretian rent" be discarded in favour of the term "factor profits" for the surplus returns to productive agents over and above opportunity costs. He also suggests that rent is best defined as the opportunity cost of land at the level of the firm.[5] The suggestions appear quite sensible and are quite in keeping with Adam Smith's analysis of when rent does and does not enter into price. It will be recalled that what Adam Smith called the natural rate of land rent is its competitive rental as determined by opportunity cost and what he called the monopoly rent of certain vineyards in France was their "factor profit" over the returns in alternative uses. Moreover, Adam Smith by taking the social point of view was able to consistently hold, as did Marshall[6] and do as most advocates of the Paretian concept, that rent of land is not a cost of

production to society as a whole.

Thus the Paretian concept of "rent" seems to amount to little more than the statement that factors are not homogeneous nor is an economic system always in equilibrium--concepts which have no necessary connection with land rent as a surplus over real cost. It does seem best to use different words for different ideas, and to recognize that "opportunity cost" concepts are not substitutes for "real cost" concepts.

CHAPTER 10

CONSUMERS' SURPLUS AS A RENT

In the identification of the concept of surplus with rent towards the end of the nineteenth century, Alfred Marshall in the first three editions of his Principles designated consumers' surplus as "consumers' rent." The motivation for this terminology was the analogy with producers' surplus or rent in the familiar partial equilibrium supply and demand analysis.[1] However, in later editions, Marshall abandoned the term and in Appendix K, "Certain Kinds of Surpluses," one senses that this abandonment is due to his desire to emphasize that the surpluses of material agents other than land disappear in the long run whereas "from a social point of view land yields a permanent surplus, while perishable things made by man do not"[2]--a view which is the same as the Physiocratic notion of land rent as the unique surplus.

CHAPTER II

RENT AND QUASI-RENT

The concept of quasi-rent was developed by Marshall as a natural adjunct to his wrestling with the question of whether or not rent enters into price.[1] If one adopts the social point of view and the time period is so short that the supply of man made appliances cannot be altered then the rental prices of land and capital goods are on a par. Neither payment represents a real cost of production (the agents of production are already in existence) and factor payments on the basis of opportunity cost are simply a means of allocating a scarce supply of factors to the most productive uses. Hence, in the short run, the rental of capital goods is a quasi-rent—because it is not a real cost of production. In the long-run, however, as Marshall points out, this is not so: efforts and sacrifices are required to replenish, renew and expand the stock of capital goods.[2]

Marshall's use of the term quasi-rent has an advantage in clarifying the ambiguous use of "interest" for both "interest payments" and "rate of interest" by J.B. Clark:[3] Marshall makes it clear that the value of the existing stock of capital goods does not determine the rate of interest but vice versa through capitalization of quasi-rents.[4]

Quasi-Rent and Capital Sunk in Land

Adam Smith had remarked that the rent payable for a unit of land was partly regulated by the "natural or improved fertility of the

land,"[5] which raises the question whether the rent of land can conceptually be distinguished from the quasi-rent of capital sunk in the land. Smith's answer was yes. He included in his definition of capital "improvements of land . . . what has been profitably laid out in clearing, draining, enclosing, manuring, and reducing it into the condition most proper for tillage and culture."[6] Smith also stated that augmented rents due to improvements by landlords were but a return to capital.[7] Where, however, a landlord demanded an increased rent due to alterations in fertility due to capital sunk in the land by a tenant,[8] this was indeed land rent because one had to assume that tenants on long leases would only sink capital into land if they could recover capital plus profit before the expiration of the lease[9]--a conclusion which is in keeping with the notion that rent is a surplus over real cost. Interestingly enough, New Zealand land valuation law[10] echoes Smith's view that capital sunk in land is generally recoverable as a terminable annuity[11] and that not all the effects of land improvement are attributable to those improvements but to latent qualities of the land itself.

Ricardo, however, saw rent as the principle of differential productivity and hence allowed that superior machinery could earn a rent.[12] He also modified his definition of rent and suggested that what is today described as the quasi-rent of capital sunk in land was "strictly of the nature of rent"[13] in spite of his recognition that such capital earned profits ex-ante and quasi-rent ex post. Essentially, Ricardo has no clear concept of quasi-rent and assumes that capital sunk in land is not subject to obsolescence, physical deterioration and

yields a perpetual, not a terminable, annuity.

J.S. Mill, while maintaining that the owners of existing fixed capital on land will receive quasi-rents equivalent to interest on the replacement cost of such capital, follows Ricardo "with regard to capital actually sunk in improvements, and not requiring periodical renewal, but spent once for all in giving the land a permanent increase in productiveness."[14] Like Ricardo he classifies all the return to such improvement as rent:

> "I cannot think that the incomes of those who own the Bedford Level . . . ought to be called profit and not rent because those lands would have been worth next to nothing unless capital had been expended on them. The owners are not capitalists, but landlords; they have parted with their capital; it is consumed, destroyed . . ."[15]

Mill does not explain how "consumed, destroyed" capital can be capital "not requiring" renewal and giving a "permanent increase in productiveness." He seems here to equate the spending of money with the destruction of capital. Mill is also incorrect in asserting that these undrained lands "would have been worth next to nothing."

As Mr. G.F.C. Campbell, formerly New Zealand Valuer-General, explains of such land drainage schemes,

> "It is the actual improvement which is valued, not the effect of that improvement. For instance, suppose that the expenditure of a small sum in cutting an outlet for water has converted a swamp into first-class agricultural land. The fact that the swamp was capable of easy drainage would enhance its unimproved

value, and the cost only of cutting the drain would be valued as the improvement."[16]

Marshall correctly states that capital sunk in land earns quasi-rents, not rent[17] which is the solution to Ricardo's and Mill's difficulties, though it is not clear whether Marshall believed there were capital improvements which yielded a perpetual return at no more than the current rate of interest.[18]

The significance of this debate over whether capital sunk in land earns profits (quasi-rents) or is rent lies in the attempt of some writers, notably Carey and Bastiat, to argue that land rent is nothing but the quasi-rent of sunk capital (in Bastiat's case the argument was used to defend private property in land[19]). The answers to this argument can now be seen:

(1) Capital sunk in land generally deteriorates (the principle of terminable annuities stated by Smith and Walker).

(2) It may become obsolete and detract from land value, rather than add to it.[20]

(3) Its replacement cost generally falls over time, as new construction techniques are developed.

(4) The inherent and latent powers of the land are wrongly attributed to the capital which unlocks them (an understandable error in view of Ricardo's "original" powers of the soil).

(5) The public value of land is confounded with the private value due to capital sunk in the land by tenants or landlords.[21]

(6) Capital expenditure is compounded forward at a rate of interest which ignores the returns received from that capital invest-

ment.[22]

The conclusion is then that the rent of land is distinguishable from the quasi-rent of sunk capital and that Adam Smith's statements to that effect have never been successfully controverted.

CHAPTER 12

RENT AS A REWARD FOR RISK

It has sometimes been asserted that rent is a reward for risk, that speculation in land is productive and must be rewarded. Naturally, such a view has implications for the desirability of taxing what it alleges is in fact an earned, rather than an unearned, increment.

There are several variations on this theme:

(1) The landowner "performs a very important productive service. He finds, brings into use, and then allocates, land sites to the most value-productive bidders."[1] "As in other industries—if not quite so much as in other industries—the speculator is useful in finding a market for the article."[2]

(2) The discovery of natural resources (e.g., minerals) is a service for which rent is the reward in a risky endeavour.

(3) "Owners of land that is not in active use perform services . . . they hold the land while it is ripening into use . . . the ripening process is a part of the productive process in land utilization . . . It would be in the end a waste to put upon this land inferior buildings which would have to be torn down."[3] This argument applies equally to the owner of minerals in deciding the timing of extraction (i.e. user cost).

(4) Another argument is that the unearned increment is an incentive to building. "In many instances, buildings are not depreciated at all, the owners counting upon the increment in the land value

to balance the depreciation of the building . . . the consumer of the product gets the benefit through a reduction in the cost of production represented by uncharged depreciation."[4] Thus the rent of land represents a risk premium necessary to induce capital to assume the concrete form of a building.

(5) Marshall put forward the argument that in a new country the prospect of the unearned increment was in fact a necessary reward for the settlers' enterprise:

> "A settler often takes up land with the expectation that the produce which it affords while in his possession, will fall short of an adequate reward for his hardships, his labour and his expenditure. He looks for part of his reward to the value of the land itself, which he may perhaps after a while sell to some new-comer who has no turn for the life of a pioneer."[5]

"But when the land is all taken up, the desire to obtain its title no longer acts as a motive to further improvement and to further production."[6] This argument was also put forward by J.B. Clark, A.S. Johnson and T.S. Adams.[7]

(6) Finally, the argument is advanced in a general form that parcels of land are risky assets (values may fall as well as rise) and that private property in land allows individuals to allocate these risks in the best fashion.[8]

All of these arguments are either incorrect or grossly overstated.

(1) With regard to the first argument, the allocation of land to its best use, it confounds the personal and functional receipt of

income. Rent is a demand-determined price and it is the bids of users that allocate it, with the aid of real estate brokers. The landowner can and often does play a purely passive function, which would be an impossibility if this argument were correct.[9] The allocation function _is_ severable from ownership. Moreover, speculation in land, unlike speculation in commodities, does not serve the social function of encouraging and maintaining production;[10] such speculation will be considered in Chapter 29.

(2) As for the argument that rent is a reward for exploration and discovery of mineral resources, this is akin to the argument that depletion allowances are necessary to reward mining investment. One would expect the risk element to be accounted for in the required rate of return of capital invested in mining ventures. No one seriously maintains that Christopher Columbus required title in perpetuity to the Americas before he set off exploring and yet this is the logical reductio ad absurdum of the argument that rent is the necessary reward for discovery.

In fact one could argue that from a social point of view, allowing rent to be appropriated as the reward of discovery misallocates resources. Too much may be spent exploring for mineral resources rather than developing existing deposits. Such a criticism would be analogous to that sometimes levied against the patent system which may encourage research in an area and then stifle it once the first patent in that field is granted.[11] In any case, the analogy with patents would suggest that if rent is to be the reward for discovery it need not be so for more than a limited number of years.[12]

Moreover, the fact that prospectors pay for the rights to explore disproves the contention that rent is produced by discovery, for in such cases a clear net return is enjoyed by passive landholders who neither risk nor search.[13]

(3) Ely's argument that landowners perform services by holding land out of use and waiting to commit it to a superior use simply amounts to the contention that in equilibrium the value of unused natural resources must be rising at the current rate of interest. This is true, but does not prove that rent is a reward for productive service: rather it raises the important question of whether land value taxation is neutral and/or optimal in its effect on the timing of the use of natural resources.

(4) The argument that the unearned increment is an incentive to building is clearly wrong. In the first place much building takes place on leaseholds where the builder will not receive the increment, but, more importantly, there is no necessary connection between the increment in land value and the depreciation of a building on it. It is simply not necessary for a landowner to accept a subnormal return to capital in order to gain any increment,[14] unless some kind of improvement is necessary to retain title,[15] in which case, as we shall see later, the result is a misallocation of resources.

(5) The suggestion of Marshall and Clark that land rent in a new country was a necessary reward for settlers had been considered before they wrote by Wakefield, John Stuart Mill and Henry George, all of whom had seen its fundamental defect, namely, that there was no reason to expect an optimal pattern of land settlement to result.

As J.S. Mill put it in his chapter on "Grounds and Limits of the Laissez-Faire Principle," the Wakefield system of colonization

> "is grounded on the important principle, that the degree of productiveness of land and labour depends on their being in a due proportion to one another; that if a few persons in a newly-settled country attempt to occupy and appropriate a large district, or if each labourer becomes too soon an occupier and cultivator of land, there is a loss of productive power, and a great retardation of the progress of the colony in wealth and civilization . . . Mr. Wakefield therefore proposed to check the premature occupation of land and dispersion of the people, by putting upon all unappropriated lands a rather high price, the proceeds of which were to be expended in conveying emigrant labourers from the mother country."[16]

J.S. Mill defends Wakefield's proposal by pointing out that the "free-rider" problem would otherwise operate and individual profit maximization would not coincide with a social optimum.

Wakefield's system was, in fact, adopted in the settlement of South Australia, though one may also question whether the policy of putting an artificially high price on land was optimal--a better policy would appear to have been suggested by James Mill, namely the reservation of rent as State revenue, which would not have distorted marginal rewards to capital and labour in either direction;[17] this is considered in Chapter 33.

It was this distortion of factor rewards caused by the unearned increment which caused Haig, Davenport and H.G. Brown to question the

idea that rent should be regarded as a reward to risk. They pointed out this could only be so at the social cost of a misallocation of resources.[18]

It may also be pointed out that Marshall seems to have viewed the conversion of land from prairie to farmland as the "production" of land,[19] which is surely confounding the emergence of value when a good ceases to be free with its physical production, in which case any diversion of land to a higher and better use "produces" land and hence all rent is "produced."[20]

Henry George seems to have concurred with J.S. Mill that the unearned increment would lead to a suboptimal pattern of settlement but to have gone further and suggested that even in a settled community the pursuit of the unearned increment would lead to a suboptimal distribution of population—overcrowded cities and sparsely populated rural areas.[21] His reasoning appears to be based upon the pre-emptive motive for land acquisition discussed by J.S. Mill, later generations in an old country being in the same position as later settlers in a new country.[22]

(6) The general argument that land is a risky asset and the private receipt of rent is necessary to ensure the proper allocation of risk seems to fail on several counts.

In the first place, all factor incomes are uncertain in the future so what is unique about rent?

In the second place, as Turgot pointed out, money invested in land brings in a lower rate of return precisely because land is not a risky investment.[23]

Finally, if we conceive of risk not as the variability of

factor returns per se but rather as the possibility that a factor will be locked into a lower return and unable to benefit from a rise in its reward, then it is capital, not labour or land, that bears risks. As Ely remarked, it is the "inferior buildings which would have to be torn down" if land is inappropriately developed--it is thus the capital on the land that bears the special risk of obsolescence: the land can always be salvaged and turned to its highest and best use; capital must accept its quasi-rents,[24] which may diverge sharply from the return to free or uninvested capital.

Thus it can be seen that rent is not the return to risk. The discussion has, however, raised the question as to the nature of land speculation. It has become apparent that the term covers two ideas: the first is that land speculation, like speculation in general, simply guides or holds land for its highest and best use and is therefore socially useful.[25] It will be shown later that land value taxation is neutral with respect to speculation of this kind which is warranted by the normal marginal conditions of optimization.

However, the second idea of land speculation is that of the unearned increment as making up for otherwise unprofitable investment decisions[26] and is the kind of speculation that Wakefield, J.S. Mill, Henry George, H.G. Brown, and others have accurately stigmatized as socially wasteful, particularly where it represents an attempt to establish monopoly market power by controlling non-reproducible natural resources in advance of real demand.

If it can be shown that land value taxation is neutral with respect to the first kind of speculation and discourages the second

kind, then the apparent conflict in the literature as to the relationship between land rent taxation and land speculation will have been resolved. It is my intention to show that some, at least, of the classical advocates of land rent taxation understood something of this distinction which explains why they could hold that land rent taxation could be "unshiftable" and yet "non-neutral" at the same time. Indeed they saw it as "super-neutral" insofar as they alleged it would cure an existing bias towards resource misallocation.

CHAPTER 13

RENT AS RENTAL

Towards the end of the nineteenth century, the classical division of rent, profit and wages as the rewards of land, capital and labour respectively was abandoned in favour of a classification which designated rent or rental as the reward of all material agents of production and wages as the reward to the human factor. It is to this trend in thought, pioneered by J.B. Clark, that we owe the ubiquitous production function $Y = F(K,L)$[1] and it is well to realize that this assimilation of land into capital was largely a response to the "single tax" of Henry George:[2] defenders of the status quo were wont to assert that "capital vests itself in land"[3] and hence landed property is equally sacred, whilst Socialist opponents agreed but drew the conclusion that both land and capital were equally worthy of nationalization.[4]

The arguments which have been advanced for the assimilation of land into capital may be summarized as follows:

(1) Capital is a fund of value:[5] we must follow the point of view of the individual entrepreneur and see land as one of his possible financial investments.[6]

(2) In the static state, there is no abstinence, capital is a permanent, imperishable fund[7] which earns rentals[8] in its material, embodied forms. The ratio of these rental value flows to the value of the fund establishes the rate of interest.[9]

(3) Rent is rental—the price of any flow of productive service,

whether man-made or Nature-given.[10] Interest is not a phenomenon peculiar to produced capital, rather it is agio or time-discount which applies to all factor returns.[11] Hence the old distinction that land earns rent and capital earns interest is meaningless.[12]

(4) Land is produced under economic conditions. Investment in land earns profits in no way different to other individual investments.[13]

(5) All capital goods involve a fusion of valuable natural resources with embodied labour; hence we cannot think of capital as reducible to dated labour. Capital goods are, in fact, partly land, which continues to yield land services even though embodied in a capital good.[14]

(6) "The entire notion of 'factor of production' is an incubus on economic analysis, and should be eliminated from economic discussion as summarily as possible."[15]

These arguments for treating land as capital as advanced by Clark, Fetter and Knight have had an enormous influence on economic theory, an influence which is to be regretted because they are fundamentally misleading, as Bohm-Bawerk, Marshall and Taussig well saw. In the light of the subsequent Cambridge controversies Bohm-Bawerk's judgment is worth recalling: "J.B. Clark's concept of 'true capital' leads to aberrations far more subtle and deceptive and for that very reason far more dangerous."[16]

Let us now consider why the assimilation of land into capital cannot be justified on the grounds suggested above:

(1) Clark's identification of capital goods with capital value

is a misuse of metaphor;[17] it amounts to reasoning in a circle and does nothing to explain the origin of interest[18]--the marginal productivity theory explains the determination of rents and quasi-rents, not the rate of interest. In fact, Clark's inclusion of land in a fund of capital which determines the interest rate[19] represents a sad loss of the insight of Turgot and Adam Smith that the causality runs in the other direction: rents are capitalized at the rate of interest to give the value of land.[20] Logically, the existence of what is to be valued in exchange precedes valuation, or as Carver put it, "A quantum of value is no more capital than a quantum of weight is pig iron."[21]

As for the assertion that economic definitions must follow those of the individual businessman, its absurdity becomes apparent when one asks whether this fund of capital is to include capitalized monopoly privileges.[22]

(2) Clark's assertion that in a static state capital is permanent like land begs the obvious question as to why the designation of factors of production should be chosen with reference to static states when the real world is confessedly dynamic.[23] Clark himself admits that in a dynamic state land is distinguishable from capital, by reason of permanence and fixity of supply.[24]

There is another confusion in Clark's fund concept of capital. Capital, Clark tells us, has its genesis in abstinence and interest is the reward of abstinence.[25] However, Clark adds, it is only the creation of capital that represents abstinence, not its conservation.[26] These postulates provoke two questions:

First, in what sense did abstinence create land?

Second, in the static state the amount of capital does not change,[27] which implies there is no abstinence, in which case, why is there a positive interest rate at all?

It was Taussig who observed the crucial importance of this assertion that "abstinence is confined to the genesis of true capital" which struck him as "fundamentally untrue," since capital had to be conserved.[28] The effect of Clark's reasoning was to treat capital as if it were ready-made: "Land and capital are treated as if their conditions of supply were the same."[29] In short, the assimilation of land into capital obscures the vital distinction between rent and quasi-rent.

(3) To the assertion that rent must be seen as rental, the price of any flow of productive service, and that interest represents a time discount, it can be replied that the substance of this contention is valid, but we may yet want to distinguish between the physical inputs which earn these rentals on the basis of whether they are necessary to elicit factor supply. Marshall's concept of quasi-rent does precisely this.[30] Alternatively, the same basis for distinguishing between land and capital goods may be stated in noting that all commodities are reducible to dated inputs of land and labour--the original factors: capital earns only its cost--the agio of time discount, whereas land and labour earn net incomes.[31]

(4) The notion that land is produced under economic conditions seems to have three possible interpretations:

(a) That the efforts and sacrifices of individual landowners have been sunk into the land, which is really capital. This

is a re-incarnation of the Carey-Bastiat thesis and depends on the substitution of opportunity cost in lieu of real cost.[32] The individual viewpoint is substituted for the social. Slavery and piracy were carried on under economic conditions and doubtless returned no more than the market rate of profit to individuals but we may still doubt whether they produced manpower or wealth.

(b) An increase of land value due to social externalities such as roads and growing markets, is treated as though it were production of land.[33] National income accountants would find this view rather startling.

(c) A simple refusal to acknowledge the old definition that capital is the produced means of production; expending capital in the land being described as "producing land."[34] This is a matter of semantic preference: it implies nothing about the validity of the old definition.

(5) This assertion (that all capital goods include embodied natural resources) may or may not be true, depending on whether we agree with Marshall that there is a no-rent margin in the production of goods. Certainly, gold and diamond jewelry suggest themselves as examples where the value added component may not be so large in relation to the value of the land input. Theoretically the answer to this problem seems to be the further pursuit of imputation; practically one is entitled to question its significance—as John Locke and Adam Smith observed, by far the greater part of the value of goods represents value-added.[35]

(6) To discard the notion of factor of production in favour of the notion that there is only one factor of production, capital, a fund of value is, surely, "a confusion of no mean proportions between physical and value concepts."[36]

Ultimately, the attempt to assimilate land into capital has failed. It was based on a static state which ignored augmentability and the conditions of physical supply. It did, however, raise interesting questions: Is land to be considered as a permanently given factor of production? If capital is that which must be conserved, then what is the basis for distinguishing capital from exhaustible resources, whether renewable or non renewable? Is rent exclusively a payment for the "original and indestructible powers of the soil?"[37]

The Definition of Land

It is clear that we have chosen to restate the definition of rent in terms of the traditional division of the factors of production into land, labour and capital; and that we have followed Bohm-Bawerk in seeing the distinction between land and capital as that between the free gifts of Nature and the produced means of production:

> "land and other capital goods in many important respects travel different ways. The former is immovable, the latter is for the most part movable; the former is a gift of nature, the latter as product of labour; the former cannot be increased, the latter can . . . Most important of all, when the great social problems are discussed, property in land and property in capital are the subject of attack and defence on two distinctly different fronts."[38]

This approach has not gone unchallenged and before exploring the problems of definition let us set out the possible positions which can be adopted.

(1) Land cannot be distinguished from capital.

(2) Land can be distinguished from capital because

(a) capital is produced; land is not

or (b) is permanent; capital is not

or (c) capital is reproducible: land is not.

The argument that land cannot be distinguished from capital has its origins in the observation that all products result from the fusion of land and labour. As Fetter put it

> ". . . it may be said that the distinction between land and capital by the older economists was not made with respect to the <u>purposes</u> for which agents of production were used, but with respect to their <u>origin</u>, their naturalness, or artificiality . . . Those goods which were called natural were treated . . . under the land and rent concept and those that were artificial were treated under the capital concept. The material of everything in the world was once 'natural.' When did it become 'artificial'? At what moment did the bit of iron ore, the piece of coal, the piece of wood, the piece of 'land,' miraculously become capital? Was it at the first touch of man's hand? Then is every cultivated bit of land artificial, and by that token is capital?"[39]

Other arguments of a like kind are that land must be conserved, like capital;[40] that land and capital goods are valued alike by a process of

capitalization[41] and that advocates of the traditional distinction between land and capital have inconsistently asserted that capital sunk in land becomes land--in sum "The attempt to distinguish between the part of the value of a material thing that is due to labour and the part that is due to nature, keeping this nature (or land) and capital distinct, is vain when once the labour has been spent."[42] It is, of course, precisely this last contention we deny on theoretical grounds, and we would adduce the facts of commercial experience and of land value taxation as it has been applied in regard to empirical grounds for this contention.

Before examining the question of capital sunk in land, let us examine another basis of distinction between land and capital which attempts to answer these objections. This is the suggestion that land is whatever is permanent, while capital is that which is not, regardless of whether the object is natural or man-made. Such a distinction avoids the conservation objection and sees a distinction emerging between land and capital in that the former has a capitalized value, but not a cost of production. This distinction has been suggested in part or in whole by Wicksell,[43] J.B. Clark,[44] and modern neo-Austrians.[45]

However, this attempt to solve the problem generates other problems. We are asked to regard permanent goods such as dwelling-houses,[46] canals or cleared land,[47] as "land" and yet perishable topsoil,[48] virgin forests[49] or exhaustible ore deposits[50] would seem to be "capital." Finally, one could even question whether any resource, natural or man-made, is physically permanent: mountains are continually being eroded, rivers are naturally being silted, just as man and his tools decay and rust.

Thus some writers have proposed another basis of distinction between capital and land: capital is reproducible, land is not. This classification has some practical appeal and the United Nations System of National Accounts adopts it as an asset classification. It can then be argued that depletable mineral resources are "land" because they are not physically reproducible but, even if this is conceded, it remains that topsoil and virgin forests must be classified as "capital."[51]

For these reasons, the proposed definitions do not seem to be an improvement over the traditional division of land and capital on the basis on non-produced means of production. Only this definition is congruent with the ideas of surplus over real cost, of the free gifts of nature. We must therefore return to face the questions of whether capital sunk in land becomes "land" and whether we can meaningfully distinguish the value of a material thing due to labour from that due to nature.

The answer to both these questions is, I suggest, in the affirmative. Adam Smith,[52] Henry George[53] and Bohm-Bawerk[54] were, I suggest, correct in asserting that capital sunk in land becomes land. The reason is to be found in the remarks of George that land "is the substance to which labour gives the form" but that such forms are not permanent; "Nature does not proceed from man, but man from nature, and it is into the bosom of nature that he and all his works must return again."[55]

The fact is that there are no permanent improvements to land; there are permanent alterations, perhaps, but is an alteration an "improvement" when a century later it is at best irrelevant or at worst, a hindrance, to the highest and best use to which the land can be then

put? Would a plot of Manhattan land perpetually fertilized in 1700 be valued any differently from any other plot for today's best use, that is, a building? Is a two-story building that has to be demolished for a twenty-story building an "improvement"--or is it better described as a "produced hindrance to production"?

What happens to all capital over time is that it either loses its physical for naturally or it is demolished or it is preserved--but only at the cost of continued renewal and repair. Railways and dams are often cited as examples of capital which yield perpetual returns yet many dams become hopelessly silted in 50 years, while the deterioration of the American railroad beds in the last 30 years is known to unfortunate thousands. Whether an asset is formally depreciated for accounting purposes or whether, in lieu of depreciation charges, renewals and repairs are treated as current expenses the underlying reality is the same--all capital goods perish and no investor ever regards the creation of fixed capital as yielding a perpetuity; rather he views his capital investment as the purchase of a terminable annuity, for the future is uncertain and he knows that the land or matter associated with his capital may one day have to be salvaged and turned to a better use. As both Adam Smith[56] and Henry George[57] realized, there was no reason for an investor to sink capital irretrievably into land on leasehold unless he could recover capital plus profit within that finite time. The example of the Suez Canal being built on a 99 year lease with reversion to the landlord is a good case; no doubt the investors were well aware that there was a possibility (since unrealized) that even this capital work might be abandoned as a means of production if

airships as large as sea-going freighters were to mean revenues below canal maintenance costs.

Thus, as capital is form impressed upon matter, when that form is destroyed we may legitimately impute the value to matter: the value of land is its salvage value,[58] which does not necessarily reflect its original powers. With regard to movable goods, the salvage value of their matter is generally infinitesimal[59] (except in the case of precious metals and jewels); with immovable property it is generally the reverse.[60]

In summary, the traditional definitions of land and capital still seem to offer "the deepest and most significant line of fissure"[61] between the two: the "real and natural distinction is between things which are the produce of labour and things which are the gratuitous offerings of nature."[62]

This definition implies that naturally given depletable resources, whether renewable or not, come under the land concept—natural topsoil, virgin forests, mineral ores, fisheries are all included.

CHAPTER 14

EXHAUSTIBLE RESOURCES AND THEIR RENT

Adam Smith in his discussion of land rent had clearly included all payments for the use of the free gifts of Nature and did not seem to feel that the question of exhaustibility of a naturally given resource was relevant in deciding whether its remuneration is, or is not, rent. Smith clearly adheres to the notion of rent as a surplus of factor earnings over the real cost of original productionof a factor. Thus he concludes that royalties and severance payments for kelp,[1] stone, timber[2] and coal[3] are price-determined surpluses, and hence, rents.

Smith, as we shall see, was essentially correct, but unfortunately Ricardo's loose assertion that rent was a payment for "the use of the original and indestructible powers of the soil"[4] caused Smith's insights to be lost much in the same way as Ricardo's other famous declaration that "rent does not enter . . . as a component part of . . . price"[5] also caused Smith's analysis of opportunity cost of land to be neglected. Ricardo's influence is reflected in statements such as "Truly indestructible economic goods that require no maintenance are rare indeed . . . so rare that we cannot think of one example."[6] Such a statement logically leads towards an assimilation of land into capital and a denial that such a thing as rent exists.

The emphasis on the word "indestructible" as the criterion for rent has led some writers to stress the permanence of a resource in

defining land or rent-goods and to ignore whether the resource is a free gift of Nature or man-made.[7] On this view, "land" in the economic sense does not include its exhaustible qualities though some writers would further distinguish between exhaustible but non-renewable natural resources (included in land) and exhaustible but renewable resources (not so included).[8] It is obvious that these perplexities of definition have a profound importance for any attempt to tax economic rent, hence it is necessary to examine carefully the controversy over whether a royalty or severance payment for an exhaustible resource is or is not rent.

Ricardo's argument that a royalty is not a rent is set out in Chapter II of the Principles: Adam Smith, he says,

> "tells us that the demand for timber, and its consequent high price . . . caused a rent to be paid for forests in Norway which could before afford no rent. Is it not, however, evident that the person who paid what he thus calls rent, paid it in consideration of the valuable commodity which was then standing on the land, and that he actually repaid himself with a profit on the sale of the timber . . . the compensation was paid for the liberty of removing and selling the timber, and not for the liberty of growing it. He speaks also of the rent of coal mines, and of stone quarries, to which the same observation applies—that the compensation given for the mine or quarry is paid for the value of the coal or stone which can be removed from them, and has no connection with the original and indestructible powers of the land."[9]

However, in Chapter III, "On the Rent of Mines," Ricardo applies the concept of differential fertility to mines: "Mines, as well as land, generally pay a rent to their owner; and this rent, as well as the rent of land, is the effect and never the cause of the high value of their produce."[10]

It is clear that Ricardo's argument is partly a result of his own definition: unlike J.B. Say, Ricardo does not include all natural agents under "land", and it is equally obvious that the differential fertility of mines is not "indestructible." What is surprising is that Ricardo refers to a naturally given resource as a "commodity," a word normally associated with produced goods.

Marshall endorsed Ricardo's view that royalties are not rents: "the produce of mines is merely a giving up of their stored-up treasures . . . the produce of the mine is part of the mine itself."[11] A royalty, we are told, "does no more than cover the injury done to a mine by taking ore out of it."[12]

> "A royalty is <u>not</u> a rent . . . For except when mines, quarries, etc. are practically inexhaustible, the excess of their income over their direct outgoings has to be regarded, in part at least, as the price got by the sale of stored-up goods—stored up by nature indeed, but now treated as private property; and therefore the marginal supply price of minerals includes a royalty."[13]

In other words a royalty is a return of "principal, not income."[14]

However, the Ricardo-Marshall argument rests on an implicit assumption of the individual as opposed to the social point of view—

the "therefore" follows on the fact that the mine is "private property": from a social point of view we may regard rent as a surplus over real cost (as does Marshall elsewhere) and there is no reason to think that the value of a mine represents real cost[15]—discovery is often accidental and, in any case, we should beware of the fundamental fallacy of historical cost accounting, viz., that value must equal cost. As Gray succinctly puts it, the essential fallacy of the Ricardo-Marshall argument "lies in the fact that the so-called royalty is nothing more than a depreciation charge which results from capitalizing a terminable series of incomes."[16] For example, if one were to discover accidentally a buried treasure of gold coins on one's property, its subsequent alienation by sale in the most advantageous way no more represents a real cost to society than the alienation of a landed estate by subdivision, though in both cases prudent owners would not entirely consume their receipts if they wished to "maintain their capital intact."

If then depletion of a mine does not represent a real cost in the sense of being the necessary reward for discovery, could it be said that depletion is a cost to society in the sense that it is losing forever a resource?[17]

The answer would appear to be that this is an opportunity cost, generated endogenously by the time pattern of use of the resource: it is no more a real cost to society than is the spending of an inherited legacy a real cost to an heir. This does not mean that depletion should not be charged against production in the national accounts: it should, since depletion is to "natural capital" what depreciation is to man-made capital.

If Marshall is wrong in his contention that a royalty is not a rent because it is a real cost of production and, unlike rent, therefore enters into price, he is equally right in contending that a royalty is a capital account payment, not a current account payment.[18] A royalty is, indeed, not rent—it is capitalized rent or what lawyers call "rent-in-advance," the present value of future flows of service from a natural agent. The true relation of royalty to rent is the same as the relation of a fee simple value of land to its annual rental. In theory, one could rent a ton of gold for 99 years and turn it into jewelry just as a builder rents land for 99 years and puts a building on it. The reason a lump sum royalty for severable natural objects is preferred to an annual rent is simply the obvious problems involved in collecting such an annual debt.

We can now see the answer to Ricardo's questions about the forests of Norway, mines and quarries: the rent of such lands comprises a flow of rent for its permanent qualities and a royalty or "rent-in-advance" for its severable qualities (e.g., trees). Both are price determined, not price-determining, neither are real costs of production. Of course, once the natural forest is cut down, if a new one is planted then its reward will be a return to capital (produced means of production), not a royalty.

To sum up, exhaustibility has no essential connection with the concept of rent,[19] the crucial concept is that of the free gifts of Nature,[20] the idea of surplus over real cost.[21] From the point of view of public policy, it becomes clear that taxation need not confine itself to those free gifts of Nature which are inexhaustible—no

sovereign should refuse to collect a market royalty for the sale of his forests simply because one day they will be gone:[22] he should however be careful to put some of the proceeds in the bank if he wishes his revenues to continue in perpetuity.

CHAPTER 15

RENT AS A MONOPOLY RETURN

"Land monopoly is not the only monopoly, but it is by far the greatest of monopolies—it is a perpetual monopoly, and it is the mother of all other forms of monopoly."

—Winston Churchill[1]

The idea that rent is a monopoly return is as old as Adam Smith and yet in recent theory it has not been seriously entertained. However, I shall endeavour to show in this section that the modern incomprehension of the classical notion of rent as a monopoly return has resulted from redefinition of terms rather than from any inherent weakness in the classical concepts, which, indeed, are now being rediscovered in the literature of competition.

Before commenting on the writers who claimed that rent is a monopoly return let us consider some of the ideas associated in the literature with the words "competition" and "monopoly."

"Monopoly" has been used in two senses:[2]

(1) A producer faces a downward-sloping demand curve[3] (which will always be the case if the word "product" is narrowly enough defined).[4]

(2) There are barriers to the entry of other producers.[5]

"Competition," on the other hand, has been associated with the following ideas.

(1) A producer faces a horizontal demand curve, or in other

words, there are indefinitely many producers of a homogeneous product.[6]

(2) The equalization of factor rewards on each resource in all uses (also the condition for maximum output from given resources).[7]

The weaknesses of the first-mentioned notions of monopoly and competition and their non-equivalence with the latter-mentioned notions are now well known.[8] The result of this re-appraisal of the neo-classical concepts of competition and monopoly has led to the conclusion that

> "In order, then, for us to speak freely of a lack of competitiveness in a market process, we must be able to point to something which prevents market participants from competing. What is it that might succeed in rendering particular market participants secure from being competed with—that might make it possible for them to continue to offer inferior opportunities to the market, immune from the pressure of having at least to match the more attractive offers which other participants might be making available?"[9]

The answer is that "in the absence of government restrictions on given activities the only possible source of blockage to entry into a particular activity must arise from restricted access to the resources needed for that activity."[10] Consequently "What the monopolist is able to secure for himself (beyond any possible purely entrepreneurial profits which his alertness may discover) is a monopoly rent on the uniquely owned resource from which he derives his monopoly position."[11] This "approach to the analysis of monopoly . . . sees its harmful effects . . . in the incentive which monopoly ownership provides for

not using a scarce resrce to the fullest extent . . ."[12] Closed-monopoly rent "is achieved by restricting the transference of resources, so that a difference between value of product and costs is created."[13]

We have already seen that classical writers saw land rent as resulting from a surplus of product price over real cost of production: we shall also see that some viewed absolute private property in scarce non-reproducible natural resources as an intertemporal barrier to entry, in that future generations of producers would not necessarily have access to equivalent resources on the same terms.

J.A. Schumpeter claims that Adam Smith had "no theory of monopoly price" and "reasoning from his cost theory of value, Smith not unnaturally—though wrongly—arrives at the conclusion that the phenomenon of rent can be due only to a 'monopoly' in land."[14] Smith is allegedly wrong because "the landed interest is not a single seller and therefore its income cannot be explained by the theory of monopoly."[15]

However, Smith uses the word "monopoly" in several senses, ultimately derived from the concept of barrier to entry. Bearing in mind the history of "monopoly" in English law,[16] we can see that Smith deduces that a barrier to entry must result in an excess of price over cost:

> "A monopoly granted either to an individual or to a trading company has the same effect as a secret in trade or manufactures. The monopolists, by keeping the market constantly under-stocked, by never fully suppiying the effectual demand, sell their commodities much above the natural price, and raise their emoluments, whether they consist in wages or profit, greatly above

their natural rate."[17]

Smith thus links the latter two notions of monopoly and competition discussed above.

The question naturally arises: if monopoly means an excess of price over cost, what cost is relevant--real cost or opportunity cost? Smith's answer is that both are relevant.

When discussing land which has alternative uses, but which pays less than its given use, resulting in a surplus of price over opportunity cost, Smith refers to such a rent as a "monopoly" rent: thus the dearness of house-rent in London is in large part due to "the dearness of ground-rent, every landlord acting the part of a monopolist, and frequently exacting a higher rent for a single acre of bad land in a town, than can be had for a hundred of the best in the country."[18] Similarly, vineyards which produce highly-prized wines earn monopoly rents above their natural rate because they are not subject to competition from the "common land of the country."[19] It is interesting to note that improvements in transport are "the greatest of all improvements" because they destroy such special monopoly rents and promote more efficient use of land.[20]

However, when considering land as a whole, Smith regards all rent as a monopoly return because it is a surplus over the real cost of production of land services:

"The rent of land, therefore, considered as the price paid for the use of the land, is naturally a monopoly price. It is not at all proportioned to what the landlord may have laid out upon the improvement of the land . . . but to what the farmer can

afford to give."[21]

Rent, like all monopoly prices,[22] is demand-determined and not governed by real cost of production. The same notion is found in Ricardo, John Stuart Mill and Henry George, all of whom contrast values which are governed by cost of production with values determined by natural or artificial scarcity.[23] Smith's views on rent as a monopoly and, as such, a potential barrier to prosperity, are developed in his remarks praising a policy of free access to cultivable land, enforced by laws against engrossing, in the case of the English colonies in America.[24] However, this idea that absolute private property in natural resources could be inimical to efficient resource allocation was to reach much fuller development at the hands of John Stuart Mill and Henry George who, as we have seen, were severely critical of the suggestion that the increment in land values was an appropriate reward for settlers in a new country.

Finally, we may note that Smith also uses the term "monopoly" in reference both to regulations which keep land off the market,[25] as well as in the contemporary usage of collusion,[26] and it is in this latter sense that he remarks that "Country gentlemen and farmers are, to their great honour, of all people, the least subject to the wretched spirit of monopoly."[27]

Linking all these concepts of "monopoly" are the fundamental ideas of an excess of price over cost and the inevitably associated barrier to entry. One may criticize Smith's failure to develop a more detailed vocabulary but it is, I feel, a great mistake to pronounce his treatment of monopoly inconsistent.

Before concluding this brief survey of Smith's treatment of rent as a monopoly return let us note his remark that

> "The most fertile coal mine too, regulates the price of coals at all other mines in its neighbourhood. Both the proprietor and the undertaker of the work find, the one that he can get a greater rent, the other than he can get a greater profit, by somewhat underselling all their neighbours . . ."[28]

Ricardo was severely critical of this remark[29] but, as Schumpeter comments, Smith is thinking of the dynamic process of moving to equilibrium and Ricardo was contemplating an equilibrium already achieved.[30] Smith shows here a remarkable insight into how the possession of a superior non-reproducible natural resource can allow a producer to engage in predatory pricing, one of the major means of establishing monopoly.[31]

In 1814, David Buchanan, reflecting on Smith's remarks that rent emerges from the private appropriation of land,[32] pushed forward to prominence the notion that

> "The profit of a monopoly stands on precisely the same foundation as rent. A monopoly does artificially what in the case of rent is done by natural causes. It stints the supply of the market until the price rises above the level of wages and profit."[33]

Buchanan was led to deny that rent was a taxable surplus because, like monopoly, it was injurious to consumers,[34] and should presumably not be allowed to exist.[35]

Malthus was goaded by these remarks to write "Almost all these writers [Smith, the Physiocrats et al.] appear to me to consider rent

as too nearly resembling in its nature, and the laws by which it is governed, the excess of price above the cost of production, which is the characteristic of a monopoly."[36] The practical conclusion of the Physiocrats, "namely, the propriety of taxing exclusively the neat rents of the landlords, evidently depends upon their considering these rents as completely disposeable, like that excess of price above the cost of production which distinguishes a common monopoly."[37]

Malthus' answer to Buchanan rests on the assertion that rent represents an original part of national income, and that the labour theory of value is invalid.[38] Nontheless, Malthus does not succeed in his attempt to suggest that land is a partial monopoly rather than a natural monopoly,[39] nor does he refute the Physiocrats for he admits that "rents are neither a mere nominal value, nor a value unnecessarily and injuriously transferred from one set of people to another; but a most real and essential part of the whole value of the national property, and placed by the laws of nature where they are, on the land, by whomsoever possessed, whether the landlord, the crown, or the actual cultivator."[40] Malthus has simply shown that rent is a necessary part of the price system from the point of view of resource allocation and, only to this extent, does he refute Buchanan's statements on rent.

Ricardo promptly remarked that Malthus was in error "in supposing rent to be a clear gain and a new creation of riches,"[41] rather "rent is a creation of value . . . but not a creation of wealth."[42] Ricardo is correct in spotting this weakness in Malthus' argument, but Ricardo himself seems confused as to what rent is for he does elsewhere regard rent as a part of the original net revenue of a

nation and as such capable of bearing taxes,[43] the opposite conclusion to that which David Buchanan reached from the same concept of rent as a transfer income.[44] Ricardo also seems in sympathy with Smith's approach when he remarks that: "The exchangeable value therefore of a commodity which is at a monopoly price is nowhere regulated by the cost of production"[45] and sees this result as due to non-augmentability. However, Ricardo does not clearly develop this idea in relation to rent. For the term "cost of production" may mean several things:

(1) cost of original production

(2) cost of identical reproduction

(3) cost of reproduction of a substitute

(4) cost of production at the margin

(5) real cost of intra-marginal produce.

David Buchanan seems to have thought of monopoly price as a surplus over cost of original or intra-marginal production,[46] Ricardo seems to have viewed monopoly price as surplus over cost of identical reproduction,[47] otherwise he would have had to admit that forests yielded a rent, which he did not.[48] Moreover, it seems that Ricardo preferred to describe land as having a scarcity value rather than employ the word "monopoly" which he used at one time in the sense of unitary control.[49]

Ricardo may have been equivocal about the description of rent as the reward of a natural monopoly, but John Stuart Mill was not: "A monopoly value means a scarcity value. Monopoly cannot give a value to anything except through a limitation of the supply."[50] Land is limited in supply and "from the very nature of the case, whoever owns land,

keeps others out of the enjoyment of it. The privilege, or monopoly, is only defensible as a necessary evil."[51] Rent, we are told, "is the effect of a monopoly; though the monopoly is a natural one, which may be regulated, which may even be held as a trust for the community generally, but which cannot be prevented from existing."[52] Mill goes on to contrast this sense of "monopoly" with the use of it to denote collusion. However, Mill, like Ricardo, is not entirely clear. Elsewhere he says

> "It was long thought by political economists, among the rest even by Adam Smith, that the produce of land is always at a monopoly value, because (they said) in addition to the ordinary rate of profit, it always yielded something further for rent. This we now see to be erroneous. A thing cannot be at a monopoly value, when its supply can be increased to an indefinite extent if we are only willing to incur the cost."[53]

On this basis why should rent itself be a monopoly return? Location rents can be avoided, for example, if only we are "willing" to pay higher transport costs.

Mill did not, I think, fully understand Smith's analysis of rent in terms of both real and opportunity cost (Mill gives no citations) but this is understandable in view of the different senses in which Smith used the term "monopoly." This lack of understanding is, I suggest, manifested not only in the above conundrum but also in another passage where Mill follows Smith in talking about special monopoly rents of situation (surpluses over opportunity, not real, cost) without making it clear that this is a third usage.[54] Nonetheless,

Mill firmly grasped Smith's main point, that land rent, in the aggregate, is a surplus over land's real cost of original production. Henry George was emphasizing the same point when he wrote that "Land, without which there can be no production, is monopolized,"[55] and went on to argue that land values represented the exchange value of monopoly, a "value from obligation," and could be taxed as such without excess burden.[56] George went further. In a similar vein to John Stuart Mill,[57] he argued that absolute private property in land was incompatible with the best use of natural resources, that the lure of the unearned increment would lead to a suboptimal result as producers jockeyed for unencumbered possession in perpetuity of superior resources.[58] In effect, George was arguing that untaxed private property in land allowed monopoly rents to subsidize unprofitable investments,[59] and, unlike Kirzner, would have argued that society is never better off for allowing entrepreneurs to compete for a monopoly position,[60] by selling land once and for all.

The significance of the claim that rent is a monopoly return lies in its implication, stressed by Mill and George, that land rent taxation could be simultaneously unshiftable and super-neutral. By denying to any producer the luxury of being able to under-utilize natural resources and under-cut his marginal competitors, resource allocation would be improved.[61]

From Marshall onward, there seems to be little interest in the notion of rent as a monopoly return, "monopoly" being confined to the description of collusive action,[62] though Marshall is also aware of the interaction between location, superior resources and predatory

pricing.[63] However, the old connections between rent and barriers to entry have recently re-emerged in the theory of spatial pre-emption, the idea that location can be used as a barrier to entry.[64]

CHAPTER 16

EXTERNALITY AS A CAUSE OF RENT

Nonmarket interdependence creates what is known as external economies or diseconomies. The problem for resource allocation lies not in the interdependence as such, but in the failure to price that interdependence.

In practice, however, it appears that virtually all "externalities" are priced via land rent--air pollution, highway improvements, complementary land uses, public spending all have their effect on rent. In other words, externality may be "accounted for" without necessarily being "internalized" or credited to the originators.

The power of land to capture external economies, subsidies, the benefits of local spending, etc., derives ultimately from its spatial nature. If all externalities are spatially limited, capital and labour homogeneous and mobile, then it is clear that rent will, thanks to the operation of competition, benefit or suffer from whatever causes a super- or subnormal level of profits and wages. Just as a local tax on mobile capital and labour will cause land rent to fall by their exodus, so a spatial external diseconomy (which is a tax in kind) will have precisely the same effect. This is, of course, simply a modern analogue of the Physiocratic doctrine that all taxes fall on land, the immobile factor.

Although virtually all conceivable externalities are spatial in nature and accounted for by land rent, it does not follow that there

need be, for example, no public policy towards pollution since some land rents may benefit from polluting although others suffer more. Rather it would appear that the optimal policy is that which maximizes aggregate land rents, an echo of Adam Smith's notion that the progress of society is a rent maximizing process.[1]

Adam Smith was, in fact, well aware of how land rent could reflect externalities and synergism. He remarks that rent is influenced by "the general circumstances of the society or neighbourhood"[2] and illustrates his point by showing how the rent of one piece of grass land may be affected by the actions of neighbours in enclosing their fields[3] and how rent will be increased by the growth of adjacent markets and the reciprocal complementarity of town and country:[4] "as the fertility of the land had given birth to the manufacture, so the progress of the manufacture re-acts upon the land, and increases still further its fertility."[5]

Smith also observes that

> "the sea in the neighbourhood of the islands of Shetland is more than commonly abundant in fish . . . But in order to profit by the produce of the water, the inhabitants must have a habitation upon the neighbouring land. The rent of the landlord is in proportion, not to what the farmer can make by the land, but to what he can make both by the land and by the water."[6]

If one applies this type of observation to Meade's well-known examples of externality in the apples-honey and timber-wheat cases,[7] one sees the genesis of the criticism since made of Meade that resource rents will ensure that externality does not of itself lead to resource

misallocation.[8]

Another area in which Smith made some cogent remarks is the effect of transportation improvements upon rents:

> "It is not more than fifty years ago that some of the counties in the neighbourhood of London, petitioned the parliament against the extension of the turnpike roads into the remoter counties. Those remoter counties, they pretended, from the cheapness of labour, would be able to sell their grass and corn cheaper in the London market than themselves, and would thereby reduce their rents, and ruin their cultivation. Their rents, however, have risen, and their cultivation has been improved since that time."[9]

Smith would concede that such improvements may effect a redistribution of rents but he counters that the ultimate effect of such improvement is to raise aggregate rents by inducing increased productivity through that division of labour which depends upon the extent of the market: transportation improvements

> "are advantageous to the town, by breaking down the monopoly of the country in its neighbourhood. They are advantageous even to that part of the country. Though they introduce some rival commodities into the old market, they open many new markets to its produce."[10]

These comments probably represent the first contribution to the discussion of cost-benefit analysis and highway improvements.

Ricardo did not consider the effects of externality on the rent of land but John Stuart Mill did discuss the effect upon land rent of

the development of better transportation. Mill is concerned with answering Carey's argument that the value of land is not worth the capital expended upon it, including capital spent on roads, canals and railways. Mill argues that

> "The roads, railways and canals were not constructed to give value to land: on the contrary, their natural effect was to lower its value, by rendering other and rival lands accessible: and the landholders of the southern counties actually petitioned Parliament against the turnpike roads on this very account. The tendency of improved communications is to lower existing rents, by trenching on the monopoly of the land nearest to the places where large numbers of consumers are assembled."[11]

Mill, in fact, suggests that if transport costs become nil, rent would be "annihilated."

Mill's discussion is somewhat unsatisfactory. Unlike Smith's, the analysis is static and partial equilibrium in its nature. Mill does not seem to consider the answer Smith gave, that the effect would be a spatial redistribution of rents followed by an aggregate rise. Moreover, his comments on annihilation of rent could only be true in a non-spatial timeless economy (since time of transport is also a cost), which shows that it is irrelevant to the point at issue.

Perhaps the writer who most clearly perceived the relationship between rent and externality was Henry George. He argued that externality was natural, that it was spatial in nature and hence reciprocal and non-appropriable as between those who produced it, since competition meant that they could only earn normal wages or

profits. Instead the benefits of external economies would be reflected in land rents, the growth of which was not therefore to be exclusively ascribed to diminishing returns.

In discussing the growth of a town George says

> "The presence of other settlers—the increase of population—has added to the productiveness . . . of labour bestowed upon it [land], and this added productiveness gives it a superiority over land of equal natural quality where there are as yet no settlers . . . To labour expended in raising corn, or wheat or potatoes, it will yield no more of those things than at first; but to labour expended in the subdivided branches of production which require proximity to other producers, and, especially, to labour expended in that final part of production, which consists in distribution, it will yield much larger returns. The wheatgrower may go farther on, and find land on which his labour will produce as much wheat, and nearly as much wealth; but the artisan, the manufacturer, the storekeeper, the professional man, find that their labour expended here, at the centre of exchanges, will yield them much more than if expended even at a little distance away from it; and this excess of productiveness for such purposes the landowner can claim just as he could an excess in its wheat-producing power . . . The increase of productiveness or utility which increase of population gives to certain lands, in the way to which I have been calling attention, attaches, as it were, to the mere quality of extension . . ."[12]

George's view that externality is a natural phenomenon already accounted for in the rent of land is revealed in his discussion of the effects of rent taxation:

> ". . . there is to the community also a natural reward . . . no one can keep to himself the good he may do, any more than he can keep the bad. Every productive enterprise, besides its return to those who undertake it, yields collateral advantages to others. If a man plants a fruit tree, his gain is that he gathers the fruit in its time and season. But in addition to his gain, there is a gain to the whole community. Others than the owner are benefited by the increased supply of fruit; the birds which it shelters fly far and wide; the rain which it helps to attract falls not alone on his field; and even to the eye which rests upon it from a distance, it brings a sense of beauty. And so with everything else. The building of a house, a factory, a ship, or a railroad benefits others besides those who get the direct profits. Nature laughs at a miser . . . Well may the community leave to the individual producer all that prompts him to exertion; well may it let the labourer have the full reward of his labour, and the capitalist the full return of his capital. For the more that labour and capital produce, the greater grows the common wealth in which all may share. And in the value or rent of land is this general gain expressed in a definite and concrete form."[13]

What is interesting about these remarks by George is that they foreshadow the role the concept of rent has played in the criticism of

the Pigouvian tradition regarding divergences of social from private costs. The problem of externality becomes a problem of the non-appropriability of rent for, in the absence of transactions costs, rent will correctly price any externality.[14]

Alfred Marshall's views on the nexus between rent and externality to some extent follow those of Henry George. In his first edition, Marshall stated

> "there is a constant and rapid increase in that part of the aggregate price paid for commodities which does not go to reward the new efforts and sacrifices required for their production . . . but goes to the owners of those differential advantages which arise from situation. This is partly due to the increase in the number of sites which derive a high value from their proximity to markets . . . It is these space relations of land which . . . distinguish it most strongly from other material things; and it is they which are the chief source of those differential advantages in production that acquire an increasing scarcity value from the progress of the industrial environment."[15]

Marshall agreed that a large part of the rent of land was due to these external economies, which offset the law of diminishing returns, but he also noted that an excessive concentration of population could eventually cause external diseconomies.[16] Indeed, when Marshall introduces the term "external economies" he immediately links it to the localization of industry[17] and develops the theme later when he states that "the situation of a business nearly always plays a great part in determining

the extent to which it can avail itself of external economies; and the situation value which a site derives from the growth of a rich and active population close to it, or from the opening up of railways and other good means of communication with existing markets, is the most striking of all the influences which changes in the industrial environment exert on cost of production."[18]

Marshall also points out that the rental value of land is

> "commonly called its 'original value' or its 'inherent value'; but much of that value is the result of the action of men, though not of its individual holders. For instance, barren heath land may suddenly acquire a high value from the growth of an industrial population near it; though its owners have left it untouched as it was made by nature. It is, therefore, perhaps more correct to call this part of the annual value of land its '<u>public value</u>'; while that part which can be traced to the work and outlay of its individual holders may be called its 'private value' . . ."[19]

The idea of "public value" of land lies at the heart of Marshall's analysis of onerous and beneficial rates; "onerous taxes on site values tend to be deducted from the rental which the owner, or lessee receives"[20] while beneficial rates, by attracting industry and population, tend to be capitalized in higher land values. Local taxes and subsidies, like external diseconomies and economies, will be reflected in site values,[21] provided capital and labour are mobile. This is another modern version of the Physiocratic doctrine that all taxes fall on land.

Marshall also makes the interesting remark that local onerous taxes on capital, while depressing land values in the affected area, will raise values elsewhere, in the areas to which capital has been diverted. One would expect, however, aggregate rents to be less because of the excess burden of this misallocation of resources and Marshall would appear to agree with this.[22] What Marshall does not explicitly state, but which is implicit in his discussion, is that precisely the same reasoning can be applied to spatial external economies and diseconomies: their ultimate effect will be upon the amount and spatial distribution of rents.

In discussing the effect of improvements in transportation upon land rents, Marshall follows Smith, rather than J.S. Mill: he too argues that "anything that promotes the prosperity of the people promotes also in the long run that of the landlords of the soil."[23]

The question naturally arises as to why externality is so specially linked to the value of land. Marshall does not fully consider the question but he does make a suggestion:

> "But though the development of the industrial environment tends on the whole to raise the value of land, it more often than not lessens the value of machinery and other kinds of fixed capital . . . A sudden burst of prosperity may indeed enable the existing stock of appliances in any trade to earn for a time a very high income. But things which can be multiplied without limit cannot retain for long a scarcity value . . ."[24]

This explanation echoes J.S. Mill's division of commodities into those whose value was determined by scarcity and those whose value was

regulated by cost of production. Perhaps another way of looking at this is to observe that, in the long run, capital and labour are homogeneous and spatially mobile--they cannot appropriate the gains from externalities differentially, competition forces them to share gains equally. In contrast, land is immobile and will therefore bear the burden or reap the benefits of local taxes or diseconomies and local public goods or economies.

The relationship between rent and externality is the underlying link between local public goods theory,[25] the analysis of social benefits of projects,[26] and the critique of the Pigouvian distinction between social and private costs. In all these various fields, the ultimate rule for optimality appears to be the maximization of aggregate land rents.[27] Nor is this surprising, if one views rent as a surplus over real cost: Adam Smith and the Physiocrats did so regard rent and hence equated its growth as synonymous with the prosperity of society.[28]

CHAPTER 17

RENT AS A PAYMENT FOR LOCATION

That rent will be paid for location follows naturally from the fact of spatial externality. Transport costs represent the most obvious barrier to enjoyment of such externalities and, obviously, if transport were costless and instantaneous (time is money) then location rents would not exist.

Adam Smith clearly recognized the spatial character of externality and its relation to rent. He gives two causes for rent, its fertility and "the general circumstances of the society or neighbourhood in which the land is situated."[1] Thus

> "in the neighbourhood of a great town, the demand for milk and for forage for horses, frequently contribute . . . to raise the value of grass above what may be called its natural proportion to that of corn. This local advantage, it is evident, cannot be communicated to the lands at a distance."[2]

And, in keeping with his terminology, such a local advantage is a "monopoly of the country in its [the town's] neighbourhood."[3] Smith also clearly recognizes the inverse relationship between rent and transport costs.[4] Consequently, he favoured transportation improvements to break down such monopoly rents of situation, since monopoly was an enemy to good management.[5] In other words, he felt that such improvements would reduce the surplus rewards such land received over the rent for similar land in alternative locations.

This has some relevance to the contention of R.M. Haig that all other things being constant, a transportation improvement would reduce aggregate land rents.[6] Smith's answer would seem to be rather that such improvement would level out rents spatially (by introducing more competition among land parcels) but raise aggregate land rents by increasing productivity,[7] as we saw in the previous section.

Ricardo recognizes that location influences rent,[8] but he does not analyze its relationship to externality, nor does he consider whether it is an original and indestructible power of the soil. If he had considered rent as a social product, perhaps he could have shared Smith's view of its growth as a sign of progress rather than the approach of the dreaded stationary state.[9] Unfortunately he did not, and as a result Smith's more subtle analysis of rent was obscured in this aspect, as in others.[10]

John Stuart Mill follows Ricardo in that he recognizes location as a major cause of rent,[11] but does not stop to analyze it. Taking the same view as Ricardo, he treats location as though it were a natural physical quality of the soil, for implicitly he assumes the distribution of markets and population is exogenously fixed.

Henry George responded with the objection that location was not a thing possessed inherently by land, but rather a relation between people and things.[12] Hence, location was generated as a result of human settlement. Closer settlement would be matched for a time by increasing returns due to external economies[13] and then by decreasing returns due to diseconomies such as congestion.[14] George regarded the law of diminishing returns in agriculture as simply one manifestation

of the general principle of increasing and then decreasing returns to spatial concentration of labour and capital.[15]

This ties in with the view that it is the existence and maximization of aggregate land rent which will ensure that capital and labour are most productively employed,[16] since it will not be in the landowners' collective interest to allow decreasing returns to set in prematurely (though George would have argued that it may suit the interests of an individual landowner).

Alfred Marshall remarked that the spatial quality of land was that

> "which, though as yet insufficient prominence has been given to it, is the ultimate cause of the distinction which all writers on economics are compelled to make between land and other things. It is the foundation of much that is most interesting and most difficult in economic science."[17]

Marshall recognized, as we have seen, the nexus between site value, external economies and complementary land uses[18] but he left himself open to criticism in not pursuing the concept more closely.[19] Indeed, in his summary of the theory of value, Marshall suggests that "the influence of time" is "more fundamental than that of space,"[20] a comment which is understandable in view of his major contribution in the concept of "quasi-rent" but which is nonetheless misleading.[21] It would seem more correct to recognize that both are fundamental.

It has since been recognized that the combination of space and time may lead to a suboptimal allocation of resources. The arguments rest on the fact that entry into product markets is not instantaneous[22]

and that therefore prior producers in command of superior sites or natural resources[23] may use their resource rents to subsidize predatory pricing whether directly or by pre-emption of sites in a growing market.[24] An existing producer may find it in his long run interest to establish himself on a site at a time when it would be uneconomic for a potential entrant to do so, since for the existing producer the immediate losses are ultimately recouped through enhanced market power. Natural monopoly begets conventional monopoly.

Obviously such behaviour tends towards the dissipation, rather than the maximization, of aggregate land rents (or more strictly, the present value thereof), but this is simply another case of the conflict between individual and collective rationality, similar to the problem of pollution externalities when one landowner will not find it in his interest to curb pollution since his land may thereby earn a higher rent even though other landowners' aggregate losses are greater. One might also remark that land use zoning must logically rest upon the same assumptions about individual versus collective rationality.

The nexus between location, monopoly and the cornering of socially produced external economies is not, however, of entirely recent discovery. Carlton argued that

> "men who control land in proximity to markets, . . . are able to capitalize these opportunities . . . and to levy toll upon the people who buy and sell in the markets thus controlled . . . they are able to obtain a return in excess of the interest rate on the capital invested . . . what causes value to adhere to land proper? It is the very fact of a lack of competition. In

so far as one land area, as land, is more valuable than another . . . to that extent is its situation as regards a market more desirable . . . The right to occupy and possess land to the exclusion or displacement of others is 'a right conferred by government of conducting an occupation either in particular way or accompanied with particular privileges'."[25]

Thus a tax on land values, he argues, is but a franchise tax on the capitalized value of market opportunity rent.

Henry George would, of course, have agreed with this. As Blaug remarks, his 'single tax' "was designed to reduce the [private] price of land as mere space to zero . . . it would put all property on the same basis irrespective of its location,"[26] and, we might add, do this for successive generations of producers.

Thus the significance of rent as a payment for location is seen to lie in the prospect that its appropriation by individuals is not necessarily conducive to the competitive and optimal allocation of resources. Those in possession of superior sites may rationally choose to use them as a lever towards further market power and spatial monopoly.

CHAPTER 18

CONCLUSION TO PART I—LAND RENT AS THE ONLY LONG-RUN SURPLUS OVER REAL COST

". . . the balance of advantage seems to lie in favour of reserving the term Rent for the income derived from the free gifts of nature, whenever the discussion of business affairs passes from the point of view of the individual to that of society at large."

Alfred Marshall[1]

Rent Best Defined as the Opportunity Cost of Land

The exploration in the previous pages of the concept of rent clearly shows that the term has acquired various meanings and it is not at all clear which is dominant at the present time. The concept which is consistent with classical economics and which underlies the theory of land rent taxation is that rent is that factor payment which is made for the free, albeit scarce, gifts of Nature; it is the only long run surplus over real cost (i.e., labour and capital costs).

The modern and competing concepts are that rent is any payment for a differential advantage or that rent is any surplus over opportunity cost of a factor.

One is, of course, free to use terms in whatever sense one chooses to define for them but it is obvious that communication is easiest when a word such as rent is used in the same sense by all. For

this reason I find myself in complete agreement with H.G. Brown[2] and D.A. Worcester[3] in their criticisms of the surrender of the traditional sense of the word to the Paretian concept.

The history of the rent concept and the analysis of taxation both support the contention that rent is best defined as the opportunity cost of land at the level of the firm;[4] that is, rent is the market value offered for the use of land.

This definition has several consequences:

(1) The definition of rent in terms of market-determined opportunity cost excludes from rent any surplus returns over the market rent which an individual land-user may be able to secure through superior entrepreneurial ability. Thus, if one land-user can obtain a net surplus over labour and capital costs of $200, say, from a given acre while the next most efficient user can only obtain a surplus of $150, say, then the opportunity cost of the land under a market auction will be just over $150. The real market, and the definition proposed above, would impute the difference between the $200 and actual rent to the superior entrepreneurial ability of that most efficient land-user: it would not be included in rent. This point is of some practical importance in meeting the objection that land value taxation would discourage entrepreneurial efforts to put land to better uses.

(2) The proposed definition of rent links it firmly with the concept of "land"; rent is perceived as a payment for the free gifts of nature, in contrast to quasi-rents paid for the use of produced means of production. Land in contrast to capital is, by definition, inelastic in supply—so-called "made" land is really capital sunk into land and,

while capital can be substituted for the use of land, the definition of land as the non-produced means of production excludes the idea that land is reproducible.

(3) Since land is exogenously given (neither its existence nor its value depends upon the actions of its individual owners) while capital and labour are endogenously supplied by individuals within an economic system it does follow that there is a legitimate sense in which we can speak of land rent as the only long-run surplus over real cost. In an ultimate sense, there is no such thing as a closed economy—capital can disappear by emigration and dis-saving, while labour-supply can be modified by the choice of leisure or easier occupations and by emigration and changes in birth rates. This was, I think, Marshall's point when he argued that land rent was an enduring surplus in a way other surpluses were not.[5] It is not customary in modern economic theory to think in these terms but there is validity to Marshall's emphasis on long-run supply responses by labour and capital, in contrast to land.[6] One does not have to subscribe to a strict classical subsistence wage theory to note demographic responses to economic conditions: the British "brain drain" and changes in birth rates in the Depression come readily to mind.

(4) It will be seen in the conclusion to Chapter 26 that there are good reasons for distinguishing land rent from other surpluses. Other suggested surpluses are either not surpluses or are transitory or, if they exist, cannot be identified. In contrast, land rent can be identified as a surplus over the expenses laid out for the real costs of production, for the "exertions of all the different kinds of labour that

are directly or indirectly involved . . . together with the abstinences or rather the waitings required for saving the capital used."[7]

A Review of Competing Rent Concepts

In attempting to develop more closely the implications of the old idea, which has just been endorsed, that rent is the return to land, let us review the various approaches to rent we have surveyed, and note to what extent they are compatible in whole or in part with this classical concept of rent.

(1) The idea that rent is due to the bounty of Nature is more correct than commonly believed: Marshall is surely too severe when he declares that "the producer's surplus from land is not evidence of the greatness of the bounty of nature, as was held by the Physiocrats and in a more modified form by Adam Smith: it is evidence of the limitations of that bounty,"[8] when he himself has spoken of land as the "material and the forces which Nature gives freely for man's aid."[9] A normal person regards something for nothing as indeed a bonus and is ill-regarded should he have the bad manners to expect more.

(2) The notion that rent is a payment for the use of the inherent fertility of the soil, we observed to be too narrow in that it ignores the influence of location and opens doubts as to whether payments for exhaustible natural resources are rents.

(3) The identification of rent with diminishing returns we noted above as essentially mistaken.

(4) The perception that rent is a demand-determined or monopoly price, that is, a price not governed by the cost of original production of land, is one which naturally follows from the idea of "free gifts of

Nature."

(5) That land rent represents a unique surplus follows from the observation that in the long run, as Marshall noted, it is the only income which represents a surplus over the real costs of its production.[10] The Physiocratic argument that only land rent represents a net product is quite as logical as the elimination of depreciation and intermediate sales and purchases in modern national accounting practice. Moreover, it furnishes a welfare criterion, namely that public policy should aim to maximize aggregate land values (the present value of land rents) rather than the commonly accepted welfare rule of maximizing net national income over time. This choice of welfare criterion avoids the problem of the cost of foregone leisure which the current criterion has to face. Adam Smith had perhaps something of this in mind when he remarked

> "The land constitutes by far the greatest, the most important, and the most durable part of the wealth of every extensive country. It may surely be of some use, or, at least, it may give some satisfaction to the Public, to have so decisive a proof of the increasing value of by far the greatest, the most important, and the most durable part of its wealth."[11]

(6) Given that land is taken to mean the free gifts of Nature it follows that, in the aggregate, rent is not a cost of production since no payment was necessary to elicit its coming into existence. This in no way contradicts the assertion that land has alternative uses at the micro level and that its remuneration in one use represents a cost to another use. Rent serves to ration land, not to call it into

existence.

(7) Rent is not necessarily, however, a payment for the "original and indestructible powers of the soil." We noted above that land rent, because of the spatial character of land, can capture the effects of externalities. Rent remains, indeed, a payment for the use of the free gifts of Nature but the value (though not the physical existence) of those gifts is inevitably dependent on human actions. We also noted that exhaustible natural resources also yield rents, albeit as capitalized amounts, and that they too fall under the heading of land. Thus, a virgin forest is land while a planted one is capital; the distinction between land and capital always following that between non-produced and produced means of production and the parallel distinction between rent and quasi-rent always turning on the concept of what is, or is not, a real cost of production.

The above views of rent have included those ideas which harmonize with the concepts of land and its rent found in the classical political economy. Their reiteration is neither original nor would be desirable were it not necessary to draw clear attention to what is not "rent" in the classical sense.

(1) Rent does not encompass any infra-marginal surplus, it is not regarded as having its alpha and omega in the principle of differential advantage: in spite of J.S. Mill's analogies it is clear that he, too, regarded the unique character of rent as deriving from the original free gift by Nature of its supply.

(2) The Paretian concept of rent is irrelevant to the classical view of things and has no bearing on the development of the theory of

land value taxation; Paretian rents are better described as "factor profits."[12]

(3) Attempts made by writers such as J.B. Clark, Frank Fetter and F.H. Knight to reduce the idea of rent to rental are equally distant from classical concerns. "Rent" in the classical sense is, indeed, a flow of factor service, but not all such flows are "rent."

(4) Nor does the idea of quasi-rent justify the assimilation of the earnings of land and capital under one head, as Marshall himself clearly warned. The time-worn example of the alleged rent earned by works of art is, however, still to be found, notwithstanding J.E. Cairnes' protest that "surely the case must be felt to be desperate when such an argument is seriously put forward."[13] Would the patronage of, or efforts by, artists be undiminished if paintings were taxed? Perhaps it will be contended that "sufficiently many" years after the death of the artist the return on his paintings becomes rent, to which it may be remarked that the number of Old Masters from England which have been sold across the Atlantic would suggest otherwise. In any case, the "rent" of classical political economy was a concept applicable at the time of production, or "coming-into-being," of goods and services; otherwise one may as well say that wages are "rent" because a tax levied on the proceeds in the hands of the labourer's heirs 500 years hence will not much affect <u>his</u> endeavours. All that the old example of the "rent" of paintings illustrates is that taxes delayed are taxes denied and that taxes denied long enough are virtually no taxes. And no taxes have, predictably enough, no effect on productive effort.

(5) Finally, the suggestion that land rent can be viewed as a

reward for risk is equally foreign to the classical definition of rent in terms of the real cost of production of land services. If to discover land is to "produce" it, why is not to discover a better use for land equally to "produce" it? And why not go further and say that a buyer "produces" a product when his bid is based on a use known only to him?

Leaving aside such conundrums let us reiterate that it is the capitalist who sinks his money irretrievably in a project who bears risk in a sense that labour and land do not.