

## CHAPTER XIII.

### OF GROUND RENT AND GROUND VALUE.

The part played by rent in the problems of poverty can scarcely be overestimated.

*John A. Hobson.*

It must be noted that the normal marginal land-form of any market is not the least productive land-form in use, but the least productive one *necessarily* used to supply the demand of such market. In normal conditions no one would occupy a poorer land-form than the natural scarcity required. But under a system which encourages the appropriation of land-forms from which there is not present adequate return, but from which great values are expected in the future, it frequently happens that the producers who occupy the poorest land-forms are far beyond the normal economic margin. Some of these occupants expect a greater future return to compensate them for their present lack of adequate net values, and voluntarily go into the wilderness and forestall progress by taking up the best land-forms in advance of the needs of society; but the great majority of the occupants of an artificially depressed economic margin are driven there from the fact that many superior land-forms are held out of use by their owners for speculative purposes, and thus the normal economic margin is not available for use by the normally marginal laborers.

The artificial depression of the economic margin by the

holding of superior land-forms out of present use and occupation necessitates a distinction between the normal economic margin and the artificial margin which usurps its place. The artificial margin is the result of juridical institutions, laws and customs, which sanction the holding of superior land-forms wholly or partially out of use; the normal margin is the margin unaffected by such juridical institutions, laws and customs. We may distinguish between land-forms which are superior only to the normal margin from those which are also superior to an artificially depressed or abnormal margin by designating the former normally superior, and the latter abnormally superior land-forms.

Land values appear under two forms; annual, or rental values; and ground, or selling values. A normally superior land-form acquires an annual rental value because its present products at current prices yield a differential net value. The producer collects this differential when he sells his products. If he is the owner of the land-form as well as its user, he retains this differential value, and the fact that he may do so gives ground or selling value to his land-form. If the producer is a tenant, he pays this differential value over to the land owner as ground rent, and reserves to himself at the most only the net labor and capital differentials of his product. The fact that the owner can collect an annual ground rent from the tenant gives to his land-form a ground or selling value. The differential net value which distinctively results from the use of a superior land-form is reflected in ground value whether the owner is the actual land user or not. In either case he acquires

this net value as *owner* of the land-form and not as *user*.

The amount of ground rent in any case where land-forms are used productively is determined by the excess of the net value which may be secured upon a given land-form by a given expenditure of labor-power and capital-forms over what a like expenditure would produce, if applied upon the economic margin. The tenant gives to his landlord as ground rent substantially that part of the differential value of his products which results from the use of a superior land-form, and thus puts himself upon the same level as the man who produces at the margin. The value which thus accrues to the owner does not result from any expenditure of labor-power or use of capital-forms by such owner, and is in excess of the return which could be secured by the tenant by an equal expenditure of labor-power and capital-forms upon the margin.

The illustrations which we have used all refer to the ground rent of land-forms which are used for the production of labor-forms and the creation of net value. Yet we know that land-forms upon which nothing is produced, but which are used rather for the purposes of the consumption and enjoyment of labor-forms, also yield ground rent. This is a fact entirely overlooked by those who accept and follow the Ricardian formula concerning rent, as that formula is currently stated. An illustration showing that in any country where marginal land-forms yield five dollars' worth of wheat per acre, land-forms yielding ten dollars' worth per acre will bear an acreage rental of five dollars is correct as far as it goes; but it does not explain why an acre of land will bear a ground rent when used for resi-

dence purposes only. In order to explain this phenomenon we must look not to the producer's and seller's, but to the buyer's and consumer's side of the market.

In our discussion of value and cost we learned that value, disvalue, and net value pertain to the seller, and that cost, alternative cost and net salvage pertain to the buyer. The seller seeks net value, and the buyer net salvage. The seller is distinctively a producer, and the buyer as buyer is distinctively a consumer.

In seeking net value the seller, as producer, naturally seeks for those land-forms upon which most can be produced with the least disutility. This gives rise to those differential net values which distinctively accrue upon the more productive land-forms, as our illustrations have shown. In like manner the buyer, as consumer, in seeking a salvage of cost, naturally seeks for those land-forms which are best situated for the purchase at low cost, and best suited for the inexpensive consumption of those labor-forms which he must buy. The importance of living near a market where one may buy to advantage is just as great as living near one where advantageous sales may be made. Net salvage to the buyer is just as truly reflected in ground rents as is net value to the seller. In a city where substantially everything may be bought at the lowest market price and in any desired quantity, residence lots are of much greater value than those in a small village where prices are high and goods scarce. Ground rent may represent net value, net salvage, or both. The selling or ground values of residence lots, like those of productive land-forms, are

simply anticipated net values, or their economic equivalents in net salvage.

The owner of a superior land-form not only annually acquires, in the form of ground rent, the differential net value of all current products which are due to its superiority, but his land-form acquires a ground or selling value by virtue of the fact that its future products will yield differential net values. This ground value, which is expressed in the selling price of the land-form, accrues to the owner as owner and not as user. It accumulates until it equals what is known as so many years' purchase.

If the annual ground rent of a given land-form is \$100, and the current rate of interest on long time and secure investments is 5 per cent, the selling price of the land-form in present conditions is substantially 20 years' purchase, or the aggregate sum of 20 years' ground rent. Stated in another way, when interest is 5 per cent, the payment in advance of a sum equal to 20 years' ground rent will purchase the property. This is true because the seller seeks a price which, if invested in secure long time commercial paper at the current rate of interest, will procure him an annual income equal to the annual rental value of the land-form sold; while the buyer will not pay a price upon which the annual ground rent will not pay the current rate of interest. When current interest is 4 per cent a sum equal to 25 years' ground rent upon a given land-form, if put at interest, will produce an income equal to the annual ground rent of such land-form. When current interest is 5 per cent a sum equal to 20 years' ground rent will suffice, the number of years' ground rent, or num-

ber of years' purchase, being found by dividing 100 by the number expressing the current rate of interest. Where land-forms have no strictly speculative value, this rule is sufficiently accurate for practical business, and is commonly acted upon, especially in England; but where speculation in land-forms is in vogue, due allowance must be made. The selling price of land-forms represents their ground value.

**Ground Rent** is annual land value.

We are not yet prepared to define ground value, but quantitatively considered it is the present worth of anticipated ground rent.

**Present Worth** is a phrase used in speaking of a debt before it is due, and is the sum which, at the prevailing rate of interest, will amount to that debt when it is due. In a commercial sense, the selling price of a land-form is future ground rent capitalized at the current rate of interest.

Ground values not only adhere to land-forms which are actually used for the purposes of consumption as well as for production, but also to land-forms of which no present use is made at all. This is strikingly illustrated by the cases of vacant lots and lands. In the "South Side" business district in the City of Chicago there were in 1894 vacant lots to the amount of ten acres and of the aggregate ground value of \$8,000,000.\* This and vastly more ground value has accrued in that city notwithstanding the fact that neither owner nor tenant has expended either

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\*Eighth Biennial Report Illinois Bureau of Labor Statistics.

labor-power or capital-forms upon the lots themselves. After due allowance is made for all moneys spent by the owners for improvements in the streets adjacent thereto, these lots have acquired a rental value of many thousands of dollars per year as bare land-forms. The same phenomenon, upon a smaller scale as regards values, may sometimes be seen in country districts. In some places farm lands have been held out of use until they have become of comparatively great value.

Ground rent is shown by the foregoing illustrations to adhere to land-forms as a result of the distinctive net values and net salvages actually or potentially produced or consumed thereon. These net values and salvages are primarily involved in the prices of products, but are there indistinguishable and unmeasurable. In the end, however, they all appear as land values, and accrue solely to the owners of the superior land-forms as land owners and not as land users. Land values absorb all differential values which result from the use of superior land-forms. Such differential values can be distinctively recognized and measured only when reflected in the value of the superior land-forms themselves.

The importance of thoroughly understanding the full import of the marginal return, differential value, ground rent and ground value, as we have defined these terms, is so great that we will pass in review their distinctive features. This will carry us back to a fundamental fact of Economics, viz., that all production is the result of the application of labor-power to land-forms. Labor-power may be assisted to great advantage by auxiliary capital-

forms in overcoming the resistance of matter, and pure capital-forms may be used to overcome the irksomeness of waiting. But capital-forms are themselves the results of labor-power expended upon land-forms; as between the two, labor-power is the creator, the capital-form is the creature. In the process of production labor-power is usually the principal, capital-form usually the assistant. It is only when the disutility of time is to be overcome that capital-forms have a distinctive function and collectively rise to the dignity of a coördinate factor in production. The efficiency of labor-power, whether aided by capital-forms or not, is governed by the utility of the land-form upon which it is expended.

Every market has tributary to it a certain number of land-forms which must necessarily be used in order to supply the demands of such market. Of these necessary land-forms some are least productive of all. The men who occupy these least productive land-forms receive a given return for the disutility which they undergo. Men who occupy land-forms of greater utility receive a greater return for a like disutility. If we undertake to compare the differences of return for like disutilities throughout the territory of the market, we can only do so by taking the upper limit of the marginal return as the point from which to measure, and the marginal return itself as the basis, but not the unit of comparison. The unit we shall develop later.

Ground rent, like that differential net value which it reflects, begins at the upper limit of the marginal return. It extends upward in varying degrees and manifests itself in



the annual value of the particular land-form to which it attaches. This annual value is determined by the excess of the net value which may be acquired on the land-form in question over that which may, with like disutility, be acquired upon the economic margin. The landlord will receive no less as annual rent because of the one-sided competition always existing between land user and land owner in present conditions. The tenant will give no more because he can occupy the margin rent free. It must be remembered that in this market the competition is not for land-forms merely, for of these, such as they are, there is an abundance for all. The competition is for land-forms which are tributary to some general market. Of these the supply is always limited and the demand ever increasing. In the competition for land-forms, however, tenants will give no more than the excess of net value over the marginal return; that is, no more than the land differential, because they can occupy the economic margin and acquire the marginal return without the payment of rent.

The fact that ground rent is but a reflection of differential net values of product has an important bearing upon a much mooted and generally misunderstood question of Economics. This is the question of the relation of ground rent to the prices of labor-forms produced or consumed upon the particular land-forms upon which the ground rent accrues. It is sometimes said that "ground rent does not enter into price," or that "ground rent is not an element of price." From these statements it is easy to glide into the totally unrelated and erroneous statement that

“ground rent is not paid out of price,” price in each case referring to market price of products.

The real solution of the matter is this: The prices of all labor-forms are fixed by the marginal pair and, in ordinary circumstances, are the same for all producers. In ordinary circumstances, also, the marginal seller receives *some* net value—he receives the marginal return. The occupiers of superior land-forms receive the same price, but because the superiority of their land-forms enables them to produce with less disutility, their net values are greater than the marginal return by the amount of the land differential. This differential value is reflected in ground rents. The price of the products existed before the ground rent accrued, and instead of ground rent affecting price, it is affected by price. The higher the price of products the more rent; the lower this price the less rent. Ground rent does not enter into price, but price does enter into ground rent and affects it at its upper limit.

A farmer who pays high ground rent gets no more for his grain on that account. But if prices of grain are high, he will pay more rent. And as every one knows from experience, the prices of goods are not higher in the “down town” districts of a great city where ground rents are enormous, but on the other hand, are lower than in the outlying districts where rents are comparatively low. From these facts it will be seen that the first two statements above quoted are true, but are liable to be misunderstood, while the third is palpably untrue. The only means which the ordinary farmer has of paying ground rent is out of the price of his products; while the business

man, in order to succeed, must make his prices cover all expenses, including ground rent. The merchant, however, does not raise his prices because his ground rent is high, but pays high ground rent because his net values at current prices are great. Ground rent, from the point of view of market price of products, is a result and not a cause.

We have already noted the fact that the owner of a land-form not only receives the current differential net value which is reflected in ground rents, but discounts future differential values in the selling price or ground value of his land-form. If he rents to another, he is paid a current differential value annually by his tenant, and if he sells, he is paid the present worth of anticipated future differential values by the buyer of his land-form.

Although all land differentials originally inure to the owners of the land-forms in any community, a part of these values are annually taken by the State in taxation. All taxes levied wholly upon land values, irrespective of the values of improvements, fall upon the owner of the land-form as owner, and are paid out of current ground rents. It is impossible that the tax upon the value of a given land-form could equal the entire ground rent every year. For if it did, it would require all the differential value of product to pay the tax, and the owner would be no better off than if he occupied or owned a land-form upon the economic margin. Hence his land-form would have no selling value whatever, and without a selling or market value there could be no basis for taxation. By regularly taking all the ground rent in taxation (if this were

possible) the State would destroy all ground value; for ground value is simply future rental value anticipated by the owner. In order for land-forms to have any selling or ground values some part of the ground rent must systematically be left to the owner after payment of taxes; this amount left to the owner may not be less than a sum equal to the true discount of the annual ground rent at the current rate of interest.

Suppose the annual ground rent of a given land-form to be \$105, the current rate of interest 5 per cent, and that the annual tax imposed by law is regularly to be 100 per cent of the selling price or ground value of all land-forms. A purchaser will invest \$100 in the given land-form, and its owner can secure no more. The ground value is then less than the annual ground rent; the former is the present worth of the latter. The purchaser by paying \$100 for the land-form can annually thereafter collect \$105 from the tenant, turn \$100 over to the State as taxes, and retain \$5 net ground rent. This is equivalent to interest at 5 per cent upon \$100, the amount of the investment; and ordinarily he can turn this investment into cash at any time by a sale of the land-form for the same price he paid.

From this illustration we see that while the State cannot take 100 per cent of the rental value—ground rent—of a land-form, it can take 100 per cent of its selling or ground value every year. And we also see that if taxes upon land values, irrespective of improvements, were increased from present rates to 100 per cent of ground value, the selling price of land-forms would fall from the anticipated aggregate of about 20 years' ground rent to the

present worth of one year's ground rent, if the current rate of interest is 5 per cent per annum.

The foregoing illustration shows what would be the relation between ground values and ground rents, if all the former were annually appropriated to public uses. An illustration already used in this chapter shows the relation between ground values and ground rents in present conditions. Each shows that while ground rent has an origin entirely distinct from that of economic interest and is independent of it, ground value is directly governed in all cases by the current rate of interest. The ground rent of a given land-form might remain the same, if a change were made from present conditions to a condition of the full socialization of ground values, and the current rate of interest might also remain the same. But assuming the ground rent to be \$105, and the current rate of interest to be 5 per cent, the ground value of such a land-form would decrease from about \$2,100 to about \$100. In each case the ground value represents a sum of money which, put at interest at the current rate, yields the economic equivalent of the net ground rent.

A man having a certain sum of money for investment, either in present conditions or in conditions attending the complete socialization of ground values (land tenure otherwise remaining substantially the same), has a choice of putting it at interest or investing it in land-forms. In case the latter investment is chosen he collects all the ground rent, and whether he keeps it substantially all, as in present conditions, or turns substantially 95 per cent of it over to the State in payment of taxes, he receives the cur-

rent rate of interest on his investment and, as a rule, nothing more. If investments in land-forms yield more than the return to capital-forms at the current rate of interest, money is withdrawn from other forms of investment until the equilibrium of current returns is restored, and *vice versa*.

From these illustrations it appears that in so far as ground rent is equivalent only to the current return of money put at interest it is not, strictly speaking, a differential value. Above this return it is distinctively a differential value and manifests itself in the form of ground value whether it is absorbed by the State or is allowed to accumulate to a given number of years' purchase in private hands. We are now prepared to define ground value, not quantitatively but qualitatively.

**Ground Value** is differential ground rent, capitalized at the current rate of interest.

The absorption of all ground rent into the public treasury by means of taxation simply involves the socialization of all differential ground rents.

The fact that ground rent is capitalized in form does not convert it into capital. It simply gives it one of the characteristics of capital in its outward appearance; fundamentally they are as distinct as before.