The Tyranny of Words

The following article by Roy A. Foulke, retired vice president of Dun & Bradstreet, appeared in the New York Daily News *in 1949, and was reprinted in the* Henry George News *in 1971. Thanks to Ed Dodson.*

In *Wealth of Nations*, Adam Smith pointed out, over and over again, that all production is divided into three streams: one in the form of wages to employees, one in the form of rent to landowners, and one in the form of profits, to suppliers of capital.

These terms, as used by Adam Smith, carry connotations that are somewhat different from their meaning in our present-day industrial life. In wages to employees is included payments to officers of corporations, to proprietors and to partners for their services, as well as to labor. The payment of rent represents the return to the landowner on the value of the land in its natural state without improvements of any kind, and not the payment of a monthly or yearly sum, which today has generally come to include two payments, economic rent on the value of the land, and a return on capital (i.e. the improvement). Profit, according to Adam Smith, is the return to capital after the payment of all wages and the rent of the land in its natural state has been deducted from production. Then Smith carefully observed, “When those three different sorts of revenue belong to three different persons, they are readily distinguished; but when they belong to the same they are sometimes confounded with one another, at least in common language.”

Because of the confusion in the term “profit” as used by Smith in 1776 as the return to capital, and by the general public as the excess of income over cost, Henry George in 1879 decided to substitute the word “interest” in place of the word “profit” as used by Smith to represent return on capital.

It is possible that substitution in terms — though carefully explained with great clarity — has been the source of steadily increasing confusion in the mind of the pragmatic businessman. The accounting profit of business, representing the excess of income over cost, is a heterogeneous mathematical term and has nothing to do with economics.

Few business corporations were in existence in 1879. Not until 1886 did the Supreme Court decide that a corporation was a person in the meaning of the “due process” clause of the Federal Constitution. That decision gave an element of unprecedented security to the existence of the large corporation, which was just becoming a dynamic power in our economic life.

In 1879, there was no firm of public accountants in the United States. The first firm of accountants of consequence was organized in 1883 in New York City. It was not until 1896 that the accounting profession was legally recognized; it was then that New York State first granted certificates of qualification.

From the viewpoint of classical economics, it is understandable that we fail to ascertain reliable figures for aggregate profits (George would say “interest”) under the mathematics of accountancy as it is practiced today. The reason is that the “accounting” profits of corporations, which own land where some of their plants, warehouses or other installations are located, actually encompass economic rent. Moreover, we lack even a faint ideas to what represents value earned on the value of land in its natural state and what part represents the return on capital invested in a business which includes improvements on the land.

What we run up against today is the confusing reality that “accounting” or the businessman’s profit, in addition to being a relative mathematical concept, is not economic profit or, in the words of Henry George, is not “interest.”