The Complicated Concept of Rent

We all know what Rent is.

It's something paid by a tenant to his landlord. However, that answer conceals more than it reveals.

The central tenet of Georgist doctrine, if I may state it in that way, is that tenants unfairly pay an unearned Rent to landlords. So, it would be just to collect this Rent and return it to the people. A bonus would be that this collected Rent could take the place of taxes. We could live in a tax free society!

Except perhaps in the Henry George Schools, the economic and environmental effects of collecting Rent appear to come in as an afterthought. Georgists now appear to stress the revenue aspects of collecting Rent.

So, how much revenue would there be? Very large amounts would be collected according to Georgist statisticians including hypotheses that Rent collection could pay all federal taxes. Verily, this is a true single tax that would possess none of the problems encountered by other taxes.

Perhaps we should take a step back and examine Rent a little more closely than we usually do.

Ricardian Rent

We teach Ricardian Rent in the Henry George Schools. We use an island with different degrees of fertility and show what happens when the island fills up with people. The most fertile land is occupied first followed by the other fertilities until all land on which laborers can survive is filled. The difference between the productivity of the better lands and marginal land (land on which Labor can barely survive) is Rent.

(For decades, I have immediately repeated this model, but this time I had Ted Gwartney and his family arriving first on the empty island. Once the crops were planted, Ted immediately got his sons to work fencing in all the better land leaving subsistence level land for the second family to arrive. I like to bring reality to our models.)

Important to note is that using farmland removes fertility. After use, there is less fertility (and less Rent?) than before. One must allow the land to stay fallow and underused, or import fertilizer to replace the lost fertility and replace the Rent!

One can see a parallel between farmland which is using up its fertility and a goldmine which loses value as the ore is extracted. In both cases, usage diminishes its value.

Mineral "Rents"

Georgists are likely to equate the value of gold, other minerals, and oil, with Rent. The important characteristic of Ricardian Rent is that it is a differential — the difference between one value and another. This does not apply to gold and oil and suchlike, so using Rent to describe these gifts of nature is a little off-key. Of course, differential Rent could apply to a gold mine — a goldmine next to the bank vault would be a better location than the goldmine perched on a mountain top hundred miles away and Rent would be involved. But this Rent would have nothing to do with the contents of the mine.

Gold, oil, other minerals, in their natural state have no connection with Rent. Yet we are inclined to regard these as "rents" belonging to the people.

Urban Location Rents

Then, there are the most important Rents — the values that attach to urban locations. Such Rents soar into the stratosphere in central city locations and are perhaps the principal grist to our mills. We spend a lot of time on urban Rents, but somehow we have lost our way. Rent is assumed to be something paid by a tenant to a landholder. The term would be better applied to the values of the urban locations.

Commercial Rents

Let us start with the downtown commercial areas. Values in the High Street depend on the presence, access, and economic well-being of the surrounding community. It should be noted that a good infrastructure improves access for the surrounding community and therefore has a direct connection with Rent.

The value that attaches to a location will be there whether or not it is collected and whether or not it is collected by a private land owner or by the community. This value is market determined, which assumes the market is working — a large assumption as we shall see.

Rent — the value that attaches to a location — is community created. It is the result of people gathering together into a village, town, or city. It is not deliberately produced by the community; it is a consequence of community. This adds strength to the contention that Rent should be collected for public purposes. If Rent is a result of people in community, its collection for community purposes seems a valid and just response.

Residential Rents

Rent also exists in non-commercial areas, where people reside. There are good reasons, both personal and economic, for people to live with other people. This will affect Rent. When enough people live in an area, Rents rise to a point where it becomes possible for a supermarket or restaurant to thrive, and perhaps a cinema or bowling alley.

A point should be made that improvements follow Rent rather than the reverse. One cannot economically provide a shopping mall or an apartment block unless there are people to fill them. There is a mistaken notion that Rent increases because an improvement has been built. This is just not so. It may be that entrepreneurs may jump the gun and build in the expectation that Rents are going to increase, or that they may build in error, but normally improvements are erected when Rents allow them to be profitable. Improvements follow Rent.

So, we can define an urban Rent. It is a differential indicating how much more a site is worth to production than marginal land - that is land that can be obtained rent-free..

"Urban Rent is a price mechanism determined value (a free market determined value) created by the presence and access of the community, which value attaches to a location."

Land – the Natural Monopoly

But, it is not that easy.

Land locations are a natural monopoly. Each location is unique. When entrepreneurs look for a location, they may end up with a location that is "almost as good" or "about the same" but they know full well the location they would prefer to have. In similar fashion, a homeowner may find a location a mile away from a supermarket or school, but he would prefer perhaps to be across the road from the supermarket or school. (He might also prefer to be 5 miles away, but in any event he is probably well aware of the pluses and minuses of any location before he settles.)

This competition for best, or better, locations forces up location Rents and also their capitalized sales prices. One should understand the action of the price mechanism — the operation of supply and demand. When market demand forces up the price of goods from their equilibrium, factories make more goods and then rush them to market. The influx of goods satisfies demand and drops the price back to equilibrium.

Unfortunately, locations can neither be produced, nor can they be moved. When the market heats up, Rents rise along with their corresponding sales prices. At this point, the price at the market is far higher than "a value created by the community". If land were a relatively unimportant good, the increase in price, far above the community created value, would perhaps not matter too much. But, land is a primary Factor of Production, part of every action that Labor undertakes. The Rent, or price, of land is of major importance in production.

The soaring cost of land — much above its community created location value — has significant economic consequence. There is nothing to stop this increase until it reaches a point where production stops. At this point Labor cannot afford to use land, for not enough is left to keep him fed after payment of Rent. As Henry George said, any higher exaction would lead to a "cessation of life".

Rack-Rent

Georgists have fallen into the habit of calling this monopoly exaction 'Rent'. This is a grievous error for it has little to do with the "value provided by the community". It needs another name and I call it rack-rent.

It is understandable that if one uses Rent not as a value that attaches to a location but as something paid by a tenant to a landholder, then a rack-rent may be considered to be Rent. This is how it is often used by Georgists. Yet, they will follow it up by pointing out that a heavy tax on this "Rent" will flood the land market with locations that speculators can no longer afford to hold. In this way, the free market would return and people would pay a price mechanism determined Rent equal to the value provided to a location by the community.

So, what do we call the monopoly Rents that exist today? I have suggested rack-rents, but perhaps some other label will be preferred. Just let us not call them Rents.

Georgist statisticians do not use Rent to calculate their aggregates — they use rack-rents. This leads to the enormous Rent totals that are repeatedly touted by our friends. I suggest that actual Rent is far less than the 20%, 30%, or 40%, of the federal budget that is often asserted. I would argue that urban Rents will pay for little more than the infrastructure of the city.

Assuming a change to Rent collection today, modern infrastructures will probably need all the Rent they can get to maintain and repair the results of perhaps decades of neglect. One can imagine that when a city is back in good shape, there would be a surplus — perhaps enough to hand back a dividend to people in the community. But a lot of work will need to be done in any present city that comes to mind.

Land As a Collectible

The relationship of a landholder to his land bears a strong resemblance to the relationship of the collector to his collectible. The collector is not interested in the income of his collectible — only in its sales price. He holds his collectible because he expects the price to rise. Therefore, the value of the collectible to him is always greater than the present sales price. He will not use the collectible in any fashion that might diminish his anticipated future return.

In similar fashion, a landholder will expect his land continually to rise in value. With an advancing economy, the value of land rises in parallel with increasing production, offering every inducement not to sell at the existing market price. As with other collectors, the value of his land is likely to be his anticipated future return — a reason not to sell but to hold.

Just as a book collector preserves his collection in mint condition to maintain the value, so does a land collector prefer not seriously to invest in improvements to his land. Any serious investment is likely to reduce the price he might eventually get. Additionally, a serious investment would not be recoverable. Better to leave the site alone - except if some costs - such as a rising property tax - become a nuisance.

Then a temporary structure could bring in enough revenue to pay it. Thus, the site receives some blacktop and becomes a parking lot. This interferes little with a prospective sale but achieves its function as a "taxpayer".

We rarely go into the psychology of land ownership, but it is relevant. There is a certain cachet attached to the ownership of land. When land is sold, along with it goes the cachet. Also, a land sale is a one-off deal. When a product maker makes his goods, he wants them quickly to move off the shelves so he can replace them. When land is sold, that's it. It seems reasonable not to rush to the market.

It may be that most land sales (other than by Real Estate professionals) are spurred by outside circumstance. A business reverse, educational financing for the kids, a complicated and serious operation, may lead to selling one's land. Otherwise, as has been indicated, why sell?

Sales Price of Land

It is assumed that the sales price of land is capitalized Rent, but as has been argued, this isn't so. Rather, it would be capitalized rack-rent. However, the collectible nature of land means that sales prices are higher than capitalized rack-rent. Thus, sales prices lose their connection with Rent and cannot be used to calculate it.

Yet, I fear they are.

Harry Pollard (June, 2010)