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ON LAND AND RENT

On Separating the Landowner's Earned and Unearned Increment:

A Georgist Rejoinder to F. A. Hayek

By ROBERT V. ANDELSON*

ABSTRACT. On a given site, some increments of rent or land value may reflect improvements by the owner, either to it or to adjacent sites he or she also owns. Because these increments cannot always be distinguished with precision from the value arising from natural features and/or from improvements due to communal efforts, F. A. Hayek dismissed the Georgist paradigm as fatally flawed. This paper disputes Hayek's criticism on the following grounds: 1. As Professor Backhaus observed, the degree of certainty in measurement demanded by Hayek is more rigorous than that required in practice for enforceable tax assessment. 2. Under a Georgist-style system, landowners who improve their land would, in any case, get to keep much more of the fruits of their efforts than under any alternative public revenue system. 3. The distinction between value produced by the owner, on the one hand, and that produced by nature and society, on the other, remains authoritative as an ideal even if not perfectly realizable in practice; hence, there is a sense in which even the theoretical elegance of Georgism is not undercut by Hayek's criticism.

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I

Introduction

"IT WAS A LAY ENTHUSIASM FOR HENRY GEORGE which led me to economics." So wrote Friedrich August von Hayek in a letter to Peter K. Minton in 1962.¹ Elsewhere, he explained that this enthusiasm came about as the result of his having been "exposed to a group of single-taxers" as a first-year law student at the University of Vienna just after World War I.²

In time, however, Hayek came to reject the Georgist model because of an objection he set forth in his magnum opus, *The Constitution of Liberty*. This objection constitutes a superficially formidable argument which the defenders of Georgism seem almost wholly to have neglected. The reason for this neglect is probably threefold: First, the argument is readily overlooked, occupying, as it does, a single paragraph in a book of more than 500 pages. Second, it is easily confused with a different argument— one that has been widely, and to the satisfaction of probably all Georgists, conclusively, refuted. Third, it is expressed following a technically inaccurate definition on Hayek's part of the model to which his objection is directed. However, the validity of his objection does not depend upon the accuracy of his definition, and his argument calls for a scholarly rejoinder, not merely in view of its author's towering prestige, but due to the fact that, once disentangled from its flawed context and correctly understood, it seems at first blush compelling on its merits.

II

The Issue of Separability

HAYEK'S ARGUMENT is important because, although presented in a discussion having to do with practical difficulties of town planning, it attacks the moral basis of Georgist theory. That basis is expressed by Nicolaus Tideman, who distinguishes three different sources of the rent of land: (1) the value attributable to nature; (2) the value attributable to public services; and (3) the value attributable to private activities. By "private activities," he means aggregate private improvements and other non-

governmental operations that positively impact a neighborhood. With respect to the last of these sources, Tideman asserts that “[t]hese increments of rent are not due to the actions of the landholders, so landholders cannot justly complain if the increments are collected publicly.”³ While this claim may be very largely true, since such increments frequently accrue to owners who have done little (or even nothing at all) to earn them, there are instances in which such increments of land value on a given site are the result of improvements by the owner of that site, either to it or to adjacent ones he also owns. A perceptive Australian writer, Philip Day, notes that “at least in some circumstances, some part of increased land value can be attributed to the quality of development constructed by individual landholders, rather than being wholly attributable to public planning decisions or to population growth and general community development.”⁴ An obvious example would be Disney World,⁵ although in this instance, as in many others, “quality” should be understood to embrace more than architectural superiority. One might properly claim that it is in the Disney Corporation’s capacity as developer and not as owner that the improvements have been made, and cite numerous examples to show that the incentive to improve a site need not depend on owning it.⁶ However, this would not address the problem that Hayek regarded as insuperable—that of separating the increments of value created by the owner (or his predecessors in title) from those created by natural advantages, public services, or the private activities of others. Let us now, therefore, examine the passage in which he made this point:

There still exist some organized groups who contend that all these difficulties could be solved by the adoption of the “single-tax” plan, that is, by transferring the ownership of all land to the community and merely leasing it at rents determined by the market to private developers. This scheme for the socialization of land is, in its logic, probably the most seductive and plausible of all socialist schemes. If the factual assumptions on which it is based were correct, i.e., if it were possible to distinguish clearly between the value of “the permanent and indestructible powers of the soil,” on the one hand, and, on the other, the value due to the two different kinds of improvements— that due to communal efforts and that due to the efforts of the individual owner— the argument for its adoption would be very strong. Almost all the difficulties we have mentioned, however, stem

from the fact that no such distinction can be drawn with any degree of certainty.⁷

III

Peripheral Considerations

THE FIRST THING to be remarked about this passage is that Hayek's definition of "the 'single-tax' plan" is really not of the single-tax plan at all, but rather of George's "second best" alternative. Socializing land and leasing it while proportionately reducing or eliminating taxes on productive effort was described by George as "perfectly feasible,"⁸ and has, in fact, shown itself to be so in Hong Kong and Singapore.⁹ But George's preferred approach, the single-tax, would leave titles to land in private hands while socializing only its rent (whether realized or not). This error on Hayek's part is very curious in view of the decisive role played by Georgism in awakening his interest in economics, but it does not touch the hypothetical validity of his stricture since that stricture is logically applicable to both approaches.

Another puzzling thing about the passage is this: Why should socializing all or most of either land or rent while concurrently reducing to the same degree the government's levy on other property or income be characterized as "a socialist scheme" any more than the usual, converse, practice? *Any* political system funded by compulsory payment is to that extent, by definition, socialistic. Yet from a libertarian standpoint, the Georgist system has the virtue of exacting payment only from those who opt "to receive from society a peculiar and valuable benefit, and . . . [except for the occasional and usually comparatively slight surplus which is the object of the present theoretical discussion] in proportion to the benefit they receive."¹⁰

A third feature of the passage that requires comment is that Hayek was *not* saying that it is impossible to separate land value from improvement value, as a hasty reading might suggest. Assessors do this all the time, if not always with absolute precision, at least well enough to meet normal statutory requirements. Where they fall short, the answer is improved training, staffing, and technical equipment. Hayek was not talking about improvement value as such, but about *that portion of land value* that reflects the value of the owner's improvements.

Two instances were mentioned by George himself—the value imparted to land by drainage and by terracing.¹¹ However, in these instances improvement value ultimately lapses into land value because over time the improvement becomes physically indistinguishable from land—a needless theoretical complication in terms of the focus of the present study. That focus is more clearly illustrated by the Disney World example, in which improvements to a given site increase the value of surrounding acreage also owned by the improver.

IV

An Unreasonable Standard

HAVING DISPOSED of these peripheral considerations, we are now almost ready to consider whether Hayek was justified in drawing the extreme negative conclusion that he did from the alleged impossibility of clearly separating the increments of land value that reflect the landowner's improvements from those that reflect other factors. But first we must note a telling comment by Jürgen G. Backhaus, who holds that Hayek demanded an illogically high standard of separability:

Hayek's claim, despite the forceful wording in which it is presented, is in fact vacuous. Any tax legislation has to be enforceable and actionable in a court of justice. . . . Since the degree of certainty Hayek requires for his analysis is different from the degree of certainty that actionable tax assessments require, it is sufficient to point to empirical scenarios in which a Georgian tax scheme is being implemented and where such taxes are being paid. An abundance of such empirical examples contradict Hayek's claim.¹²

This contention is supported by the testimony of such professional assessors as J. Ted Gwartney¹³ (to cite just one of many), who hold that the separation can be and is being made adequately for normative legal purposes.

V

A Mere Quibble

BUT LET US SET Backhaus's argument aside. Even if Hayek were correct in supposing that it is impossible (whether absolutely or relatively) to separate that portion of a site's value attributable to improvements by

its owner from that portion attributable to improvements by (other) owners of surrounding or nearby properties or by the public in its corporate capacity, one need not accept his conclusion that this constitutes a definitive refutation of the Georgist system.

Assuming that public revenue were derived entirely from land rent, with the burden of taxation lifted proportionately from the earnings of labor and capital, the owner of land, part of the value of which reflected the value of improvements he or she made on it or on adjacent land, would still get to keep much more of what he or she produced than would be the case under any alternative public revenue system, either existent or imaginable. This is because the owner's improvements themselves would escape taxation altogether. Practically speaking, therefore, it is hardly an overstatement to say that Hayek's objection is reduced to a mere quibble.

VI

In What Sense Hayek's Objection is Wrong Even in Theory

THEORETICALLY, however, the objection would appear to undercut the system's elegance. For, if Hayek was right, we can no longer assert literally with the late Danish parliamentarian and sometime cabinet minister, Dr. Viggo Starke: "What I produce is mine. *All* mine! What you produce is yours. *All* yours! But that which none of us produced, but which we all lend value to together, belongs by right to all of us in common."¹⁴ The clear division between mine, thine, and ours, which makes the Georgist paradigm so morally appealing, now looks like rhetorical hyperbole.

And so it is, but in one sense only. There is another sense in which the theoretical division remains quite valid.

Many years ago, when the present writer was working on his doctorate at the University of Southern California, he would occasionally encounter on campus the striking figure of a regal-looking gentleman whose wavy white hair and pink complexion were always set off by an elegantly-cut blue suit. Tall and erect, with luxuriant but carefully trimmed moustache and piercing blue eyes behind rimless glasses, Dr. Rufus B. von Kleinschmidt seemed every inch a university president—as, indeed, he had once been. Some years before, however, he had

been elevated at USC to the chancellorship, a position insulated from contact with the faculty. Thereon hangs a tale, which may or may not be apocryphal:

The Western Association of Colleges and Universities had published the salary schedules submitted to it by the presidents of all the institutions of higher learning accredited by it, USC among them. Upon reading this report, members of the faculty began comparing notes, and soon realized that USC's salary schedule was highly inflated, bearing little relation to what they were actually being paid. When they confronted President von Kleinschmidt with this discovery, they received the following response: "But that *is* our salary schedule. I never said that we were able to meet it." Let us be charitable and leave open the question of whether this equation of the real with the ideal on von Kleinschmidt's part was an expression of Platonism or of disingenuousness.

There is a strain of qualified Platonism in Henry George's thought, but he was the least disingenuous of men. He anticipated Hayek's stricture, and addressed it head-on in an article in *The Standard*, August 17, 1889:

I am convinced that with public attention concentrated on one single source of public revenues, and with the public intelligence and public conscience accustomed to look on the payments required from that, not as an exaction from the individual, but as something due in justice from him by the community, we would come much closer to taking the whole of economic rent than might seem possible at present. Yet I regard it as certain that it must always be impossible to take economic rent exactly, or to take it all, without at the same time taking something more. . . . Theoretical perfection pertains to nothing human. The best we can do in practice is to approach the ideal. . . .

Is it not better that the state should, on the whole, get something less than its exact due than that individuals should be compelled to pay more than they ought to be called upon to pay? If so, we must in any case leave a margin.

This I have always seen. What that margin should be I have never attempted to formulate, and have never put it at ten per cent or at any other per cent. What I have always stated as our aim was that we should take the whole of economic rent "as near as might be."¹⁵

Perfect justice, then, is what Reinhold Niebuhr termed "an impossible possibility."¹⁶ Our inability to attain it does not relieve us of the

obligation to approach it as closely as we can. This the Georgist model does, while few of the others even try. And where, in practice, it falls short of the ideal (as, to some extent, any human effort always must), George would have it err on the side of the individual.

Notes

1. Register of the Friedrich A. von Hayek Papers, 1906–1992, Hoover Institution Archives, Stanford University, Stanford, CA.

2. F. A. Hayek. (1994). *Hayek on Hayek: An Autobiographical Dialogue*, Stephen Kresge and Leif Wenar, eds.; Chicago: University of Chicago Press, p. 63.

3. Nicolaus Tideman. (1994). "The Economics of Efficient Taxes on Land," in Nicolaus Tideman, ed., *Land and Taxation*, London: Shephard-Walwyn Ltd., p. 134.

4. Philip Day, *Land: The elusive quest for social justice, taxation reform & a sustainable planetary environment* (Brisbane: Academic Press, 1995), p. 102. Day's response to this phenomenon is merely to emphasize that it is "the *existence of a community and its organised social structure*, as well as its exercise of land use planning powers which provide the developer with the opportunity to develop and to choose the quality of development which is likely to prove most profitable." (Note 3 to chapter 11, p. 109.) While this consideration may justify reducing the percentage of land value retained by the owner, it does not fully resolve the problem to which this paper is addressed, which is not so much a problem of magnitudes as it is of principle.

5. Cited by Charles Hooper (1993) in his article on Henry George in David K. Henderson, ed., *The Fortune Encyclopedia of Economics*, New York: Warner Books, pp. 789–90. Hooper sees the problem as a defect in George's proposal, but apparently not as an invalidating one.

6. In New York City, the Chrysler Building, the Empire State Building, and Rockefeller Center were all built on leased land, and the same is true of most major buildings in Hong Kong and Singapore.

7. F. A. Hayek. (1960). *The Constitution of Liberty*, Chicago: University of Chicago Press, pp. 352–53.

8. Henry George. (1962 [1879]). *Progress and Poverty*, New York: Robert Schalkenbach Foundation, p. 404.

9. Sock-Yong Phang. (1997). "Hong Kong and Singapore," in R. V. Andelson, ed., *Land-Value Taxation Around the World*, 2nd edition, New York: Robert Schalkenbach Foundation, Ch.16.

10. George, *Progress and Poverty*, p. 421.

11. *Ibid.*, p. 426. Because such permanent improvements become indistinguishable from the land itself, he held that after a certain lapse of time their value should "be considered as having lapsed into that of the land, and . . .

taxed accordingly,” which “could have no deterrent effect on such improvements, for such works are frequently undertaken upon leases for years.”

12. Jürgen G. Backhaus. (1997). “Reading Henry George in 1997,” a paper presented at a conference on Henry George Re-Considered, Maastricht University, The Netherlands, Oct. 28.

13. In undated correspondence and conversations with the present writer. Gwartney was formerly assessment commissioner of British Columbia.

14. Slightly paraphrased with emphases by the present writer from “Our Daily Bread,” *Proceedings of the Eighth International Conference on Land-Value Taxation and Free Trade*, London: International Union for Land-Value Taxation and Free Trade/Danish Henry George Union (1952). The conference was held at Odense, Denmark, July 28 to August 4, 1952.

15. Reprinted in Kenneth C. Wenzel, ed., *An Anthology of Henry George's Thought*, Volume I of the Henry George Centennial Trilogy; Rochester, NY: University of Rochester Press (1997), pp. 82, 83.

16. Reinhold Niebuhr. (1935). *An Interpretation of Christian Ethics*, New York and London: Harper & Brothers, pp. 113, 117 and 118. For an understanding of what Niebuhr meant by this term, the whole of Chapter 7 should be read.