The Relation of Credit To Rent and Interest

By SEYMOUR RAUCH

Part 1: *Credit and the Rent-Interest Index*

THE Georgist analysis of depressions is frequently countered with the concept that depressions are caused by the over-extension of credit. The wide-spread acceptance in today's idea market of this point of view demands an interpretation of credit in terms of rent and interest.

The usual starting point of most new or expanded production in the present American economy is the obtaining of credit—a sum of money representing calls on wealth that the lender expects to be converted to a larger sum at a later date. The borrower (labor) uses these funds to obtain or maintain the tools (capital) and production sites (land) for carrying out production at an increased rate.

The term credit is used to include all transactions in which transfer of physical entities of value or claims to value are made from one economic person to another for disposal, without immediate payment for the value received. The characterizing criterion of credit lies in a time lapse between value received and payment therefor. Examples of credit situations are charge accounts, commercial bank loans, government bonds, railroad bonds, installment purchases, etc.

During good times only casual thought is given to problems of political economy and the relations of rent, wages and interest to the servicing of credit commitments. However only when the increased yield gained by a lender from a particular producer-borrower is derived from expanded production that also gives the borrower an increased yield, can the particular enterprise be considered successful enough to endure.

The period in the business cycle called "boom" is characterized by an upward movement in total production that generally provides both lenders and borrowers with increased yields. Since bad times can only originate in natural processes occurring in good times, credit-extenders, business men and politicians would do well to examine prevailing economic thinking which is still rooted in concepts that have not been distinguished by any ability to solve the problem of recurring depressions. If they wait until hard times begin, then the urgency to do something, will, as it did in 1933-39, compel economic practices which serve to postpone, re-arrange and compound the distress rather than relieve it permanently.

During any "boom," the natural action of the tools and the commodities comprising active capital is to increase per capita production. The natural action of land as production proceeds to inferior sites is to decrease per capita production. Interest, i.e., wealth accruing to the use of capital, is a measure therefore of the increased productivity induced by the use of current capital. Rent, i.e., wealth accruing to the use of better land, is a measure of the decreased productivity induced by the use of poorer sites.

When the effect on the total labor force of the productivity of capital compensates for the decreased productivity of inferior lands called into use, production must be expanding. Those who labor are provided with increased real wages. At the same time, there is available a surplus to service all credit calls on the economy. Rent and interest may be spoken of as existing in a favorable ratio towards each other.

As the increased productive state proceeds into "boom" times, land speculation increases rent faster than production and so prevents capital from compensating for the inferior land called into use. An adverse "rent-interest index" comes into being and production must shrink. Not enough surplus funds are available to service all credit commitments.

Many producers can meet all their commitments only by depriving labor of some of its wages through wage cuts or layoffs, by liquidating some of their capital, or by cutting production schedules. Trade being the exchange of production for production, any shrinkage thereof means further reduction in wages and, of course, demand. New opportunities for the profitable employment of labor and capital are kept low by the rent line remaining very high. Some disemployed workers stay idle causing further reduction in demand and production.

The reduced production, employment, demand and consumption are conspicuously reflected at the entrepreneurial level by commercial loan and bond defaults, foreclosure of mortgages, assignee and bankruptcy sales. If all of these cross-aggravating retardations of production remain unchecked, the inevitable result is the period called "bust" or depression.

The increased number of failures to pay credit liens accumulating and occurring at the same time gives a situation superficially describable as originating in the "over-extension of credit." It is impossible to believe that these defections are derived from the epidemic appearance among most credit lenders of a peculiar virus that prompts them, after years of successful lending practices, to concurrently make the same technical blunder of lending to inefficient producer-borrowers.

The phrase "over-extension of credit" is actually descriptive only in character and devoid of the attribute of causality. The necessary causality can be supplied only by the concept of insufficiency of the credit-servicing surplus owing to the speculative rise in rents beyond the ability of capital to compensate. In terms of price equilibria, this means an inability of the active producers of wealth (labor and capital) to buy back what they produce. When inventories over-accumulate in stores and warehouses, other superficial thinkers are led to loudly proclaim that depressions are caused by "overproduction." The "rent-interest index" reasoning can easily be applied to demonstrate the speciousness of this concept much in the same manner as can the idea of "over-extension of credit" be refuted. If one wishes to oversimplify and to indulge in a generality that glitters as much as "overproduction" and "overextension," the only plausible one to use is "underproduction" as being the cause of depression.

There is a considerable uncertainty prevailing in theoretical and practical circles about the immediate economic future. This uncertainty might be relieved by a statistical investigation of the suggested "rent-interest index." Perhaps it can give us a barometer capable of presaging swings in the business cycle. Such a barometer would fill the acute need of the Georgist economic perspective for a statistical corroboration of the concept that rising land values acting to diminish wages and interfere with the appropriate use of capital causes depressions and that falling land values accompanied by capital innovations initiate recovery.

(To be Continued)