20. Economic Rent — The Surplus Product

So far, this book has attempted to present a diagnosis of the condition of general ill-health in which the modern world languishes. The final task is to prescribe treatment designed to effect a cure and a return to normal health. To do this let us borrow from modern economics the practice of using a 'model'. In this case, the model will be a hypothetical economy and, for convenience, that of Australia will do as well as any other.

As a first step, a recapitulation of the symptoms is in order. These are:

a degree of malfunction in the organs of production and congestion in the channels of distribution, producing acute suffering in widely differentiated areas;

loss of balance, the consequence of the adoption of unscientific methods of medication ('inflation') including a crude form of compulsory blood-doning with compensatory blood-infusion — known respectively as 'taxation' and 'welfare';

pathological confusion over external relations ('trade') leading to fantasies of 'self-sufficiency' and isolationism ('economic nationalism').

The next essential step is to write the prescription, the main objective of which is restoration of full function to the productive organs and correction of the flow of the product through the right channels of distribution, the key to which is the proper disbursement of a substance known as *The Surplus Product*, which must now be identified and its significance recognised.

Among the priceless gifts of Adam Smith to the thinking world is the masterly exposition of 'the division of labour', the main value of which is its demonstration of the mathematical proposition that the total product of any group of producers is greater than the sum of their individual products. From this he leads us to the concept of the co-operative community, or 'economy', by which all its members, in seeking the satisfaction of their individual material desires with the least effort, achieve the satisfaction of all, or the general good, without conscious effort, by the process embodied in Smith's immortal phrase 'the invisible third hand'.[1]

Let us turn now to our hypothetical economy and assume, for the sake of simplification, that it began to be 'settled', not by those who actually were the first to arrive on the shore of Sydney Cove, the convicts and their guards who gave Australia its infamous beginnings as a penal colony, but by 'free settlers' similar to those who created the State of Pennsylvania in the North American Continent. And let us assume also that the situation was not complicated — even to the relatively minor degree that it was in Australia —

by the presence of an already indigenous people; that the land was, in fact, *free* to be occupied and used by whoever would do so.

We have, then, a situation such as Henry George so magnificently describes in the passage in *Progress and Poverty* which begins: "Here, let us imagine, is an unbounded savannah . . ."[2]

Here we have the beginning of community, and here is, as we watch in retrospect the concertina'd procession of development, the demonstration of the advantages of the division of labour; the benefits of shared labour, the economising of effort, the increase of facilities, the spread of *civilization*, the growth of the market — the growth, in fact, of *the economy*.

We have something else which, as George shows us emerging, in the passage referred to, is a significant product of the presence and growth of population — *rent*. Not the rent which someone who has put his capital to use building homes may charge for their occupancy and which is a return on the capital so employed. Nor the rent which someone ingenious enough to have invented a utility in great demand charges under a patent law, nor the rent charged by a manufacturer who prefers to lease his products instead of selling them outright, as in the case of machines of high cost, such as a computer.

This rent can more readily be seen and its nature understood if man, as wealth producer, is seen to operate in three ways — by *labour*, the outlay of personal effort; by *investment*, the outlay of his personal property, his 'saved labour' or capital; and by *association*, whereby, through exchange, he profits from the aid rendered by his fellow exchangers. The return he receives from the market, through *price*, is a corresponding distribution of wealth through three channels, namely *wages*, a personal return for his labour; *interest*, a personal return for the investment of his capital; and *rent*, an impersonal return, or profit, derived from the act of associating.

This rent is in the nature of a differential, in that it reflects that difference in return which is expressed in the *Law of Rent*, attributed to Ricardo and recognised by all economists since his time:

> "The rent of land is determined by the excess of its product over that which the same application (of labour) can secure from the least productive land in use."

It is a differential in that it reflects the relative advantages of a site on which production takes place. The advantages of a site at a seaport or a railhead relative to one a hundred miles away from either is obvious. The aid to greater production which the former site provides is expressed in the price it commands, this being the measure of the rent, which might very well be ten, fifty or a hundred times that commanded by a site a hundred miles distant.

But, since production is only completed at the point of distribution as wealth, that is in the market, where it is exchanged for other forms of wealth, at the point which is the focus of streams of goods flowing in from innumerable factories and workshops in outlying places, and where buyers and sellers gather together to make the exchanges which bring about this distribution of wealth, the *rent*, that third part of the economic equation, is enormously increased as a proportion of the total wealth, reflecting the advantages enjoyed by every one of the thousands involved in the exchanges, of being able to buy anything from a pot of paint to food and clothing, books and furniture in the same retail store. The rent of the site on which all this takes place is in all probability vastly greater than that of those on which the goods exchanged were originally produced.

So great is the rise of the rent, this differential in site value, that it may clearly be perceived in every city in the world. It is visibly apparent to the least observant eye in the heart of Sydney, for instance. It is through the natural propensity of man to achieve the satisfaction of his material desires with the least expenditure of effort that the market came into existence. It is through this natural propensity that great cities grow, founded always on the market, the fundamental organ of the economy.

Here, then, is seen the rise of *rent* to its highest peak, the rent that is the *Surplus Product*, that part of the total wealth which is the property of no individual, since it is the property of all producers in their totality and thus the property of the whole society; the true and natural revenue of the State, the function of which is to defray the cost of government.

In New South Wales, of which Sydney is of course the capital city, under the State Government's system of local taxation, known as 'rating on the unimproved value of land', a portion of the Surplus Product is already being collected by the State. [3] That is from the productive land to which the tax applies. However, the rate is so low that the State's share of the Surplus Product is minimal, leaving the residue to be privately appropriated. The tax is also applied to all other land, e.g., non-productive residential sites, from which the amount so raised is *not* a part of the Surplus Product.

In the price obtained for productive sites there is a large element of 'ransom', for the price is so inflated by the effect of speculation in rent that it is not a price determined by the value of its Surplus Product but an excessive price resulting from the private appropriation of the Surplus Product and its capitalisation into 'land value'. Thus is created an artificial scarcity of sites, raising the normal rent line set by competitive producers; it is thus a levy on the latters' market return of wages and interest. *It is this excess price, or ransom, levied on producers, which distorts the whole economy.*

'Land value' arises only through the private appropriation of the Surplus Product, the true *rent;* for 'land value' arises from rent, not rent from 'land value', as is mistakenly held by the advocates of the 'taxation of land values'.

It should be clearly understood that rent, in the economic sense, must not be confused with interest, the reward for the investment of capital. The rent a tenant pays a landlord is a mixture of economic rent and interest, i.e., rent which attaches to the site and is relinquished by the tenant, and interest (commercial rent) for the capital invested *on* the site.

'Land value' is accepted throughout the world, almost universally without question, as a natural phenomenon of the economy. Instead, it should be recognised for what it really is; like cancer, it is the evidence of a breakdown in natural function of an organism, in this case the economy. 'Land value', however tangible it may be to real estate operators, is a false value arising out of the artificially created scarcity of land consequent on the society's failure to prevent land from being held out of use and to appropriate its true and natural revenue, the Surplus Product.

The disorder created by this perversion of the market organism had led to the assumption that economic justice can be achieved only through a *political* re-distribution of the 'economic cake', by an assault on the incomes of the 'haves' in order to give to the 'have-nots'. The social principle that each individual gets a living by co-operating with his fellows in the market is thus degraded into getting a living at the expense of others; and government, as Frederic Bastiat said, "becomes a device whereby everybody tries to get a living at the expense of everybody else."

Once the Surplus Product is fully appropriated as public revenue, the value that attaches to productive land, i.e., land in the economy, will disappear. That which is described as the price of land — the capitalisation of both the rent differential and the speculative rent — will evaporate like the mists of morning before the rising sun. And while those who now enjoy the privilege of receiving and retaining it as *private* revenue will, at first sight, appear to be deprived of a right long recognised (too long recognised!), they, with the rest of the society, will soon discover their real benefit as they share, not any longer in the general plunder, but in the general good as the health of the economy is restored.

It is the utter simplicity of this formula which has been responsible for its obscuration beneath the overlay of what has passed for economic theory and disputation for centuries. It is a formula which was accepted without question by every one of the early despots, either pure or paternalistic. The author of the Book of Deuteronomy proclaimed it: "The land shall not be sold forever". What the kings and princes did with the revenue thus obtained on behalf of their people is another matter. The fact remains that the rent of land was the support of the sovereign in the name of the general good, however much it may have been misused in pursuit of his own ambitions and delusions of divinity.

It was left to the advent of the modern state, notably that of the Romans, to begin the destructive process of permitting the private confiscation of the rent and the imposition of taxes on those deprived of their birthright in order to compensate for the robbery. As was described earlier in this book, the history of this process is laid bare in Richard Cobden's devastating speech in the English Parliament in 1845[4], in which he outlined the progressive reduction of the rental revenue of the state from feudal times to his own day, with the consequent rise of taxation.

The formula, then, is the basis of the prescription for a return to the general good health of the economy. To revert to medical metaphor: having excised the overlay of economic obscuration, one can observe that the behaviour of the productive cycle is normal once such obstructions to its free movement as restrictions and monopolies are removed, together with cessation of the practice of enforced blood-doning and inadequately compensatory transfusion. What remains to be done is to seal the leak in the distributive arteries. The patient then will soon be back on his feet ready to resume normal healthy life.

It was asserted at the beginning of this book that the present condition of human society is, as recognised by the environmentalists in the ecological sphere, the consequence of transgression of natural law. This natural law, derided by the pragmatists as the product of philosophical fantasy, may be clearly observed in operation once the mind is freed from its subservience to the doctrines of modern economics, the fruits of which are self-evident in the present state of the world.

The law that man seeks the satisfaction of his material desires with the least expenditure of effort draws him into association with his fellows through the division of labour and the co-operative system of mutually beneficial exchange. From this association arises a profit to the whole society over and above the profit to the individual. This 'profit of association' may be seen, though it may not be quantified, in all the amenities commonplace to modern society, such as communication systems, transportation, education, innovation, and invention, despite the fact that, *as a proportion of the national wealth,* wages and interest are falling. Rent, the Surplus Product, however, a part of this profit of association, *can* be measured as the differential return between sites in productive use, the result of the competition of producers for those sites with the most advantages.

To summarise: the Surplus Product arises out of the total exchange activities of producers, out of their total competition. Individual producers secure the profit of their mutually profitable exchanges; collectively they produce this overall profit, or bounty, through their association, which is seen to attach to sites for which the co-producers compete. This part of the overall profit, the differential in the evaluation of sites, is what is known and recognised by all economists as *economic rent.*

Economic rent is received as part of the distribution of wealth in the market by the occupier of a site on which production takes place. When, as now, it is appropriated by the site owner as personal income and capitalised into the price of land, the community is being systematically robbed of its profit of association, the government is starved of its natural revenue, and recourse is inevitably had to levies upon individual wealth and income and upon goods and services in the course of exchange in order to compensate for the loss of the natural revenue. This, in turn, brings on all the evils of the modern 'welfare state' as the cost of the substitute for the real revenue spreads throughout the economy like an oil-slick. It also brings on the disastrous phenomenon of the modern city, as the public wealth, wrongly confiscated, is re-invested in the mounting gamble of 'real estate' speculation, once again reproducing the financial chaos and ruin of previous so-called 'economic crises'.

Among the worst of the social consequences of the present economic chaos is its effect on the availability of sites suitable for home-building. So long as land is permitted to be held out of use for the prospect of an ever-higher price, the advantages of the redistribution of wealth consequent on the correction of the economic balance will still not be available to the young home-seeker, who will continue to be forced into debt for the privilege of enjoying a normal social existence. The remedy for this would be to impose on all land held out of use beyond a defined period a levy steep enough to induce the owner to use it or make it availabe to someone else. The mere threat of such a levy would tend to throw all land in this category on to the market and enable sub-divisions to proceed in accordance with need, free of a purchase price other than the normal cost of bringing such land into fitness for occupation as home-sites or for other social purposes.

NOTES TO CHAPTER 20

1. See reference to Adam Smith in chapter 8 herein ('What Is the Economy?').
2. *Progress and Poverty* by Henry George: Schalkenbach Foundation edn., New York, 1958; Bk. IV, chap. 2, pp.235/243.
3. This system, operating in other States of the Commonwealth, originally designed as the sole support of local government, includes the taxation of non-industrial and non-commercial sites, such as sites owned and occupied as private homes, the subject of continuing public dissatisfaction. This injustice would cease once the Surplus Product was collected as national revenue, for two reasons:
   (1) the Surplus Product would be found to be sufficient to support State and national governments *once these had been reduced to the performance of their proper functions;*
   (2) local government would, ideally, itself be reduced to the performance of a few minor functions, needing only a fraction of present-day revenues. In most cases these functions could be supported by a system of payment for services rendered, e.g., as for garbage disposal.
4. A substantial part of the Surplus Product is, of course, collected in the form of royalties on mineral extraction, forest products, etc., and in the rent of Crown Lands. Public collection of the Surplus Product is thus established in principle; what is now required is that the principle be applied in full.
5. See chapter 13 (Taxation) p. 94