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1939

The Incidence of a General Output or a General Sales Tax

IT IS generally recognized by students of taxation that a tax on the output of a particular commodity raises the price of such a commodity by decreasing its supply. But what if there is a tax on the production of all commodities and services – an equal proportionate tax on all lines of production? Will such a tax raise prices? Clearly it cannot make any particular kind of commodity, such as cigarettes, relatively scarce by driving producers of it into other lines, for other lines of production are then equally taxed, and there is no advantage in leaving one taxed line for another line which is taxed to the same extent. Where, then, does the burden of the tax rest?

A good many persons too readily conclude that such a general tax must raise all prices. But there are important considerations which such persons overlook. Such a general tax cannot reduce the output of goods unless workers are willing to remain idle – for there is no untaxed line to go into – or unless owners of capital or land are willing to let their capital or land lie idle and to receive no income at all from it. Surely, most men would, in time, accept wages very considerably lower rather than be chronically idle, and most owners of capital would rather have very greatly reduced returns on their capital rather than let their capital depreciate unused and get no returns at all. Similarly, landowners – other than vacant-land speculators (and we need hardly conclude that a general output tax, apart from any incident reduction in land-value taxes,

would increase the number of these) – would presumably rather receive lower rent than no rent.’ We cannot expect, therefore, that a general tax on output would cause permanent cessation of production or that it would, as a long-run phenomenon, bring any appreciable decrease. Why suppose, then, that it could, in the long run, make prices higher?

An increase in the volume of circulating medium, whether it be through the issue of additional money or an expansion of bank credit, tends definitely toward a higher range of prices. But there is certainly no obvious connection between a general tax on the output of goods and an increase of the volume of circulating medium. There is, therefore, no basis in monetary theory for supposing that a general tax on all goods will make average prices permanently higher. To raise the general level of prices there must be either a decrease of supply of goods in general or an increase of demand (as through an increased volume of money). If a tax on the output of all goods neither decreases supply nor increases demand, on what basis is it to be argued that such a tax will raise prices?

If a tax on all goods does not raise prices, it must lower the money incomes of (the number of dollars received by) workers, capitalists, and landowners. We shall begin with the workers. Here, let us say, is a coal-mine worker who is able to add to the output of a given mine one ton of coal a day. The cost is worth, at the mine mouth, $2.00 a ton. At a wage of $2.00 a day, this worker is barely worth hiring. Now, suppose there is an output tax of 10 per cent. When the coal is produced and sold, 20 cents must be paid as a tax to the government. That leaves only $1.80. The coal-mine worker whose labor adds this ton to the total output is no longer worth a maximum of $2.00 to the employing company but only a maximum of $1.80. For, if the company can sell this coal for no more than $2.00 and must pay 20 cents of this to the government, the ton of coal is worth, to the company, not over $1.80, and it cannot afford to hire the mine worker at any greater wage than $1.80. So far as the community is concerned, the worker’s marginal productivity is $2.00. But, since the government takes 10 per cent of this, his marginal productivity is, to the employing company, only $1.80. If he wants to work, he cannot expect greater wages than his work is worth to the employing company. Nor, as we have seen, can the price of coal be permanently raised, for a similar tax is applied in every other industry and there is consequently no escape from the tax

'Of course vacant-land speculators, like other human beings, commonly prefer something to nothing. The circumstances which nevertheless make them hold their land unused, for a time receiving no rent, are set forth, at least partially, in my book on *The Economic Basis of Tax Reform* (Columbia, Mo.: Lucas Bros., 1932), pp. 268-74.

by changing to some other line. Thus, such a tax on the output of all commodities and services necessarily reduces wages.

Let us follow out one more illustration. A farm worker adds to the output of wheat 400 bushels a year. This is a "marginal" addition, what the worker can do on no-rent land or as the "final" worker hired on a piece of high-grade land (intensive margin). At a price of $1.00 per bushel, this comes to $400. But if government, by an output tax, takes $40 of the price, the farm worker cannot possibly be worth, to an employer (or to himself, if he is self-employed), $400, but only $360. If the 10 per cent tax is levied at each stage of production and there are several stages (e.g., wheat, flour, bread, retail distribution), we must, to avoid having duplication of taxation, levy the tax at each stage only on the addition of value made to the product at that stage. Or the tax might be levied at the very last stage (retail sales), in which case it will be reflected back through the various stages to the recipients of the various kinds of income, as will be shown, with due qualification, in succeeding paragraphs.

Such a tax on all output will reduce the income of the capitalist and of the landowner in the same proportion that it reduces the income of the worker,[2] but not in any greater proportion. And since wages are a much larger part of the total product of industry than is either interest on capital or rent of land, a general output tax takes more from the wages of labor than it takes from interest or rent.

Let us now see just how a general output tax reduces the return received by owners of capital. Suppose that a farmer believes that an investment of $1,000 in fertilizing or otherwise improving his farm will add to the output which his labor can bring, every year, by some sixty bushels or $60 (in excess of an allowance for depreciation). He could then afford to pay not over $60 annual interest, or 6 per cent, for a $1,000 loan. But if a general output tax takes $6.00 of the $60, the improvement adds only $54 to that value of the output which the farmer will have after paying the tax, and he would be losing money to pay more than 5.4 per cent interest. Were the lender himself to invest his savings in production under his own direction, the tax would take an equal per cent of the output; hence, he might as well lend to someone else for a lower rate than before. And necessarily, under these conditions, the demand for loans will decline until lenders are receiving 10 per cent

[2] See my book, *The Economic Basis of Tax Reform* (Columbia, Mo.: Lucas Bros., 1932), pp.

128- 29.

lower interest than previously, just as wage earners must receive 10 per cent lower wages than before. (The part of the output required to offset capital depreciation is, of course, "imputable" to the labor and other factors used in constructing the capital, and the proportionate tax on that part of the output is shifted back upon these factors.)

It is the same in regard to the rent of land. Suppose, for example, that a coal-mine operator could afford to pay $10,000 a year, as royalty, for permission to exploit a given coal mine, the coal being worth $2.00 a ton. Is it not obvious that, if the coal output is taxed 10 per cent, so that the operator receives, in effect, only $1.80 per ton, he cannot afford to pay as high a royalty? And is it not also clear that, since no other would-be operator can afford to pay as high a royalty as before, the possible competition of operators will be reduced and royalties must fall?

Or let us suppose the case of a farmer who has too little land to employ his labor most effectively. By hiring a neighboring piece of land he can, we may suppose, add fifty bushels a year to his output of wheat, without working any harder or longer than before. Obviously, he could afford to pay not over fifty bushels a year as rent for the use of this extra piece of land, or, with wheat at $1.00 a bushel, not over $50. But if an output tax takes $5.00 of the $50, he cannot afford to pay over $45. Clearly, the net rent received by the landowner must be reduced.

If, then, there is a general tax on output, the money incomes received by laborers, capitalists, and landowners must all be reduced. Since, of the prices paid for goods, a part (in our illustration 10 per cent) is taken by government, only the remainder can go as wages, interest, and rent for the factors of production. The incidence of a general output tax is, then, in practical effect, the same as if it raised all prices (as most of the public seems to suppose it does) without either decreasing or increasing money incomes. For in either case there is a subtraction, proportioned to the tax, from the real incomes of wage receivers, interest receivers, and recipients of land rent. Whether commodity prices remain the same and money incomes fall or commodity prices rise and money incomes remain unchanged, the distribution of the tax burden would appear to be identical.

A general tax on output will easily commend itself to those persons who believe that taxes should rest on everybody in about equal proportion to their respective incomes or spendings, however small these may

be, and *with no distinction as to sources* of income or as to kinds of property owned.[3]

The general output tax with which a majority of us are now most familiar is the general retail sales tax. In the American states where this tax has been adopted, it does not really apply to all retail transactions. There are various exceptions to its generality, depending on the jurisdiction, e.g., newspapers, haircuts, laundry and cleaning service, shelter, foods. But in many of the states, retail food sales are taxed the same as any other sales. In so far as the retail sales tax, as above indicated, is not all-inclusive, but bears on some lines of production and exempts others, it tends to make some prices higher than others. But since this tax, in several of the states, is so nearly a general tax, we shall, for purposes of the present analysis, assume it to apply in all lines equally.

Nevertheless, no purely retail sales tax which is not at the same time ubiquitous can apply to the entire output of goods even in a single county or state (or country), if those who live within the given territory are engaged in trade with outsiders. And, therefore, a retail sales tax, levied on all retail sales in a given state but not levied ubiquitously, will raise retail prices in that state.

Let us consider, for example, the 3 per cent general retail sales tax in Michigan, assuming, for the present, no sales taxes in surrounding states. This means that goods on which a 3 per cent retail sales tax will be levied, if they are sold to Michigan consumers, can escape the tax if they are exported to other states. If the tax applied equally on exported goods, then the factors of production, labor, capital, and land, would have to accept lower money incomes. The money returns for wages, interest, and rent would be appreciably reduced. But since exported goods escape the tax, this result does not follow. Producers of goods face no tax – even on retailers whose demand for their goods might thus be reduced – if they ship their goods outside of the state. And they will obviously accept no lower net prices from dealers inside the state than from dealers outside. Retailers in Michigan must pay approximately as high prices for Michigan produced goods which have a ready out-of-state market as if there were no Michigan retail sales tax. And since the returns to labor, capital, and land used in retailing can hardly be kept at a permanently lower level in relation to returns in wholesaling, manufacturing, etc., than before, the prices paid for goods by Michigan consumers must presumably rise.

The reasons why I cannot subscribe to any such belief but consider it essential to distinguish between sources of income and, therefore, between kinds of property, I have set forth at length in *The Economic Basis of Tax Reform* (Columbia, Mo.: Lucas Bros., 1932).

But can we have, in Michigan, wages, interest, and rent as high as before, producers’ prices as high as before, wholesale prices as high as before, retail prices actually higher than before, and a sales tax going to the state government, while the volume of circulating medium in Michigan has not increased? The answer is that the volume of circulating medium in Michigan, under the assumed conditions, will increase. For, since the tax applies on sales in Michigan and not on sales made out of state, and since, at the start, the money incomes of residents of Michigan are not greater than before, they simply cannot buy as many goods as before if retail prices are higher. Yet retail prices must be higher unless producers sell goods to Michigan retailers for less than before, since otherwise the retailers' incomes would be relatively too low. (If this is not at once obvious in the case of a 3 per cent sales tax, it certainly would be so if the tax were, say, 10 or 15 per cent.) And producers surely will not absorb the entire tax, or even any appreciable part of the tax, so long as they can avoid the tax by selling goods outside of the state. Looking at the matter, then, from any reasonable point of view, we must conclude that out-of-state sales will be relatively favored until the resulting increase of circulating medium within the state makes possible wages, interest, rents, producers' and manufacturers' prices, and wholesale prices approximately as high, in relation to the corresponding incomes and prices in surrounding states, as before, and retail prices higher by the amount of the tax. It is to be noted, of course, that the inOow of circulating medium from other states into Michigan will lower, but only to the slightest extent – since we are assuming these other states to be without general sales taxes and since only a little money would flow into Michigan from any one of them – the general price level in these states.

So far as concerns a general retail sales tax levied by a single state or by a very few states, our conclusion is that such a tax would raise retail prices in such a state or states by approximately the amount of the tax. The view of the man in the street that such a tax raises the prices of goods in general is, to this extent, confirmed.

There is another important qualification which ought to be noted here. Even if a retail sales tax is levied ubiquitously and at the same rate, there would still be some rise of retail prices. In the absence of friction (of which account is taken at a later point in this discussion), there would be an immediate adjustment of relative prices but no change in the general price level. Since the tax is levied at the point of retail sales, a wedge is driven, so to speak, between retail and wholesale

prices. Wholesale prices, producers' prices, wages, interest, and rent – all these are slightly lowered. Retail prices are raised and exceed wholesale prices more than before by the amount of the tax.

Instead of saying "Retail prices are raised and exceed wholesale prices more than before by the amount of the tax," I should have said:

"Retail prices are raised and exceed wholesale prices more than before by the amount of the tax *minus the slight reduction in the wages, interest, and rent received from retailing."* For, since the tax lowers somewhat, in money terms, wages, interest, and rent generally, we must suppose that the wages, interest, and rent received from retail operations will go down proportionally. That is, we must suppose this *on the assumption of a relatively frictionless society in which the levy of the sales tax is followed almost at once by the re-establishment of perfect equilibrium.* To anyone who may criticize such an assumption as unrealistic, I would reply that *the existence of friction* is *specifically allowed for and some of its consequences pointed out* in later paragraphs of my paper.

The later sentences of the paragraph here being amended ought to be as follows:

The decrease in the money incomes of workers, capitalists, and landowners is so balanced by the new tax receipts of the government that the total of the money incomes of individuals and government will buy as much as the incomes of individuals (and any previous government income) would formerly buy. Individually, the people have less money to spend. Collectively – through the sales-tax receipts, to be spent by the government – they have more to spend.
The average of manufacturers' and other producers' prices, wholesale prices, retail prices, individual money incomes in the form of wages, interest, and rent, and government income remains unchanged, but manufacturers' and other producers' and wholesale prices are lower while retail prices are higher.

The reason for rephrasing is that the article, as first printed, gives the impression that the total of individual wages, interest, and rent, plus the new tax receipts of government, are precisely equal in money terms to the total of individual wages, interest, and rent prior to the tax; while retail prices are higher. This means that if the total of the incomes of individuals and government before the tax would just suffice to buy the annual output of goods at retail, after the tax these incomes would not suffice. Of course, a great many government purchases may be at wholesale and, therefore, at somewhat lower prices than before and, even if government purchases at retail, it may buy at a price not including the tax. Nevertheless, the statement should be so formulated as to allow for the possibility that the income of government consequent on the tax may be increased, in terms of money, more than wages, interest, and rent to individuals are decreased. This is quite consistent with an unchanged general price level, since wholesale prices, manufacturers' prices, and raw-material prices are all somewhat reduced.

In order that the long footnote on this page may be entirely consistent with the above correction, the next to the last sentence should be amended to read as follows: "But the essential point I am trying to stress now is that average prices (counting producers', wholesale, and retail prices and also individually received wages, interest, and rent and the governmentally received tax money) as actually charged and paid in the markets, are not made either higher or lower by output or sales taxes, and that the average is, therefore, the same regardless of where the 'wedge' is driven."

Some critics may still complain that the collecting of the tax is itself, in a sense, an addition to the total of transactions and that, conceivably, it may thereby slightly delay the spending of money directly for goods, thus modifying – but hardly more than infinitesimally – the conclusions.

If the tax were levied at some earlier stage in production, instead of on retail sales, then we could speak of the "wedge" as being driven between prices at this earlier stage, the prices preceding this stage being lowered and those succeeding it being raised. But the average of all prices would still not be affected.[4]

[4] If the tax is thus levied at an earlier stage, i.e., the "wedge" driven at an earlier stage, fewer prices are, of course, reduced by the tax and more prices are raised by it. Therefore, if the average commodity price level is to be the same, those relatively few prices which are reduced must be reduced to a greater degree, and the larger number which are raised must be only slightly raised. Perhaps one way of putting the matter – though I suspect it is a way that to most persons will be more confusing than illuminating – is to say that when the "wedge" is driven at an earlier stage, the "tax addition" (if we may so speak) to the price which the buyer at retail pays must also be paid by the retailer to the wholesaler, and so on, to the point of government collection. In a sense we may then say that the tax money paid by purchasers at retail goes through several hands on its way to government and that, therefore, this tax money is, during the period of such passing, prevented from acting on "net" prices (in the sense of prices minus tax) as quickly as if it did not pass through so many stages. Thus, "net" commodity prices (in this special sense of prices minus tax) will average lower than if the tax were collected at the point of retail sale. This was probably (or so I hope!) one of the ideas I had vaguely in mind in writing "Some Frequently Neglected Factors in the Incidence of Taxation" *(Journal of Political Economy,* Vol. XXVIII, No. 6 Uune, 1920]), although enough in that article is definitely fallacious so that I am sure I could not then have really thought the problem through or fully understood it. But the essential point I am trying to stress now is that average prices (counting producers', wholesale, and retail prices) actually charged in the markets are not made either higher or lower by output or sales taxes, and that the average is, therefore, the same regardless of where the "wedge" is driven. And I want to take this opportunity to disavow anything in the earlier article here referred to which is inconsistent with the present treatment.

If a tax were levied at each stage of production, but only at a proportionate rate on the value added at that stage, then no commodity prices, whether producers' prices, wholesale dealers' prices, or retail prices, would be changed at all; but all money incomes received by individuals – wages, interest, and rent – would be lowered; and the money income received by the government for collective spending would be raised by an equivalent amount.[5] (This is on the assumption that this tax is not a substitute for other previously levied taxes but is to provide new revenue.) Such a tax really would be a "proportional" income tax "collected at source" and having "no exemptions."

Returning, now, to the general fact that retail sales taxes levied in one state, or only a few states, make retail prices higher by the amount of the tax than in areas where such a tax is not levied, we may take note of a qualification hitherto not commented on. Persons living in a state where a retail sales tax is levied, but near the borders of a state or states where there is no such tax, may do a considerable amount of shopping in such a near-by state or states. Conceivably, some retail establishments in towns near the borders of the state levying no sales tax could keep down their prices a bit, to avoid losing trade, perhaps paying less to some employees who would nevertheless continue to clerk for them because of immobility and lack of acceptable alternatives, and less as rentals for stores and sites having no equally good alternative use. But it is doubtful if this would occur to any noticeable extent, and the probability is that only those consumers would avoid the tax in any appreciable degree who really did shop beyond the state borders.

In most of the previous discussion we have been assuming absence of friction and, therefore, immediate adjustment of relative prices (including incomes) to the tax levy. Especially has no attention been paid to the theory of “sticky” prices, e.g., “sticky” wages and rentals. But when attention is paid to this theory, it is seen that the rapid and general introduction of sales taxes, though perhaps brought about, in part, by certain consequences and ideologies resulting from depression, itself tends to produce depression.

We have seen that a general and ubiquitous sales tax cannot, as a normal, long-run proposition, increase the general level of commodity prices. But now we may note that any general attempt to increase commodity prices when there is no increase in purchasing power must

Of course, less individual spending and more collective spending might change the relative demands for and marginal cost of various kinds of goods and so have some effect on their relative prices.

tend to a decrease of sales and to dull business.

But if commodity prices are not increased, then, as we have seen, money wages, interest, and rent must fall. And if these (wages, interest, and rent) are “sticky” and so cannot be quickly adjusted, then there must obviously ensue a period of unemployment and generally dull business. The rapid introduction of sales tax certainly tends to bring business depression and, if depression already exists, the introduction of such taxes must, it would seem, tend to retard recovery and to make the depression worse. (In a similar way, if wages are “sticky,” the rapid introduction and increase of pay-roll taxes to provide for unemployment-insurance and old age benefits must operate in the direction of unemployment.[6])

So here we are apparently treated to another of the various contradictions of this remarkable New Deal era. Depression has made more vocal and persistent the demands of real estate owners for “tax relief for real estate.” Depression has increased the need for funds to care for the jobless. Depression has, therefore, promoted the spread of sales taxes. Yet, if the analysis presented above is, in any essential degree, correct, the spread of such taxes has also fostered depression, has put more workers out of jobs and added to pressure for more sales taxes to care for the increased number of unemployed, and has, by virtue of the consequent heavier taxes on the poor, brought nearer to the level of “reliefers” – perhaps not infrequently below the level – not a few of those who have continued to have comparatively steady employment. As the government, under the N.R.A., to a considerable extent offset its borrowing and spending recovery program directed to the increase of purchasing power by encouraging monopolistic price rises, and as it adopted a farm-aid program which put many tenants (expecially in the South) out of employment, so it has followed a tax policy for the relief (partly) of those injured by the depression, which, itself, must have tended to cause and accentuate depression.

6 While taxes on output result in reduced wages and interest and rent, the incidence of pay-roll accident, is on wages. The subject of accident insurance I discussed in this connection in an article in the *Journal of Political Economy,* Vol. XXX, No. 1 (February, 1922), entitled “The Incidence of Compulsory Insurance of Workmen”; and this discussion was later republished as chap. vi of *The Economics of Taxation.* For a clear presentation of the theory of incidence as it relates to the new program of social security, with some reference to minor qualifying influences, see Russell S. Bauder, “Probable Incidence of Social Security Taxes,” *American Economic Review,* Vol. XXVI, No. 3 (September, 1936).

3

1941

Economic Rent:
In What Sense a Surplus?

SUDENTS OF economics have long been handicapped by the act that many of its terms are used, by various economists, in widely different senses. Even when a term seems to have acquired a clear and definite and generally accepted meaning in the craft of the economists, there is no guarantee that innovators will not adopt a new meaning for it and be extensively imitated.

It has been so with the word “rent” which, to the classical economists, meant rent of land but which, about the turn of the century, began to be applied to the yield of produced capital. As the then “modern” and “up-to-date” economists of about the year 1900 began to blur the distinction between land and produced capital and between the income from the one and from the other, and to follow the man in the street in using the term “rent” for both, it was still possible for those of us of a different point of view to make ourselves clear by referring to “economic rent.” By using the modifying word “economic,” we could still make clear that we were referring to the yield of land as such, *i.e.,* of land in the strict economic sense, exclusive of improvements made by an owner or tenant *in* it as well as *on* it.

But now it begins to look as if even this privilege is to be denied us and as if once more the very terms by which we have tried to emphasize a distinction we have considered important are to be appropriated and turned to other purposes by economists who have no sympathy with us. Indicative of this apparent trend is the recent book by

Professor Kenneth E. Boulding of Colgate University, entitled *Economic Analysis.*[1] To Professor Boulding, economic rent is not just the yield of land ownership – indeed, he seems to feel that much of this yield is not even to be included in it – but rather is “any payment to a unit of a factor of production in an industry in equilibrium, which is in excess of the minimum amount necessary to keep that factor *in its present occupation.*”[2]

Professor Boulding makes it very clear that he regards wages as, in part, economic rent. Many workers would stay in the *particular line* of work they are in, even at appreciably lower wages than they now receive, and the excess over the amount necessary to keep them in that particular line is economic rent. Boulding illustrates by reference to the occupation of weaving, in which, at $20 a week, he supposes 1,000 willing to work, each extra dollar per week increasing by 100 the number of men “willing to work at weaving.”[3] And, according to Professor Boulding: “The higher the wage, the greater will be the economic rent received by all those workers who would be willing to work at a lower wage, and the greater will be the economic rent received by all workers.”[4]

On the basis of such a presentation, a very large part of the rent of land would definitely *not* be “economic rent.” And so the expression “economic rent” comes clearly to *exclude* a large part of what, originally, it was specifically chosen to mean! For whenever a piece of land can be used almost equally well to produce two or three different kinds of goods, any appreciably lower yield from that land in one use than in the other or others would cause the land to be withdrawn from such use. And so the owner of a piece of land in a centrally located business block of a large city who derives (say) $20,000 a year on the land from a tenant who uses it for a particular kind of merchandising, but who could derive $19,900 a year if the land were used for another kind of merchandising or for banking and finance, does not really have $20,000 of economic rent but only $100!

Any part of the price of a commodity which is necessary to keep the worker *or* the capital *or* the land in the business of producing *that particular commodity* for sale is *not* economic rent in the view of Professor Boulding.[5]

New York, Harper, 1941.

2 *Economic Analysis,* p. 229. The italics are mine.

3 *Ilñd.,* p. 230.

“*Loc. cit.*

~ *Op. cit.,* p. 232.

Yet on a later page of his book the author *includes* in "economic rent" a considerable part of what he has previously *excluded.* For on this later page he defines economic rent as "any payment to the owner of a factor of production in excess of what is required to keep that factor *in continuous service."*[6] Here he does *not* say "in its present occupation." And the context is consistent with the new definition. For, advising that the legislator should "wherever possible, attack economic rent,"[7] and expressing the opinion that "a properly constructed income tax falls to a very large extent on economic rents,"[8] he immediately goes on to say:[9] "In so far as it applies to all occupations it does not affect *relative* profitabilities, and so cannot be escaped by shifting occupation." By fairly clear implication, then, as well as by his second formal definition, it would seem that Professor Boulding considers that part of a taxpayer's income which can be thus successfully taxed away from him to be economic rent.

Perhaps we should not be unduly critical of a careless slip into an inconsistent taxonomy. But it does seem unfortunate that the expression "economic rent" is now coming to be twisted, by some writers, out of all semblance to the meaning which has usually been given to it. Does not this inevitably tend to confuse students of economics? And does it not tend to turn their attention away from the problem of who should enjoy the rent of land?

When "economic rent" is taken to mean the rent of land exclusive of individually made improvements in or on the land, it is natural to ponder the question how such rent differs from income produced by work or income attributable ("imputable") to constructed capital. A considerable number of students of economics have come to the opinion that the rent of land (so understood) is properly to be regarded – with only insignificant qualifications – as an *unearned* income, an income not received in return for any service given to those from whom it is drawn. The wages of labor, on the other hand – although it is to be recognized that some labor is devoted to anti-social ends – and the yield on constructed capital are, in general, *earned* by equivalent service given.

But now we have our attention turned away from the contemplation of such distinctions as this into the question whether it would not be possible for the state to take a large part of the earnings of labor with

6 *Ibid.,* p. 787. The italics are mine.

Lot. cit.

Lot. cit.

Lot. cit.

out thereby causing the workers to cease working. We no longer are urged to inqure – certainly such writers as Professor Boulding do not urge this – whether it is socially desirable that incomes enjoyed by the citizens of a country shall have any close relation to their productive contributions. Instead, the question is how much can we squeeze out of them, even of what they fairly earn, while yet not causing their labors – or their savings – to cease (wholly or in large part). What if a large group of men are completely enslaved, either by individual masters or by government, and so are forced to work by the lash or the knout? Is *everything they produce beyond enough to maintain their ability to work* to be regarded as "economic rent"?

One wonders if this recent concept of "economic rent" is in some sense – though, of course, not consciously – part of the current swing toward social control, toward regimentation, toward totalitarianism.

Is the expression "economic rent" now to do duty for every sense in which we may say that there is a "surplus"? If so, what can the economist who believes the distinction between income from land ownership and other income to be important do about the matter? Will he, for long, be permitted the use *of any* term to express his meaning?

4

1942

Fiscal Policy and Wartime Price Control

IN A SYSTEM OF FREE enterp rise and free markets, the fundamental forces determining the relation of the price of one commodity to that of another are the forces of demand and cost. The average of all prices – what we often speak of as the general level of prices – is largely a function of the volume of the circulating medium and the readiness of the people to spend it. A large increase in the circulating medium in proportion to available goods usually and, indeed, almost inevitably, raises the average of commodity and other prices, while a great proportionate decrease – e.g., from a sharp restriction of bank credit – brings the average of prices down.

The circulating medium includes, as its largest element, bank deposits on which checks are written. These deposits subject to check are increased when banks lend freely and also when banks purchase commercial drafts, mortgages or government bonds. When banks make such purchases, of course, they give checks and, therefore, bank deposit accounts for the paper or securities involved. So, when a government finances its war expenditures largely by borrowing from the banks, selling to the banks its own bonds or short term promissory notes and thereby obtaining checking accounts to use for paying for material for its military and naval needs, there is, ordinarily, an increase of the circulating medium, increased spending by the government and by those from whom the government purchases its supplies and by the workers they hire. Almost inevitably there is a bidding for goods and services all along the line and, in consequence, a general rise of prices.