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Rent: Surplus Product, or Surplus Profit?

by Richard Giles

Recent attempts at legislation to tax minerals in Australia (iron and coal) :have highlighted ambiguity in the term "economic rent." Several Australian Georgists seem happy to follow conventional usage, and call economic rent a super profit. Gavin Putland, for example, writes that "a tax on economic rent… is a tax on the surplus over the necessary returns to human inputs, including entrepreneurship and innovation." However, we should remember that rent assigned in this way to labour and capital was the idea advanced by John Bates Clark (1847-1938) to destroy the concept of rent as a surplus product of locations.

Rent as a surplus profit is variously put. Here are some instances:

"By definition surplus profits represent cash returns in excess of the incentive to invest to create a surplus incentive."

Rent is "the difference between the price received for selling/supplying something and the minimum price required before the owner/possessor is willing to sell/supply that very thing."

Economic rent is "a money payment made for a factor of production which is over and above the minimum payment to keep it in its present use." 1

Under these definitions, there seems to be a problem in classifying land's rental value as a rent. The excess in the rent of a site is not any excess over its own cost of production (it has none), but an excess over rent-less land. Also, this concept is applied to any factor of production. So we hear for example that Frank Sinatra's voice had a rent and, in Australia, that the Collingwood football team has a rent.

We need not spend much time tracing the emergence of this other concept of rent in the works of John Bates Clark and especially in his The Distribution of Wealth (1899). Funnily enough Clark in this book twice declares that he conceived the idea from Henry George. But, as we know, he made land merely one of a myriad forms of 'concrete capital' into which 'pure capital' (or money) may 'transmigrate.' We note too that by the use of the principle of diminishing returns, Clark manages to find the general level of wages set in a "zone of indifference." That is, the general level of

wages is set by a worker whom his employer may just as easily dispense with as employ.

By this same 'principle' Clark appears to conclude that the rent of capital becomes the full value of the advantages derived from its use. If production is increased one hundred-fold by the use of some invention then the owner of that invention should get the difference. But this is quite plainly not the case.

J. B. Clark changed around the definition of rent to suit his purposes. Most importantly, the original concept sees rent as a surplus product, not as a surplus profit. This notion of rent as surplus profit is used in several ways.

One meaning is what we coyly term "asset inflation." Take the price of a Gainsborough. According to its definition a super profit is any price above what would induce one sell the painting. But what is this price? What is the basis for a tax on this selling price? Who will decide what an 'adequate' price is and, thus, the super profit?

And so to the ethics of the thing: have we a right to take as public property any 'excess' value the painting now has? Henry George, at the Saratoga Debate in 1890, argued against such a tax. A coin, a vase or a painting, he conceded, might increase in value with time but, in principle, its value belonged to its owner to possess or to sell. No one, by the way (John Bates Clark was in attendance) thought of that added value as a rent. Alfred Marshall later called this and other surplus gains quasi-rents.

Though rarely admitted, the chief form of "asset inflation" is land value. And it is often only because of the inflation of this asset that some can spend large sums on thoroughbred horses, yachts, and antique clocks.

The great trouble with a public revenue based upon profits, compared to one based on location, is that the former does little to stop "asset inflation." If there are no sales, there is no profit to tax. So this tax does little to stop the hoarding or ineffective use of valuable land. And, since by definition a "profit" is private wealth, there will always be (often valid) resistance to any radical tax on profits.

Another usage of "rent" is (excess) talent. There are some who, with seemingly no greater effort than others, achieve more. Some call superior results due to natural gifts rent. They would exact a rent from this "human resource." If rent is viewed as a super profit, why should such gains not be taxed? It is said that one could tax such superior returns since an 'adequate' return is enough to induce talented performer to work.

Indeed, that is the thinking behind the super profits tax on minerals in Australia. An 'adequate' return is arrived at (somehow) and a tax (of some uncertain magnitude) is levied on the surplus.

If rent depends on the surplus product of a location, greater efficiency is not taxed. If rent is a surplus profit, greater efficiency is taxed. A tax on efficiency must discourage it. Rent can be taxed without affecting production.

Moreover, if rent is a super profit, an inefficient company that fails to make a profit is not taxed at all. Or if this inefficient company fails to make a profit commensurate with the location it has, it will be charged much less than it should be. Further, those who hoard mineral-bearing land and produce nothing at all will escape the tax entirely. Only if rent is correctly defined as a surplus product will hoarding be discouraged and production unaffected by revenue collection.

The super profits tax is appealing in that it addresses the profits of monopoly. George was criticised for his unwillingness to tax monopolies. In fact, the great weakness of the 'single tax' is said to be that it does not capture 'all unearned incomes' — whereas rent as a super profit does.

George did not recommend taxing monopolies, but he did say a lot about their proper control. He argued that they came mostly as franchises or licences, and that such licences made the land to which they were attached more valuable. Thus, monopolies were often resolvable into ground rents. In other cases, such as natural monopolies such common services as the provision of water, gas, electricity and public transport should be operated by government. Where competition was limited it could be regulated to reduce prices to consumers.

Despite the superficial resemblance to rent, each of these cases of super profit is different — and each raises its own distinct problems of administration and ethics. On the other hand, the rent attached to location is quite obviously definable and distinguishable — and it does not raise the practical and ethical questions that arise when Labour and Capital are taxed.

Surplus profits can be a problem. The obvious remedy seems to be to tax them. Yet the rationale for doing it, and the ethical and practical problems of doing it, suggest that there are better ways to address it.

John Bates Clark opened up fresh controversy when he defined "rents" as surplus profits on Labour and Capital. Logically, this view — that surplus profits are a

legitimate return to Labour and Capital — implies that society has no just claim to revenue. Thus, government departments are remodeled in Australia as corporations and their services sold to the public for often exorbitant prices. (A birth certificate costs $65!) In financial straits governments have sold lands earmarked for hospitals and schools and leased out public roads. No one even insists that government has a right to confiscate private property in the name of patriotic sacrifice. Policies based on treating rent as a surplus profit, the impostor invented by J.B. Clark, will not correct this situation, but make it worse.

(This article has been abridged. — L. D.)