

The Ricardian Theory of Rent - A Reappraisal of Fundamentals

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The object of this essay is to apply the Ricardian theory of rent to a wider macroeconomic setting and to trace the implications of this application. The substance of the argument, which was inspired by the work of Henry George, an American nineteenth century economist, represents a fundamental challenge to the foundations of economics.

The discussion begins with an outline of the reasons why such a fundamental challenge is needed. In this context, section two then introduces the Ricardian theory of rent. Section three depicts a model of the Ricardo/George interpretation. Finally, section four delimits the models implications.

The need for re-evaluation

The first question that must be asked is why is a re-assessment necessary? Each reason for challenging the foundation of economics will be different - although each one must necessarily stem from some feeling of dissatisfaction, of discontent. This article is motivated by a belief that man has failed, in his present state, "to be true to himself." He has fundamentally missed the point - and consequently lives in a world within which he is discontented. At the same time, he dares not raise his head to examine the cause of his predicament for fear of exacerbating the situation.

Economists emerge who offer the possibility of alleviating the misery, although it can be contended that the life span of their ideas is in all cases extremely short. Other economists emerge, who use their genius to prove that our current state

is of a natural order in that nothing can be done about it. These are of a far more insidious type, in that their work serves to kill off the yearning for something better, for a natural order which allows for the thorough and complete development of all men.

Consider for example the Keynesian theory of equilibrium at under-employment. The workings of this theory are logical, but the idea that men come into the world and are subsequently denied the right to work and everything that this entails - is abhorrent. It presupposes a "niggardliness in nature", a Malthusian idea, which in all other areas of nature is contrary to observable fact. Can we imagine anything in nature that has no function, no self-dependence whatsoever? If men have no positive economic function, if they cannot even sustain themselves through their own labours, then plainly they become a burden on humanity. To blame nature for this is to make an enormous assumption, the validity of which has never been proven.

This then is the reason for "bothering". Either we discover a law which promotes justice and consequently harmony among men - and then bring our institutions into conformity with this law, or else we succumb to the inevitable consequences of our ignorance, the results of which could be catastrophic.

The Ricardian theory of rent

George (1975) clearly recognised humanity's dilemma. In an effort to elucidate a greater understanding of economic interactions, he applied Ricardo's

rent theory to the wider economic system. He defined rent to be that share of wealth which a man is able to obtain through his control of land. He distinguished this from wages, which accrue to labour. He described wealth to be simply land modified so as to fit it for the gratification of human desire. Finally, he noted that interest accrues to the controllers of wealth.

Ricardo's law of rent is as follows: "The rent of land is determined by the excess of its produce over that which the same application can secure from the least productive land in use." To George, this law was of fundamental importance. He argued that its application throughout the economic system would confer immeasurable benefits on mankind.

The theory is essentially simple. Originally there are two factors of production, land and labour. Capital, though a factor of production, is simply land modified in some way or other by labour. Every man is born with the potential to labour. Were he not, he could not survive. In this world, the earth is entirely owned by a relatively small number of people. Thus the non-landowners, the majority of men, must of necessity become employed, and because there are great numbers of them there will be competition. Wages, the fruits of labour, are forced to a minimum.

Keynes, in his treatment of unemployment, tended towards a more Malthusian view. He writes in his "Essay on Biography": "if only Malthus, instead of Ricardo, had been the parent stem from which nineteenth century economics proceeded, what a much wiser and richer place the world would be today." Hence Keynes's description of unemployment as occurring when the marginal product of labour falls to a level where its utility to the employee is counterbalanced by the disutility of employment. This is "voluntary unemployment".

Involuntary unemployment occurs

when even though men would work for a lower money wage than the marginal product would justify, there is insufficient demand for their labour. All this is brought about by pressure of numbers - the Malthusian approach. Ricardo would disagree - and his argument would be based on the law of rent.

A model

Consider an uninhabited island. A family arrive and set up on the best land - their wealth producing capacity being represented as 10 (see Figure I).



Figure I

The arrival of a second family increases the wealth of the first by virtue of the mutual benefit of co-existence. This second family settle on the next best site. It cannot produce as much as the first site (We assume equality of skill and effort throughout this model; see Figure II).

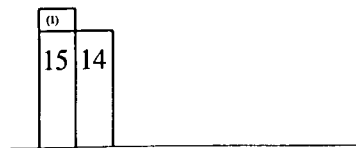


Figure II

As a result of B's arrival, wages rise from 10 to 14; that is, the wealth produced by B or the wealth produced on the best available site. Before B came along no part of the produce was rent, it was all wages. Now 1 on A's site is rent. Put another way, A could conceivably earn an income without doing anything, for he could employ B on

site A paying him 14.5, and still have 0.5. The arrival of further families (such as C) has an analogous effect. What is significant, however, is that, as the community grows, rent becomes proportionately more important than wages (see Figure III).

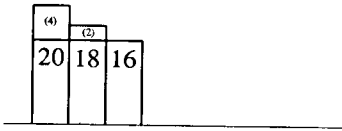


Figure III

Now a smith arrives. Position is of primary importance to him and so he settles in B's land. We will now represent this by an increase in productivity on site B of 12. It now generates 30, while A generates 25 and C generates 20. It is fair to assume a general increase as the smith will benefit all. In this new condition wages will have risen to 20 on each site - 60 in all. Rent will have risen to 15, but is 20% of total production.

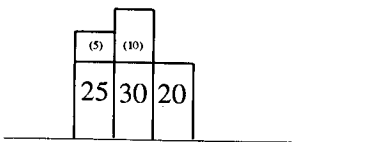


Figure IV

The natural wage is 20 and the natural rent varying from 5 to 10 depending on the wealth producing capacity of the site. It is evident that the rent is not a man made thing - it exists because of the existence of a community.

The concept of land enclosure can be easily introduced. If B recognizes the profit to be obtained from bare ownership of land, and consequently encloses land sufficient for 3 new settlers, settler E must take the next available land. Now if B asks E to work for him he will have to pay him at

least the value of this next available land. Yet this wage will be much less than if land not been enclosed.

If all the land on our island is enclosed by B and new settlers E and F arrive they have no bargaining power. If there were only work for one, and B can of course control how much work there will be, they, E and F, will compete with each other for employment and wages would fall very low. Thereafter as population is increased, the power of producing wealth on any site would increase vastly, but the share taken in wages would always be governed by competition for work. The growth in population would intensify this, for it would encourage B to continue to withhold land from use. Continuing along this path, capital would be available exclusively to landowners, as E and F can hardly be expected to buy capital on subsistence wages. The rent receivers will therefore lend their surplus funds to those engaged in industry and consequently gain control of industry. Labour will maintain their capital for them and the rent they receive will further increase their power.

The above calculus reveals that rent is composed of two sorts: natural rent above the amount labour could obtain on the best land not being used and secondly, the inflated rent, or the loss to wages by the enclosures. The whole scenario depicted through this model finds empirical evidence in the decline of the Roman Empire and in the grave societal problems caused by the sixteenth century enclosure of the Commons in England.

Implications of the model

The implications of this application of Ricardo's Law are of paramount importance to the subject of economics.

Firstly, in every well-ordered society, the relations between men rest upon recognised rights and duties. The first right of all is the right to life. Equivalently, every

man has an equal right to those things freely supplied by nature, without which he cannot live. Hence exclusive property in land is morally wrong as this property necessarily excludes others and denies them their equal right. It should therefore be proscribed.

Secondly, every man has a right to work: he must if he is to live. Thus every man has an absolute individual right to the full product of his labour, subject only to the claims of those legitimately unable to work. The crux is that, since rent is created by the community, it should be returned to the community. As wages are the foundation of private property, rent is the foundation of public property.

It is in this light that the manifest failure of the communist system can be understood. In placing responsibility in the hands of the few, a natural law was transgressed. As Solzhenitzyn observed, people simply did not love freedom enough. Ricardo's analysis indicates that, unless land is non-excludable, and the fruits of each community are returned not to a small group of individuals but rather to that community, phenomena such as unemployment and subsistence wages will arise.

Conclusion

This essay, in calling for a re-evaluation of the foundations of economics, presented and developed the Ricardian theory of rent. Section one outlined the reasons why a new departure is requisite. Section two introduced Ricardo's theory of rent. In sections three and four the application and implications of this theory were examined with the aid of a simple model.

The fact is that, despite enormous progress in science and technology, millions cannot find work, and even greater numbers subsist on minimum wages, devoting the greater part of their lives to mere survival, while a very small group enjoy enormous

wealth. Economics has too long been a subject concerning itself exclusively with the mechanics of a false world, denying the existence of a natural law governing the relations between men and society. Hope lies only in the rout of accepted wisdom. As George wrote in the nineteenth century:

"Political Economy has been called the dismal science and as currently taught, it is hopeless and despairing. But... freed as I have tried to free her...in her own proper symmetry...she is radiant with hope."

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