Rent: The Economic Relationship Between Humanity and Nature

Jock Coats. September, 2016.

Introduction

The preamble to the Liberal Democrat constitution sets out our vision of a just society and the role of different institutions, such as the market economy and government, in achieving the principle aim of building and safeguarding a “fair, free and open society, in which we seek to balance the fundamental values of liberty, equality and community, and in which no one shall be enslaved by poverty, ignorance or conformity”.

We have never dogmatically asserted that either markets or the state can achieve this on their own, but promote systems and mechanisms that seek to maximise individual freedoms whilst allowing democratic community interventions to step in to prevent or redress unjust concentrations of power or wealth that limit others from realising their economic and cultural potential.

For at least as long as people have gone by the name “liberals” they have recognised that one form of unjust concentration of economic welfare and therefore coercive power over others is monopoly. We have observed, moreover, that monopoly of the very basic needs of life such as the productive capacity of land and natural resources on which we are all dependent has been a particular cause of inequality.

This paper does not seek, however, to rehearse a hundred and fifty years of waxing and waning enthusiasm for land reform. Instead it seeks to explain why that effort has most often failed, and to show that the “land issue” continues as a result to be a fundamental cause of economic injustice, as well, just as importantly today, as a root cause of environmental and eco-system destruction.

It will begin by explaining the phenomenon of “economic rent” that has been so often ignored even by economists. It goes on to examine why “land” has been marginalised in economic discourse and to demonstrate that it is in fact as important as ever. It will then explore some of the policy areas that are affected by land and economic rent, and by ignoring it in favour of funding society's communal programmes by taxing the product of labour and capital investment.

The second half of this paper attempts to show that we all have a right to share in the revenue from land and natural resource rents to which we all contribute, and that the consequences of not doing so prevent culturural life flourishing, markets functioning and even democracy operating equitably. Pointing to the fact that these are such fundamental values for Liberal Democrats, it concludes by staking a claim for rent-sharing to be one of those fundamental principles embodied in our pre-amble.

Rapacious Rent

The thread that runs right through this paper requires readers to understand what we mean when we talk about rent. No doubt many people think of, predominantly, what people without a home of their own pay to live in someone else's spare property. More broadly, it could be a fee one pays to use someone else's capital goods temporarily. And, while this is probably the most common understanding of "rent", it doesn't really reflect what economists think of as "rent".

Since at least the school of economics known as the Physiocrats, the immediate 18th century predecessors of luminaries such as Adam Smith and the "classical" school, rent in economics has been understood as any payment for a factor of production in excess of what would be required to bring that factor into production.

We'll look further at factors of production shortly, but to apply this most simply to the current subject, this planet, indeed the entire universe so far as we know, and all the natural resources and eco-systems in and on it, simply exist. Nobody produced them and they have no cost of production. Nobody invested capital and labour into producing them. Payment to use something with no cost of production is therefore nearly all this "economic rent".

As an aside, "economic rent" also applies to many other fields, such as where artificial scarcity limits the competition in an occupation, like most licensed professions or intellectual property and competition rules on who can develop and profit from an idea or skill as well as unique artefacts such as works of art. The remedy for the resulting "superprofits" from these privileges however is usually to do with opening up competition and increasing supply: something which, we will soon see, is either impossible or very difficult with land and natural resources.

This is why I refer to rent as “rapacious”, literally, “inordinately given to grasping or taking”. All production, and all life to maintain production, requires some of the space and resources of this one, finite, rock hurtling through space that has existed since billions of years before anyone came along to claim exclusive ownership of any part of it. Indeed, it created humanity; we didn’t create it. While we can increase the supply of doctors or lawyers, or change intellectual property law to reduce the economic rent their scarcity creates, by and large we cannot increase the supply of land and natural resources on which we all depend.

When humans first enclosed pieces of land in order to cultivate sufficient for survival, while there was plenty for everyone else to do the same, it would not command any rent: anyone who wanted some could take another piece without too much inconvenience. But once one group of people, Norman monarchs, perhaps, or Spanish Conquistadors, or British Colonialists, claims ownership of more than they can use, and in doing so prevent by force others from having sufficient to survive on, then they can charge a rent for what they deign to let others work on.

Similarly, when society becomes more sophisticated through the division of labour, and the opportunities for economic gain become concentrated in particular locations, such as factories or offices in towns and cities, the locations from which it is possible to reach those opportunities also become scarce and start to generate rent. Not even Eric Idle could actually “get up in the morning at ten o'clock at night, half an hour before I went to bed…[and]…work twenty-nine hours a day down t’mill”!

But it gets worse: the rent a location can generate is not just the result of negotiation between a producer and a buyer, as might be the price of most other, reproducible commodities, and which might produce a fair market price. Because locations and natural resources are relatively scarce compared with the people who need to use them to access economic opportunities or in production the owners of those locations can bid up the price as monopolists and the would be tenants become price-takers.

In fact, as David Ricardo showed in the early 19th century, and Tim Harford described in “The Undercover Economist” land rent can absorb all of the returns to production over and above what it costs the buyer or tenant to barely survive in the least advantageous locations.

Before we move on to look more into what constitutes “land and natural resources” in this discussion, we should note a final, and crucial, aspect of rent. I can almost hear some of you saying “but I own my home, so I don’t pay rent”. In fact, once all of a territory is claimed as private property, everyone pays rent at some point. When you buy your house you are in fact, even if you don’t think about it this way, trying to second guess the future flows of rent that you will save by going to a bank, borrowing a whole load of money at interest and paying the vendor what they will accept to forego that future flow of rent. The value of the building on your chosen location will inevitably depreciate: you have to spend money constantly maintaining it if you want that bit to retain its value. The future rent you are paying, and are hoping will grow to justify you paying all that interest to the bank, is on the land, so that when you come to sell, you can ask the next buyer for more future rent to make you give up your right to claim it.

Later in this paper, we will look into the “Culture of Cheating” around land ownership, but as a taster here, I will say that since once, over centuries, all land in this country was taken by mainforce (or just as frequently by government imprimatur) from those who had rights to work it to produce a living, you who buy your home have been engaged in a long running scheme of handling long ago stolen goods. Most of you barely benefit: your next house generally costs proportionately more, and you just go and borrow, and pay back, more to the bank. The only real gainers are those with more than they need who let their spare capacity out, and the children of those who die leaving them a significant inheritance. We are, mostly, tenants and buyers alike, in a similar boat, long term.

Land is Back

Land is probably another one of those terms that most people feel they are familiar enough with. But again, for economists it has always meant something greater than the “ground beneath our feet”. For the Physiocrats and the Classical School economists, land was one of three factors of production: that is three types of input into any productive process. Capital, in the form of tools or financial resources, combines with labour and acts on land to produce new goods and services. Land, in this context then, is by definition everything that is not produced by capital or labour, that simply exists in nature, the planet and its resources.

It *is* the ground beneath our feet, of course, but it is also the ore and the hydrocarbons beneath the surface, the air in the atmosphere, the electromagnetic spectrum that modern communications rely on, the fresh water we and many industrial processes require to function, the seas that provide food and the forests that help scrub our atmosphere and produce both oxygen, fuel and raw materials.

In the second half of the nineteenth century, however, "land" in this sense, as a factor of production, was largely removed from economic discourse, and it barely features still today. In an entire economics degree it was mentioned twice, in passing. Karl Marx wanted to make an argument about capital versus labour. In doing so, as something that could be monopolised by financial capital and used against the interests of labour, land was elided into capital. Further, as more people moved away from dependence on land and into towns and factories, he argued that it simply wasn't as important in the emerging industrial class-war economy. Somewhat later, Alfred Marshall, in popularising the neo-classical school of economics, with its use of simple models to describe economic phenomena, maintained Marx's lacuna about land: his models were easier with two factors on a 2 dimensional chart!

Even today, in Tomas Piketty's "Capital in the 21st Century" the author acknowledges land as a factor, but says right at the outset, in the preface, that it is too small a part of the economy to be the cause of the inequality he will analyse and propose remedies for. However, Matthew Rognlie, a PhD student at MIT, showed that Piketty's claim that the returns to capital are appreciating faster than the returns to labour, and so increasing inequality, predominantly relate to the returns to that special kind of largely ignored capital, real estate!

As home ownership increased from 10% to 70% of households through the twentieth century, with large scale government interventions to bolster supply of housing at crunch points, and as agriculture has declined as a proportion of the economy, land reform has been largely neglected as a public policy issue since around the end of the first world war. As home ownership rates now head downwards, and in perhaps 100 constituencies over the next ten years will be below 50% of households, according to Generation Rent's estimates, economic rent has once again become a significant influence on housing markets.

It is telling that many of the world's wealthiest individuals and families own large amounts of valuable land. Even many who start off in productive processes eventually invest the proceeds in land based sectors. Many of the new billionaires in developing countries such as China base their success on rent-extracting sectors such as property development in burgeoning urban areas. In jurisdictions that assess land values regularly for the purposes of tax valuations it has been estimated that land rents may account for around half of GDP once other taxes which reduce the amount available to be sequestered through rent are factored in.

Similarly, as the world has inexorably industrialised over the past century or so for much of that time we have thought of extractive natural resources as somehow infinite and that eco-systems were infinitely resilient to pollution. But today, most of us know better, and see extractive and polluting industry as storing up enormous problems, in climate change and environmental degradation. Organisations attempting to quantify the financial implications of this degradation put the unpaid costs at over 13% of Gross World Product (the total aggregate economic activity of the entire world) or something like $7 trillion per year.

The people and communities whose lands are devastated, whose air and water is polluted, see little or none of this rent and still have to cover the costs to their own communities and health.

The Policy "Landscape"

It should come as little surprise that if land and natural resource rent is such a pervasive force in the economy, it affects, and can be used to help solve, numerous policy areas, both obvious and less so.

Most obviously, it has caused our housing crisis, which, as such a large part of many households' costs of living is an aggravating factor in low pay, social security and the living wage. As people like Danny Dorling, and the Green Party, point out, the crisis is not entirely about supply of new built homes, but about the fact that householders do not currently pay the economic costs of occupying space greater than they need. Supply will be important in some areas, but cannot be accurately matched with demand without a functional land market.

The lack of accountability for the depletion and degradation of natural resources and eco-systems means we do not adequately price pollution and waste or reward communities, at home or overseas, for the sustainable extraction of those resources. We give non-renewable energy resources an economic advantage over renewables.

Further, because we don't collect these resource rents for public revenue, and rely instead on taxing the other factors of production - labour wages, profits on capital - and transactions in goods and services, we distort and disincentivise economically beneficial productivity whilst privileging monopoly rent-seeking and environmentally destructive behaviour. This skews the economy in favour of sectors like financial services, and encourages overseas acquisition of essentially untaxed real estate. It makes our productive economy less competitive than it could be if the tax costs on labour and capital investment were reduced.

In the broadest terms, for a party which aspires to "foster a strong and sustainable economy which encourages the necessary wealth creating processes, develops and uses the skills of the people and works to the benefit of all, with a just distribution of the rewards of success…[and]…allows the market to operate freely where possible" penalising labour and capital while rewarding rent-seeking prevents that market functioning adequately.

A paper like this cannot do justice to all the policy areas on which rent has an impact, or on which switching to rent as the primary source of public revenue would have an enormous effect: that would be rightly called a "manifesto"! But it includes transport policy, including airport capacity and financing infrastructure projects like HS2; industrial and regional policy; even international aid. Even if we would prefer not to leave the European Union, the ability to repeal taxes on production and transactions, which are effectively a tariff on industry and trade, would greatly improve our negotiating position in bilateral trade agreements. For an environmentally conscious free trade policy we could impose tariffs solely on the basis of the imputed environmental cost of a product or its origin: businesses and products that minimise their environmental impact would pay the least tax or suffer the lowest tariffs.

Combined with a citizen's dividend financed from the difference between rent collected and government expenditure we would enable more people to save, to finance retirement more sustainably, to pay for their own choice of services, and to turn down low security or low reward employment opportunities. Because rents rise with productivity, if we really are approaching an era in which automation does away with the need for many workers, the surpluses generated by that automation would still be distributed to individuals and households to support them retraining or developing their own opportunities in occupations they might prefer. And the economic productivity increases that arise from migrant workers can be better recycled to benefit the many and not the few.

Common Rights

In recent years many opinion formers and policy makers have floated the idea of some kind of guaranteed basic income, as a way to simplify social welfare systems, and as a way to distribute economic welfare in a possible era of automation displacing many types of wage-labour. Some object that giving people something they have not worked for, as a right, risks creating caste of people content not to work, and to rely on living off the productivity of others. Others object that such a guaranteed base level of income will do little but raise the costs of living, especially of housing, and cancel itself out.

These are valid arguments if we are talking about funding a politically determined set payment out of the sources of government revenue on which we currently rely - other people's productivity. But if we look at the idea as a dividend, funded from the difference between the total amount of rent a territory can collect and the costs of government of that territory, these objections are largely neutralised.

First, the revenue from rent is something to which everyone does contribute. It is not money for doing nothing. The rent of any particular location is the value of excluding others who could make as good or better use of that location given their needs to access economic opportunities suitable for them. We all contribute to the publicly funded infrastructure that helps make a location valuable, currently not very accurately, however, in proportion to our incomes and profits rather than our need for or use of those amenities. The private services that we use keep locations connected and valuable: if you pay for a bus ticket that helps keep a route profitable and operating, you are contributing to the value of the locations that route connects just as much as to the operator's income. Your mere footfall in the central business district makes it attractive for customer facing businesses to operate from.

The productivity of our labour and of our capital make locations valuable. Even our choices not to occupy locations that enable others to access relatively better economic opportunities, to optimise their productivity, contribute to efficient use of scarce locations and the rent they generate. Rent is the measure of the social surplus we all create, of the value we all place on the facilities we need just to live and be productive.

Secondly, a dividend tied to the overall quantity of rent publicly collected, as opposed to a fixed income determined politically, and intended to cover someone's idea of the basic costs of subsistence, is dynamic. If it encourages people to be more productive, because their labour and capital are not being taken away in tax, it will raise the amount of rent that can be collected, since, as we have noted, rent rises to absorb the surplus over subsistence levels The dividend will rise accordingly. So if capital becomes relatively more productive because of automation, for instance, it will still end up being distributed, even amongst those forced out of work by that more intensive capital. If it does encourage people to live only off their dividend payments, rents may fall and with it the dividend until people are encouraged to work some more to top it up.

But presently these luxuries, these choices to work or not to work, are available only to the capital rich and especially to those who own the rights to collect rents from others, regardless of who actually creates that social surplus. It seems difficult to argue that this is a just or equitable distribution of the value we all contribute to: that some can live off the productivity of others merely through claims of ownership on common resources they are not using.

Before conquest or government enabled politically favoured groups to enclose and exclude others from particular locations, each household could occupy just as much as they could use to create a basic living. We have no choice, being born, but to occupy some location, whether to produce directly what we need in an agrarian society, or to collaborate with others to earn a living by the division of labour. In that agrarian society a community could allocate an equal portion of land to all members of the community. In the sophisticated society based on the division of labour, the mechanism for ensuring an equitable distribution is through the sharing of the rental value of the territory we are bound to.

The Culture of Cheating

Rent-seeking behaviour has been going on for as long as there have been governments capable of granting or protecting the privileges of one group of politically connected interests over another. Those connected interests may have changed over time, but by and large, the sources of rent over which they seek control are remarkably constant: land, the prevention of competition, and the ability to extract natural resources or pollute the basic environmental systems everyone needs to survive.

The effects are pernicious, both to the individuals whose common rights are infringed upon, and to the community as a whole. It creates an unhealthy environment in which it is easier to live off the productivity of others than to produce for ones-self. It maintains an intractable divide between those who have the protected right to collect the social surplus of the community and those who have to pay the costs of creating that value out of their labour.

The cultural life of the community divided in this way suffers tremendously. Those who have to settle for whatever wage-labour will pay the bills, and the rent to those who have enclosed the commons, have little time or opportunity to express their creativity, whilst the rent they pay enables others to develop theirs. In future, if automation really does reduce the amount of “drudge work” people have to do, it ought to be be a positive thing, enabling the caring, cultural life of humanity to flourish.

Even what we call a democracy is unable to function properly. One group can vote, even with the best of intentions, to take a greater share of the product of society’s labour and capital in the name of helping the less well off. But if they own the right to extract the rent, measures to help those least well off will eventually feed through into higher rents and land values for them. In effect, the tenant pays twice so the landowner doesn’t have to!

Only a society based on the equitable sharing of the social surplus embodied in rents creates a level playing field in which democratically made decisions justly distribute the costs and benefits of maintaining the environment in which that society can function sustainably and benefit all members of it. And only such a system allows a just market economy to flourish and to be able to identify those for whom that market does not provide sufficient so as to be able to channel support to them.

Party Processes

Now before I draw this to a close, I want to say something of the frustrations those of us who have campaigned for some of these issues have faced. As I have tried to show, the effects of the private appropriation of rent are far reaching. They affect many, if not all, policy areas to some extent. Some of us have managed to get ourselves onto policy working groups in areas where we think changes to the way we manage the rental flows in the economy could have significant effects.

But because of the way policy making is compartmentalised, and because we have tended to promote what has been known as "land value tax" or a variant of it, we are often told that it is inadmissible, since tax policy is a "treasury team matter". When we get onto working groups looking specifically at fiscal measures, it is treated as just an argument in favour of a different sort of tax, rather than an examination of a fundamental flow in the economy and how it affects so many policy areas.

For example, when I was on a housing policy working group in the early 2000s, and at the first meeting asked about considering land taxes as a way of controlling property prices and promoting more sustainable development, I was told we could not consider it, even though this is probably the area with the most obvious connection with land rents. That working party then had to operate literally with its most valuable card off the table.

I am led to believe that a similar issue has occurred with the social security policy being debated at this conference. The committee considered a universal basic income, but identified that such a policy on its own might actually increase housing costs for the poorest. But because it was a fiscal measure, they could not suggest the most obvious solution presented here - of funding it through land rents rather than redistribution of incomes.

And our new economic policy working party has been explicitly told in its terms of reference that it cannot consider levels or systems of taxation.

We need to stop projecting rent-distributive policies as primarily "tax" issues. Indeed, we could go as far as to suggest that rent-sharing enables us to have a tax free society. Tax implies an impost on a value to which the person or entity being taxed has some kind of claim, such as having worked to earn it. Economic rent is, by definition, a value that is not earned by the entity extracting it. We are used to saying that "tax is the price we pay to live in a civilised society". But in fact, now that we understand how rent arises, we can say that rent is really this price. It is a cost of living, payable to the rest of our community in return for them recognising our right to occupy or consume scarce, common resources. Understanding rent enables us to analyse the positive and negative externalities of each social intervention and ensure those who actually benefit the most pay for them.

Principles not Policy

As a party, the preamble to our constitution sets out our vision of what a just society should look like, and the broad principles which we think represent the liberal, democratic means of achieving that vision. These principles are far broader than, and do not map precisely onto, the individual policies which from time to time we adopt to foster those ends. But our policy making processes ought to measure their outputs to ensure they conform to those principles.

I hope that I have shown how the phenomenon of rent is a pervasive, and, unaddressed, a pernicious force throughout the economy. There can be no functioning market through which economic welfare is justly distributed while those whose political connectedness, often over many generations, enables them to appropriate so much of the surplus we all create. There can be no true democracy while some pay the costs of running the country and supporting those with least opportunity to realise their potential and others collect the positive externalities in the form of rent.

Whilst it is no small claim then, I do not think it is unjustified to say that the equitable sharing of rent is a sine qua non of a democratic, liberal market based society. All our policy making needs to understand how rent affects the problems we are trying to address and to analyse the effects of the interventions proposed to address them.

Rent-sharing in its widest possible sense then belongs in our preamble as a prerequisite to a functioning market economy and a fair, free and open democratic society. A fairer economy and a stronger society!