

~~Revised.~~

~~Most of same comments apply as before.~~

Final

Fragment 1

"Ground Rent in Distribution & Welfare Economics." Roughly annotated outline, January 5, 1961.

I. The concept of ground rent

A. The concept of "Ground"

1. Ground is the permanent quality of land, the location and extension (site), with that much of the natural foundation supplied by nature which is unalterable by economic man (i.e. requires only the negative contribution of his refraining from want on destruction. "Ground" vs. soil (which may be depleted in part by economic use.) Ground vs. mineral resources (which must be depleted by use). Timber, etc.

Once the essential meaning of the concept is grasped and its usefulness accepted, it can be applied to more exotic resources like airplanes, TV channels, or flowing water, with some violence to common usage but none to common sense.

2. Distinctive economic attributes of ground: natural origin; permanence; immobility in form and space (by will of man;) limited mobility in use (in contrast to metamorphosis of human products in their continuous cycle of reincarnation;) passivity; value exceptionally dependent on external influences; measure of and trap for localized benefits; etc.

One might choose to regard location as changeable in an economic sense when transportation changes, e.g. when a new highway lessens the economic distance between points. But this is covered by noting that, while the

physical ground is stationary, its value is exceptionally subject to external influences because the supply within any given perimeter cannot change in response to any change in demand, however great.

3. Elasticity of supply. Supply fixed in short run, by most definitions of short run, for the firm, the industry, and the economy. In the long run, supply for given use may be augmented by taking from other uses, (including no use,) but this is not increasing aggregate supply (unless in the special sense that improved allocation amounts to an increase of supply.) The aggregate supply in the long run may become more effective through improved transportation and technology and social organization. This is not in all respects the same as increasing the aggregate supply--e.g. it may take the form of displacing labor; and it occurs within a fixed perimeter--so it is preferable to conceive of the supply as fixed.

4. Substitution by other inputs. What is usually called substitution for ground is better described as using ground more intensively, e.g. by multi-storeys; smaller rooms; more fertilizer; more labor per acre. The fact that one can use ground more intensively is clearly no argument for denying any important distinctions between land and other inputs; and this conclusion is not changed by changing the wording to call this "substitution" of other inputs for ground.

B. The many usages of "rent."

1. Macro vs. micro (or transfer) rent. ("Ricardian" rent

as first expounded was a mixture of the two, hence an ambiguous concept.) Macro rent is the general term for the net income imputable to ground. The concept arose from the need to explain why payments should be made for that which is supplied free by nature, without human contribution. It has entailed the proposition that some lands are better than others and earn higher rents, and some writers have taken this as its essence, but it is a secondary aspect. In general ground rent arises because land is scarce relative to the demand, and would exist in this circumstance if all land were uniformly desirable in all particulars.

Micro or transfer rent is conceived by its expositors as the excess of the income of any input over its opportunity cost. However this is an indefinable concept. Expositors of the concept (cite Boulding & Samuelson) regard the best alternative employment as something arbitrarily remote and low-valued, e.g. Joe Di Maggio as a ditch-digger. Thus they define the larger part of income as "rent, and regard it as comparable to ground rent in that it represents no sacrifice by the individual but a surplus above what is necessary to make him work. But there is a whole range of closer "alternatives," and what is transfer rent and what is not depends entirely on which alternative we choose, until we have him playing for another team at an equal salary, or the same team at

a different position, and "rent" disappears altogether. Thus what is "transfer rent" depends entirely on an arbitrary decision in each case of what is an "alternative" employment, and is not a generally definable concept. It is surprising that it ever rose above the dignity of a debater's ruse.

2. Ground rent vs. human rent. Expositors of the human rent idea regard aggregate supply of labor as inelastic or perversely elastic, hence the larger part of labor income as surplus above what is necessary to cause the factor to be supplied, hence on the same footing with ground rent.

But that which expositors allege to be a supply curve of labor is rather an extremely long run historical supply response, over a period during which conditions changed--whereas a supply curve should be instantaneous. The alleged perverse elasticity is a result of the increasing value placed on leisure due to increased accumulation of assets over the period. It remains true that the response to higher wages today without assumption of their continuing in future, but just today--would be positive.

Further, labor sacrifices the alternative of leisure when it works. This is the opportunity cost of labor, regarded in the aggregate. And at the margin its value equals the marginal wage (aside from institutional barriers which are not at issue here,

being found in markets for land as well as labor.) This leisure, this opportunity cost of labor, is the primary goal of economic activity, in fact, and hardly to be overlooked. By contrast, the alternative of land is simply to rest idle, yielding no value to anyone. It is a bloodless philosophy indeed which would see here a parallel placing man in the same box with inanimate stones and dirt.

3. Ground rent vs. yields from human products regarded as rents.

Man has the alternative of consuming capital and refraining from creating more, which in a world of zero interest rates he certainly would. For if there were no constraint on borrowing, anyone could live by borrowing, and repay his loan, if ever required to, by borrowing elsewhere. There is no basis therefore for the idea that men would create or even maintain capital without positive interest returns. The ground, by contrast, originates independently of such incentives, and maintains itself the same.

4. Ground rents vs. sales of the corpus of the soil

Ground rent is an income. On the other hand, monies received for the sale of products which deplete the soil are payments for transfer of the soil fertility representing transfer of existing assets, not income. Only the land-imputable income net of depletion is properly income. National income analysis, as con-

ventionally practiced today, often neglects to make this deduction.

5. Ground rents vs. increments to land prices

Increments to land prices are incomes, like rents, but they are not rents. Rather, they are the present reflection of anticipated higher future rents (or lower yields on alternative investments.) There is no double counting, as sometimes alleged, in counting both the present increment and the future rent as incomes. For the increment is not consumed by receipt of the future rents, inasmuch as these continue in perpetuity.

National income analysis today generally fails to count price increments as income.

C. Imputation of rent.

1. Residual vs. direct imputation. They are equivalent - generally accepted point.
2. Average vs. marginal rent.

This distinction is important in comparing the efficiency of land use on holdings of different sizes. On optimal holdings, average and marginal rent are equal. On smaller holdings, with inadequate land to spread the cost of imperfectly divisible inputs, marginal rent exceeds average rent; on larger holdings, with too much land for management to handle adequately, average rent exceeds marginal rent. Thus as between a too-small and a too-large holding of equal average

rents, the small would have a higher marginal rent.

The point will be illustrated graphically.

3. Realized rent vs. latent potential rent

If rent be determined internally to the firm, whether by direct marginal productivity, or residually, it may fall below or above the opportunity cost rent, that is the highest marginal rent that might be earned by another use and/or user. This might be due to miscalculations of the individual, or to market barriers which keep the social cost (that is the opportunity cost) from being fully felt by the individual as a cost.

There has been a marked tendency to underestimate opportunity costs, as mentioned earlier, to the extent of considering most incomes as transfer rents. This is a vital part of the philosophy that monetary rewards can be severely cramped by progressive income taxation without distorting resource allocation. This is equivalent to asserting that ideal allocation of resources can be achieved and maintained, in this best of all possible worlds, without economic incentives. It is more nearly true, I would assert, that most transfer rents are negative, that is that the social opportunity costs of most resources exceed the returns they are currently earning, due to market barriers, which is to say to the weakness of economic incentives.

American property tax assessment is in theory,

and oftentimes in practice based on the latent potential of the land, rather than the rent actually imputed, and in this respect differs from England, the near East, and many other countries.

Many operations which make extensive use of valuable land, which appear to the layman as very profitable, and have been accepted in the same light by many economists, would show up very poorly if the full social opportunity cost of land were charged to them.

4. Imputation of rent over time

Distinguishing rent from income imputable to permanent improvements.

Imputation of variable income among durable inputs.

5. The tendency to dissemble rent

- a. In quality
- b. In quantity
- c. The difficulties posed for objective economic analysis

C. Summary: usage of "rent" recommended, and use in this chapter

II. The social functions of ground rent

A. Allocation of land to its highest use.

Conventional analysis--determination of use on lots of given size and shape, accepting private transportation costs as representing social transportation costs.

B. Rent as a constraint compelling economy of time in land use. Determining the timing of replacement of improvements. This might be viewed as the function of rent in allocating land between successive uses.

Subtopic: rate of turnover of inventories and customers
a means of using the 4th dimension to economize on scarce land.

- C. Rent is a constraint compelling economy of space.
1. Conventional analysis, which tends to accept lot sizes as they are, neglects this, at least in the field of urban land economics. The rent earned from a site should equal the costs imposed on others by their having to traverse it to reach the central market. Lots should be narrowed until this equilibrium is reached.
 2. The divergence of private from social transportation costs is a serious barrier to economical layout of economic activity. In congested streets the private cost is less than the social marginal cost, because the individual is not charged for his contribution to congestion, and widening streets encounters increasing costs because land is scarce. In intermediate areas, private costs exceed social marginal costs because of heavy reliance on gasoline taxes, because congestion has not reached the stage of being a serious cost, and because building roads is in the decreasing cost stage, so long as land is cheap. In very unsettled areas, social costs again exceed private costs but are born by outsiders; and long run marginal costs, which include costs of extending lines, are very high, because of the linear distance that must be added for each new use.

Until these conditions are corrected, rents, which reflect only privately felt transportation costs, will not be accurate constraints to promote optimal land use. Urban land is in general made too cheap by subsidized extension of transportation and utility lines, so that replacement of improvements (in slum areas) is too slow, and many lots are too large.

3. Rent as an important element in bringing increasing costs to scale. Neglect to impute rent as a cause of overestimating economics of scale.

Of individual firms, at peripheries and in the center

Of cities, at peripherie and in the center.

III. Public-private sharing in the distribution of rental income

A. Means of public sharing in rental income

There are many possible ways, of which perhaps some half-dozen are fairly common. The present discussion limits to a tax levied on the base of latent potential or opportunity cost rent, or the market land value derived therefrom. This method is chosen as being of the most general applicability in this country and most compatible with its institutions, as well as most defensible in terms of overall economic impact.

B. Arguments for private collection of rent

The functions of the rent collector: guiding the allocation of land; bearing the interest burden of holding title; using his leisure and financial surpluses to participate in politics; developing new lands, guided by the incentive of land prices.

C. Obstacles to the effective functioning of rent when privately collected

The disparity of individual and social costs of holding title; when the interest burden is the primary cost, due to unequal financial strength and credit worthiness of individuals.

*Revised in
fragment 2*

The narrow distribution of economic rent creates a political need to spread the benefits more widely, to broaden the base of political support by "compensating the losers." This often takes the form of governmental subsidy of public works serving and developing areas of cheap land. A common form is subsidizing extensions to transportation and utility lines, from revenues earned at the center of the system. Thus indirectly the private collection of rent is responsible for part of the disparity between social and individual transportation costs.

Such subsidized and uneconomically motivated extension of transportation lines is also intimately associated with instability in the land development process.

E. Arguments for public participation in rent collection

The social opportunity cost, as an implicit cost, is not always fully felt by the individual landholder. A tax based on latent potential rent is more directly felt, and, unlike, interest costs, is equal as among all individual (Graphic demonstration.)

The tax based on latent potential rent is a practicable device for achieving the goal of welfare economics to set prices equal to marginal costs. This goal requires a means to capture the consumer surplus gained by land advantageously placed in relation to public works, to meet the deficits occasioned by marginal cost pricing.

This may also be regarded as a means for compensating the losers by taxing the gains of the winners, thus achieving another of the goals of welfare economics. It is a direct

means of achieving the goal, without the need for building uneconomic public works to compensate (some of) the losers; and it compensates all the losers by general tax reductions. It could be used to offset the protests that would meet changes in transportation rates to equate private and social costs of transportation, and thus facilitate that reform also.

F. New problems arising from public collections of economic rent

Need for sophisticated assessors.

Transfer of risk from public to private (since present taxes vary with income, while an unpopular feature of ad valorem taxes is their fixity.) It may be desirable to use compensatory finance in conjunction with ad valorem taxes, to let them vary with ups and downs of the business cycle.

Need for greater governmental participation in land planning and development, coordination of that with assessment practices, as the incentives of speculative land developers, which hang on the price of land, are weakened.