45

THE MARGIN AT WORK IN THE CITY

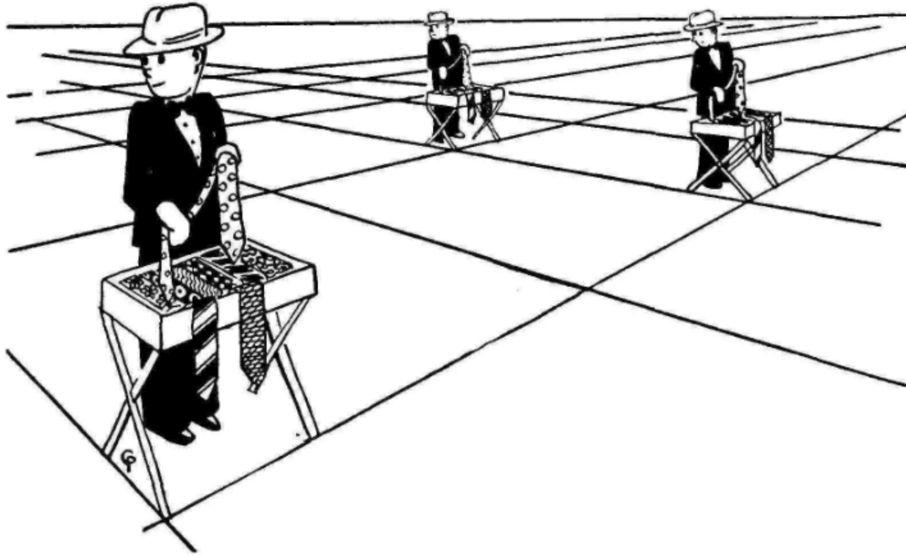
What is the city but the people?
—William Shakespeare, *Coriolanus*

IN MODERN twentieth-century big cities, just as it does in newly settled agricultural colonies, when less productive land is put into use, rent increases while wages and interest fall. It happens always, everywhere, under every form of government, and *without exception.* If we return to the two necktie-peddling brothers, Alphonse and Basil, and watch developments in their business, we shall see how the margin works in New York City today.

When we left them a few pages ago, Alphonse and his brother Basil were operating two necktie stands: one stand on busy 42nd Street and the other on not-so-busy 40th Street. Due only to the heavier traffic—greater population—the 42nd Street location (let's call it *Alphonse's* from here on) made fifteen dollars a day, while the poorer location (and let's call this one *Basil's}*, because of lesser traffic, earned only eight dollars. The difference between Alphonse's income and Basil's, seven dollars a day, we found could logically be nothing but *economic rent.*

Now let us suppose that, since we last observed the two boys, times have become a bit tougher. More men are out of work, and wages being offered around town are not so high as they had been. In almost no time at all, we may be sure, word will get around that *"a* certain guy peddling neckties on the street near the library is knockin' down fifteen bucks a day, and his brother a couple of streets away is makin' eight." As a result, many of those who are out of work or are making less than eight dollars a day on their jobs will soon be scurrying around for the best

unoccupied street corner they can find. Let's say, for the sake of demonstration, that the best corners they can get enable them to make only six dollars a day, although they work as hard and as efficiently as Alphonse and Basil. And, of course, we must suppose that they are carrying the same quality of neckties. Let Cecil represent all the peddlers working six-dollars-a-day locations. Obviously, the difference, now, between what Cecil makes and what Alphonse makes is the result of Cecil's being on a less heavily traveled corner. Therefore, Alphonse is collecting nine



dollars in rent instead of the seven he collected before Cecil came into the picture to work less productive land.

Again, to prove that the nine dollars is all rent, and that Alphonse's wages are no more than Cecil's, let's suppose that the winter season is coming on. It rains or snows every few days to chase sidewalk peddlers into shelter. The strong winds blow the neckties off their stands. A damp, clammy cold bites into the bones and numbs the toes of the shivering peddlers, and before long, we may be sure, they will begin to think in terms of more comfortable jobs, easier ways to make their livings.

Now, let us further suppose that a store, right across the street from Alphonse's stand, advertises for an experienced necktie

salesman to sell over a retail counter. That job would certainly look mighty attractive to our half-frozen street peddlers. And Alphonse, like the others, would probably be there to answer the ad. But how much would such a job pay? Even though Alphonse is earning fifteen dollars a day selling neckties, there is no chance whatever that he can expect to get that kind of money as a hired necktie salesman. For among the applicants are also the Cecils, who would be delighted to take the job for six dollars a day, since that's as much as they can earn on the best unoccupied corners open to them. And what is equally important, they can come in out of the wind and rain and still make the six dollars working in a comfortably warm and dry store. Since all of the applicants are equally skilled, there is no reason whatsoever for the "boss" to pay Alphonse more than the six dollars the Cecils would happily work for. And if Alphonse should apply to every store in New York, from swanky Fifth Avenue shops to those on down-at-the-heels Third Avenue, he would find all of them offering the same six dollars a day—the same wages that might be earned on the *least productive* street corner in New York—on the margin. The exceptions, if any, would be very rare.

We mustn't think, however, that the "bosses" of all the haberdashery shops got together to make a secret deal among themselves to keep wages for necktie salesmen down to six dollars a day. They didn't have to send research crews out to learn how much their competitors were paying, so as to be able to get their salesmen at the lowest price. It should be clear, from what has gone before, that the market price for necktie salesmen, like that of all laborers, establishes *itself, naturally* and automatically. All necktie salesmen, being human, tried to satisfy their desires with the least possible effort; and since the Cecils were able to satisfy their desires with six dollars a day, they offer to work at that price. As a *natural* result, the wages for all necktie salesmen fell to that figure. The "bosses" paid no more than six dollars for the same reason: that figure enabled them to satisfy their desires for a necktie salesman at the lowest possible cost.

And so we see that the margin determines what wages and

interest shall be in the complex society of modern New York, exactly as it does in simple, almost-primitive new colonies. Rent, on city land, precisely as it does on farm land, comes into being the moment a less productive location is put into use; and as rent increases it leaves a smaller proportion to be divided between wages and interest. It works with mathematical certainty, since it is impossible to subtract three from five and end up with more than two; to subtract rent from our stockpile of wealth and leave more than the remainder for wages and interest. It's as simple as that.

46

CONTRACT RENT BASED ON ECONOMIC RENT

CONTRACT RENT BASED ON ECONOMIC RENT

Many persons will, therefore, be desirous of obtaining possession of these fertile fields and will be content to give a certain premium for an exclusive privilege to cultivate them; which will be greater or smaller according to the more or less fertility of the soil. It is this premium which constitutes what we now call rent.—James Anderson, *Observations*

WHEN Mr. Seller goes out to rent a site for a store he intends to build, he doesn't pay any price the owners of the land may ask. The *contract rent* he will agree to pay will not be more than the amount of *economic rent* he thinks the location will give him. That is why an experienced merchant visits the neighborhood he is interested in and counts the number of people who pass the particular location he has in mind. He knows that out of every thousand people who pass, a

certain percentage will enter his store, and of these a certain percentage can be expected to buy. It is upon these percentages, fixed by the law of averages, that he estimates what might be a fair *contract rent* to pay. Similarly, before a farmer agrees to buy or rent a piece of land, he inquires around the area to learn what the probable yield of the land in the neighborhood might be. In other words, the amount of *contract rent* a man will agree to pay for the use of a piece of land will be equal to the amount of *economic rent* he expects the land to give him. In effect, the man who works the land and invests his capital in it, willingly pays over to the landowner any advantage that the land "pays" him. He doesn't always realize it, but all he expects to keep for himself is the wages and interest his labor and capital produce. Unfortunately, the best-laid plans do not always work out as hoped. When the farmer agrees to pay, let us say, two thousand dollars in contract rent, he hopes that his crop will bring him at least two thousand dollars in rent plus a reasonable return for his labor and capital. And when the merchant signs a lease, promising to pay two thousand dollars for the right to use a certain plot of ground as a store location, he expects that there will be a large enough number of people in the neighborhood who will be able to afford to buy his goods at a price that will enable him to collect two thousand dollars above what his labor and capital might earn for him on the open market. But the *economic rent* he actually collects will depend upon what business conditions will be in the future during the full term of his lease, while the *contract rent* he agrees to pay for a certain number of years is fixed according to the prices and buying power prevailing on the day he signs the lease. Obviously, if hard times come along to cut down the purchasing power of his customers, and if selling prices of goods should fall to reduce his sales volume, he will be collecting less rent than he is legally bound to pay. Likewise, if the price of cotton, wheat, corn, or whatever crop our farmer is raising should fall by, let's say, one-third, the *economic rent* he collects from his land will also be reduced by one-third—but he will still have to pay the *contract rent* he

originally agreed to pay, *in full.* That means that if either the merchant or farmer, faced with a fall in prices, collects less from his land than he has agreed to pay out for it, he must make up the difference somehow: he can either reduce his own wages; take less than what his capital would have earned for him elsewhere, or go into debt by borrowing the difference from a moneylender. But some way or other, he must pay *contract rent*

according to his agreement, regardless of how much or little *economic rent* the land may yield to him.

Since he can keep no more in wages and interest than is left to him after rent is subtracted, rent is a rather important matter. And yet it is almost completely ignored in many economics textbooks. It is rarely mentioned in many economics classes in some of our best universities. So far as our government economists are concerned, they mention *economic rent* so rarely, one might think that neither rent nor land itself even existed.

47

THE MARGIN RELATED TO THE HIGH COST OF LIVING

High or low -wages . . . are the causes of high or low price; high or low rent is the effect of it.— Adam Smith, *The Wealth of Nations*

THE HIGH COST of living is a subject that breaks into the news and into people's conversation quite frequently. On off days, when cartoonists just can't seem to dig up any other idea, we can expect them to do a picture of a balloon marked HIGH COST OF LIVING sailing skyward, and below, Mr. and Mrs. Public gazing worriedly and helplessly upward. Actually, the high-cost-of-living problem is treated as casually as the measles—something everyone must expect to suffer through—something nobody can do much about.

As a matter of fact, the high cost of living is just another name for low wages and interest. A pound of steak at even two dollars a pound doesn't seem too expensive to the man who earns ten or fifteen thousand dollars a year. But the same steak, even if offered at fifty cents a pound, is prohibitively high to a destitute or unemployed man, or even to a father of two if he earns less than three thousand a year. During periods of inflation, the afterwar periods when everyone is said to have too *much money,* prices are very high as compared to prewar figures. But high as prices are, most people can afford to pay them and do. On the other hand, after the inflation fades into deflation (deflation is another name for hard times), prices are cut to the bone by manufacturers and merchants competing for the little spending money still around. The cost of living then, in dollars, falls very

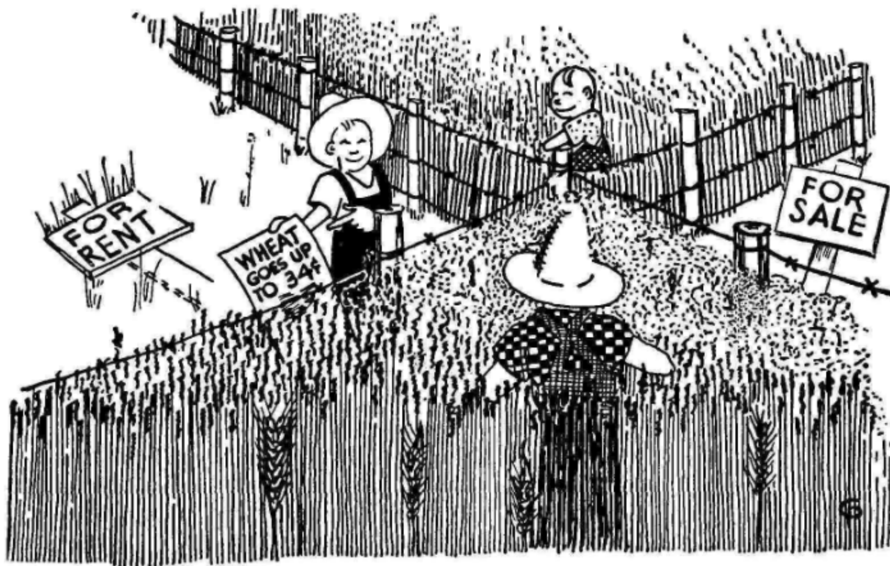
low; but since so many people are out of work, and so few of those who have jobs earn a living wage, people can't buy very much in spite of the low prices. During the early days of the depression of the 1930^8 one of the nation's largest restaurant chains hung huge oilcloth banners outside carrying the following legend: ALL YOU CAN EAT FOR 6of A few people did go in and did order one serving after another, perhaps to test the capacities of their stomachs, or to see what it would feel like to leave a table fully fed; but the number of those tempted to spend as much as 60¢ for one limitless meal was so small, the restaurants added little to their total business through the stunt, and soon after dropped it. Sixty cents was quite a bit of money during those hard times. People just didn't have more than fifteen cents or a quarter to spend for lunch. Many brought their lunch, consisting of leftovers from their dinner of the night before, from home. If we could have looked into the briefcases carried by many dignified gentlemen during the last depression, we should have found they were not filled with important legal papers, as we might expect, but with sandwiches and fruit.

The cost of living is the cost of food, clothing, and shelter. It cannot be lower than the cost of producing those things. The cost of producing them can't possibly be lower than the cost of the food, clothing, and shelter necessary to keep the producers alive and willing to produce. A ten-cent pound loaf of bread can't be made out of wheat that costs ten cents a pound to produce. Unless the cost of raw cotton goes down, the price of cotton shirts, sheets, and dresses can't possibly be reduced. Since it costs more and more to produce raw materials as poorer and poorer land is put to use, we must expect the cost of living to rise as the margin is pushed out to less productive land. To demonstrate that the margin and the high cost of living are in fact closely related, let's return to our old farmer friends, Obie and Zeke.

Obviously, the least that Zeke, who works marginal land, can afford to take for his crop is enough to replace the capital he used to produce it (seed, fertilizer, etc.), plus enough food,

clothing, and shelter to keep himself alive. He'll take more if he can get it, and sometimes he can; but since he must compete with all the other farmers working marginal land like his, the price he must eventually sell for will be around the figure that will just enable him to get by.

In this drawing we can see two properties adjoining Zeke's and Obie's that aren't being used. The reason they aren't being worked is that one piece of land can produce only 600 bushels for every $200 worth of capital and labor spent, and the other can produce only 400 bushels. That means on one piece of land



it costs more than 33¢ to produce a bushel ($200 divided by 600 bushels equals 33¢ a bushel), and on the still poorer land a bushel costs 50¢ to produce ($200 divided by 400 bushels equals 50¢ a bushel). So long as the market price for wheat is only 25¢, neither Zeke nor Obie can afford to use the idle land. By selling wheat that costs 25¢0 produce, Zeke just manages to stay alive, and any cost above 25¢ means he stops living. That is why two pieces of property are seen unused in our drawing. They just can't be worked so long as the market price of wheat stays around 25¢ a bushel. But as populations grow, more wheat is needed, and the farms

that can produce wheat at 25¢ a bushel can't produce all that's needed to satisfy the increased demand. Since the supply of wheat isn't as great as the demand, bakers and millers bid against each other for what wheat is available until their competition drives the price up to 34¢ a bushel. At that price, it is possible for a farmer—let's call him Jonathan—to work the land adjoining Zeke's. The land that requires 34¢ in labor and capital to produce a bushel of wheat can now break even, thanks to the increase in price, and now becomes the new margin.

If the increasing population, or a war, should again increase the demand for wheat, still poorer land will have to be put into use to satisfy the needs. When the demand becomes so great that millers and bakers offer 50¢ a bushel, land that will produce only 400 bushels at a cost of $200 can be put to use and we can expect another farmer, Cal this time, to produce wheat on the land next to Obie's. At 50¢ a bushel his crop will return the $200 in labor and capital he put into it—he can get by.

Now, if we tabulate the events of the last few paragraphs, we end up with something like this:

be extended farther out to even poorer land. When Zeke's 800 bushel land was marginal land, wheat had to sell for at least 25¢; then, when Jonathan's land became the margin, 33¢ became the market price; and finally, when Cal's land became the margin, 50¢ became the market price. From this, we may deduce that when prices are high, a living can be made on less productive land; and when prices fall, only better land can be used profitably. The second point revealed by our table is one we have already discussed: that is, as poorer land is put into use, rents increase on all land that is better than the least productive in use (the margin), which leaves a smaller proportion of total production to distribute itself as wages and interest.

48

THE MARGIN DURING GOOD TIMES AND BAD

After 1921, *with the disappearance of the war demand for food products, agriculture started on a course of steep and ruinous decline. The prices of farm produce fell swiftly. Farmers by the tens of thousands went into bankruptcy. Farm mortgages were foreclosed and freehold farmers driven into tenancy or off the land.*—Charles and Mary Beard, *Basic History of the United States*

So LONG as prices keep going up, things aren't too bad for most people. Because, as we have seen, as prices go up, more and more land can be used profitably by more people—more workers can earn at least marginal wages and interest—more consumers can spend money. And those who have better than the poorest land earn better livings, since they collect

economic rent in addition to marginal wages and interest. It is this fact that enabled so many of our farmers to pay up their debts and even save a little money during the last war.* It is this fact that enabled so many marginal manufacturers and side-street merchants to grow comparatively prosperous during the war years, and enabled those who used better-than-marginal locations to earn fabulous profits. The only groups that do not benefit through high prices are those living on past savings and those whose earnings are fixed by long-term contract. That is due only to the fact that their earnings, limited by contract, are not permitted to increase with the natural wartime advance of prosperity.

But after the war is over and hard times come back, to compel humans again to refrain from marrying and multiplying as fast as they did during "better" days, fewer people are able to afford to buy as many things. As a result, prices of all goods, including wheat, tend to fall until it is no longer profitable for Cal to use his land. If we suppose that the market price of wheat falls from 50¢ to 25¢, not only all the Cals but all the Jonathans as well will have to walk away from their land. Some of the Cals and Jonathans, unaware of the causes of rising and falling prices, will try to hang on; but since the more they produce at the lower prices the more they lose and the further they go into debt, they'll eventually be dispossessed by the moneylenders holding the mortgages on their land. That is precisely what happened after World War I; and that is what happened in many sections where prices fell with the end of World War II. When the

* Some say it was the subsidies given to farmers that enabled them to pay up their debts; but it must be remembered that subsidies and parity-price arrangements are merely artificial methods whereby prices are forced up above their natural level. In that sense, subsidies and parity-price controls may have stayed the next depression. But if we bear in mind that the prices are kept high at the consumers' expense—once in the form of a higher cost of living and a second time in the form of higher taxes—and if we also remember that farmers are also consumers and taxpayers, the fact that farmers are again going into debt and that many of them are again losing their farms does not come as a surprise. And the depression that is supposed to have been stopped by subsidies was simply dammed for a while and must naturally break through with even greater violence—in the form of destitution or war—when our national debt passes the breaking point.

ability of the consumer to buy falls off for any reason—lower wages, higher taxes or both—prices must fall regardless of how hard government tries to prevent it with subsidies, parity-price arrangements, loans, relief, or other political schemes.

When farmers and cattlemen lose their farms and ranches as a result of falling prices, it isn't they alone who suffer. Being without income, they can't buy very much of the manufactured goods from the industrial areas. That of course means more men will be working in factories than are needed to supply the reduced demand for manufactured goods. Since goods that can't be bought can't be sold and therefore can't be produced, the necessary result is that many factory hands are laid off regardless of how strong or efficient their labor union may be. Naturally, the unemployed factory hands must cut down on their buying too, which in turn compels retailers as well as other manufacturers to reduce the number of their employees. Little by little, the margin contracts to reduce the *economic rent* collected by the users, while the *contract rent* they must pay out stays up where it was during prosperous times; more and more unemployed men from the rural areas pile into the cities to compete for jobs, causing a reduction of wages and interest among the processors, manufacturers, and retailers. This steadily increasing unemployment, falling earning power, and lowered buying power continues to grow worse and worse until it finally reaches Wall Street to blow the top off the stock market. It is then that the editors, radio commentators, and government economists become publicly aware of a depression that began, right under their noses, years before. Actually, the financial panic that woke them up is very much like the bursting of a boil that has been painfully festering long before. The Wall Street crash is the result of a depression and is not, as is commonly believed, the cause.

During periods of war prosperity, pasture land ordinarily unfit for agriculture is used and becomes the margin, only because high prices make the use of such land profitable. And during these so-called "good times," we see many stores being opened for business and many apartment houses being built in hard-to-get-to

neighborhoods that ordinarily couldn't support such enterprises. But when bad times return, it is the marginal farmers and businessmen who are first squeezed out by the fall in prices, because, although their land no longer produces a rent, they are still obligated to pay the *contract rent* to the landowner or mortgage holder. Only those farmers and businessmen occupying land that still yields a rent larger than the one they must pay, can possibly hold on. Owners of apartment houses that had been built on marginal land located a million miles from nowhere during days of housing shortages are among the first to find falling prices and unoccupied apartments driving them to bankruptcy, receivership, nervous breakdowns, and suicide.

49

TO BUY LAND IS TO PAY RENT IN ADVANCE

Rent is also expressed in the selling price. When land is purchased, the payment which is made for the ownership, or right to perpetual use, is rent commuted or capitalized.—Henry George, *Progress and Poverty*

ONE MORE POINT before we leave Ricardo's Law of Rent behind to go on to other things. In our examples above, we spoke of the farmer and the storekeeper "renting" pieces of land upon which to employ their labor and capital. It must not be presumed that the situations would have been different if they had bought the land, instead of "renting" it, from a landowner. For, economically, buying land is no different from paying rent for the use of it.

That this is true can be demonstrated if we suppose that after wages and interest are deducted, a piece of land produces $400

in economic rent. And let's say that the prevailing rate of interest is five percent. To find the selling price, the landowner does something known as *capitalizing the rent.* That is, he treats his land as capital, and considers the rent it produces, interest. He therefore divides the rent his land produces by the current rate of interest, and thus arrives at the value, or selling price, of his land.

The reason the landowner chooses this method for determining land value, or selling price, is that the landowner is a human, and as such wants to do as well owning the buyer's $8,000 cash as he can by holding on to his land. Since it will take at least $8,000 loaned out at five percent to earn an amount equal to the $400 his land produces in rent, he won't take a nickel less than $8,000 for his land.

Similarly, neither the farmer nor the merchant would pay more than $8,000 for a piece of land that produced only $400 in economic rent, because their $8,000 can earn that much if loaned out at five percent.

Therefore, it becomes clear that the land continues to yield an *economic rent* to the user whether he owns the land or pays rent for it. If he buys the land, he is simply paying twenty years' rent in advance ($400 X 20 years = $8,000). But that is true only so long as the interest rate remains at five percent. If the interest rate should fall, let us say to two and a half percent, the selling price of the land would double! The land that produces $400 in economic rent for the user, and formerly sold for $8,000 when the interest rate was five percent, will now be worth $16,000—only because the rent divided by the interest rate equals that much ($400 rent divided by 2 1/2% = $16,000). *The buyer now must pay the equivalent of forty years' rent in advance!* All of which is just another proof of what has been hinted at several times in preceding chapters: *as the interest rate falls, land value (which is rent) rises; and as the interest rate rises, land values fall.*

The inescapable fact that any increase in rent must result inequal decrease in wages and interest should be of immeasur-