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The Concept of Economic Rent and Inequality of Income

Abstract: The concept of the economic rent is topical nowadays not always in its original meaning of «land rent», but loaded with a lot of current connotations, «rent-seeking-behaviour» among them. This accounts for the importance of the theory of justice and inequality in the globalization processes at the beginning of the XXI century and its implications in the changing society of late capitalism.

Keywords: economic rent, justice, equality, income, «rent-seeking-behaviour», wealth.

The postmodern theories (economics included) bear a lot of generalizations that bring us the news of the arrival of a whole new type of society most famously called «postindustrial society» (D. Bell) but often also designated consumer society, media society, information society, high tech society, and the like. Such theories have the obvious ideological mission of demonstrating that the new social formation in question no longer obeys the laws of classical capitalism, namely, the primacy of industrial production [1, p. 3].

The latter is connected with the notions of justice and inequality «by definition». Justice in its broadest context includes the attainment of that which is just. The concept of justice is based on numerous fields, and many differing viewpoints and perspectives including the concepts of moral correctness based on law, equality, rationality, economy, religion, etc. The important principle of justice says that social and economic inequalities are to be arranged so that they are both reasonably expected to be everyone's advantage, and attached to positions and offices open to all. Theories of distributive justice analyse what is distributed, between whom it is to be distributed and what is proper distribution.

John Rawls, a famous American theoretician, has argued that income equality is a desirable goal – except in special circumstances. John Rawls suggests that to get an objective view people must be removed from their present situation and placed in an original position where they decide what the distribution of income should be without knowing the specific place they themselves will eventually take in this distribution. J. Rawls attempts to solve the problem of distributive justice by utilizing a variant of the familiar device of the social contract. The resultant theory is known as «justice as fairness» from which Rawls derives his two principles of justice: the liberty principle and the difference principle [2].

In the book «Anarchy, State and Utopia» R. Nozick argues that distributive justice is not a matter of the whole distribution matching an ideal pattern, but of each individual entitlement having the right kind of history. It is just that a person has some goods (especially, some property rights) if and only if he came to have it by a history made up entirely of events of two kinds: just acquisition, especially by working on unowned things; and just transfer, that is free gift, sale or other agreement, but not theft (i.e. by force or fraud) [3].

Some property rights theories also take a consequentialist view of distributive justice and argue that «property-rights-based-justice» has the effect of maximizing the overall wealth of an economic system. They explain that voluntary (non-coerced) transactions always have a property called «Pareto efficiency». The result is that the world is better off in an absolute sense and no one is worse off. Such consequentialist property rights theoretician argue that respecting property rights maximizes the number of «Pareto efficient transactions» in the world and minimized the number of «non-Pareto efficient transactions» in the world (i.e. transactions where someone is made worse off). The result is that the world will have generated the greatest total benefit from the limited, scarce resources available in the world. Further, this will have been accomplished without taking anything away from anyone unlawfully. To some extent, it can be connected with Karl Marx's dialectical materialism that provided the classical historicist formula of the economic infrastructure. Marxism is known to establish a structural difference between society's traditional or cultural institutions and its economic productive forces. Rapid-paced progress occurs in the infrastructure, the economic sphere of productive activities which supports but also subverts the infrastructure, the social sphere of ideology which includes religion, politics, economy, law, etc. The superstructure, according to Marx, evolves more slowly and is more resultant to change, that the economic infrastructure, especially in the modern industrial age of advanced capitalism.

According to the utilitarians, justice requires the maximization of the total or average welfare across all relevant individuals. This may require sacrifice of some for the good of others, so long as everyone's good is taken impartially into account. Utilitarianism, in general, argues that the standard of justification for actions, institutions, or the whole world, is impartial welfare consequentialism, and only indirectly, if at all has, to do with rights, property, needs, or any other non-utilitarian criteria. These other criteria might be indirectly important, to the extent that human welfare involves them. But even then, such demands as human rights would only be elements in the calculation of overall welfare, not uncrossable barriers to action. The latter is inevitably connected with the concept of inequality, which gets more and more acute in this period of late capitalism.

Economic inequality, also known as income inequality, wealth inequality, gap between rich and poor, gulf between rich and poor and contrast between rich and poor, refers to how economic metrics are distributed among individuals in a group, among groups in a population, or among countries. Economists generally think of three metrics of economic disparity: wealth (wealth inequality), income (income inequality), and consumption. The issue of economic inequality can implicate notions of equity, equality of outcome, and equality of opportunity.

Recently some studies have emphasized inequality as a growing social problem. Too much inequality can be destructive, because income inequality and wealth concentration can hinder long term growth. Early statistical studies comparing inequality to economic growth had been inconclusive, however in 2011, International Monetary Fund economists showed that greater income equality – less inequality – increased the duration of countries' economic growth spells more than free trade, low government corruption, foreign investment, or low foreign debt.

Thomas Piketty in his recently written fundamental book on inequality and economics insists that the «central contradiction of capitalism» is the tendency of inequality to grow when the rate of return on capital (by which he means something broader than the conventional Marxist definition of the rate of profit) is higher than the economy’s rate of growth. He also notes that as developing countries industrialise, inequalities get worse, not better. In the developed capitalist world he warns that the prospect of slower economic growth in the years ahead combined with the political domination of the interests of the super rich in our political systems threatens to make these extreme inequalities even more grotesque [4].

Economic rent should not be confused with the more commonly used term «rent» which simply refers to a payment made for temporary use of an asset or property. In this connection the problem of rent appears to be topical and urgent. To begin with, the concepts and consequently definitions play an important role in current discussions. The dictionaries determine the word «rent» in economics as «any payment to a factor of production in excess of its opportunity cost; a payment by the user of land to the owner; payments by users to the owners of land, buildings, or equipment» [5, p.766]. Rent is also defined as the difference between what a factor is earning and what it could earn elsewhere (its opportunity cost) [6, p.738].

In the Russian terminology «economic rent» is an «additional income of the production factor» («добавочный доход фактора производства») or «income obtained from capitalization» («прибыль, получаемая от отчужденного капитала») [7, p.473-474].

«All economic analyses begin with the cultivation of the earth», wrote J.B. Show. And nowadays economists begin their research of rent with agriculture, analysing the quality of land (productivity), the price of the produce (for example, how the rent on the plots of land depends on the price of wheat), rent based on differences in the location of land, and so forth. Other examples of rent concern the income from the mineral deposits, as it is common knowledge that a mineral deposit may also earn an economic rent. Researchers show how an increase in the price of ore increases the rent earned on each of these deposits and induces the mining of low-yield deposits [5, p.739-740]. As for land value and civil engineering, it is usually noted that although the heights of the blocks are drawn to reflect rents and land values, they may also provide some rough indication of where the tallest buildings will be constructed (office space becomes more and more expensive to construct as a building gets higher and higher); thus buildings tend to be tallest in the prime, most expensive locations.

Economists claim: since above-normal profit is defined as a return above opportunity cost, it is by definition a rent. The most obvious illustrations are usually taken from the case of monopoly. Showing how rents are capitalised, economists maintain: higher rents result in higher land values though in practice there are many complications. In particular, the price of land will be affected not only by present rents but by expected future rents too.

A. George describes the concept of rent in economics as follows: «In the economic meaning of rent, payments for the use of any of the products of human exertion are excluded, and of the lumped payments for the use of houses, farms, etc., only that part is rent which constitutes the consideration for the use of the land... The part that is paid for the use of buildings or other improvements is properly interest, as it is a consideration for the use of capital» [7]. In short, economic rent is any unearned income, – say scientists. Rent has always been a natural target for taxation. About a century ago, Henry George built a powerful single-tax movement on the idea that nothing should be taxed but land rents. (His book Progress and Poverty sold millions of copies, and he almost won an election as mayor of New York.) Why, asked George, shouldn't we tax land rents, since they represent a pure windfall? Owners obviously don't produce the land, nor do they work for their rental incomes. Instead, they just hold the land and become wealthy from "unearned increments" as the population increases and rents rise. George argued that the land rents belong to the public as a whole, and should be taxed away from the owners and used for public purposes.

George's case was based not only on equity but also on efficiency. A levy on land rents is one of the few taxes that need not distort resource allocation. Even if half the rent on land is taxed away, it will still remain in cultivation. What else can the owner do with it? And because the quantity of land in use is not affected, there is no reason to expect an efficiency loss. (Compare this with a tax on any other factor of production. For example, a tax on wages can affect the incentive to work and might thus affect the amount of work done.

However, George's proposal to tax land raises two serious difficulties – in addition to the obvious problem that, as a single tax, it would not raise nearly enough money to cover today's large government expenditures. First, if present owners paid the current high price when they bought their land, rents are not a windfall to them at all but just a reasonable return on their large initial expenditure. (Why tax those who bought land and not those who bought stocks or bonds instead?) The only windfall is to the previous owners who sold the land for a high price. But they may now be living in Bermuda, beyond the reach of the taxing authority. Second, in practice it may be impossible to separate the rent on land from the return on buildings. If you tax a landlord's income, you will be taxing both. But the return on buildings – or on any other improvements on the land – is not a return on the land itself. Instead, it is a return to capital, and it cannot be taxed without causing distortion and inefficiency. For example, a tax on the returns from apartments will reduce the quantity of apartments in the market, and thus cause an efficiency loss.

One of the current socio-economic questions is put in such a way: «How economic rents affect inequality?» The economist Thomas Piketty in his famous book «Capital in the Twenty-First Century» highlights the dangers of an economy dominated by inherited wealth – an economy in which birth is more important than effort and ability. He provides evidence that the USA is headed in this direction toward what he calls "patrimonial capitalism" [4]. One of the explanations for rising inequality in the U.S. and elsewhere around the world is what economists call «rent-seeking behaviour». That refers to the ability of the wealthy and powerful to influence the political process, keep tip tax rates low and increase their income at the expense of everyone else. Thus, the question «Can the capture of «economic rents» by those at the top of the income distribution explain the rising inequality?» is still of great importance both for society in general and individuals in particular. This is because any change in rules or regulations, or even the failure to act – not raising the minimum wage, for example, appears politically motivated and favours those in power who can be defined as joining the model of rent-seeking behaviour.

The global economy being the single biggest factor in driving international trade implies that the concept of rent is of great significance not only in its classical application to land but to a lot of economic factors. For example, «rent model» explains the high wages in some modern professions that have been able to both obtain legal protection from competition and limit their membership notably as doctors, actuaries, lawyers. In the West these jobs are characterized by the small number of rich members of the «guild», along with a much larger surrounding of poor people competing against each other.

Thus, the problem of distributive justice which John Rawls attempted to solve is still on the agenda of the socio-economic life at the beginning of the XXI century.

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