

The Science of Economics

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1. The Collection of Land Rent

If people are free to conduct their economic lives as they please, so long as they do not harm others, in accord with the universal ethic described in Chapter 1, then they live in a free society with a free market. The ideal market economy is built on a legal foundation in which human rights, including property rights, are protected. Its two main principles are

- 1) self ownership - each person owns his or her life and labor, and
- 2) charging rent for the use of natural resources, since land cannot be claimed from self-ownership.

Economic land rent is the potential, if not actual, yield on land exclusive of capital goods tied to land, such as buildings. The amount of rent is determined by the value of the uses to which the land can be applied. Some rental value is due to natural features, such as sunlight and rain for farm land. For urban land, the bulk of value is due to human action: population and commerce create a demand to be located in this territory, increasing rent and land value. Still more site value and rent are created by civic goods and services, such as transportation, security, and parks. This rent generated by civic goods can be collected by the agency providing the goods, which can include private proprietary communities and residential associations as well as governments.

But will rent alone supply enough revenue for government? Land rent comes from three basic sources:

- 1) natural benefits, such as proximity to water;
- 2) population and commerce;
- 3) civic works.

On the third source, the increase in rent generated by civic services determines the socially desirable amount of the service. If a service does not generate enough rent to cover the cost, then it should not be provided. On the other hand, there is no such market measuring device for taxes on labor, interest, wealth, profits, and value added. Moreover, since economic land includes all space, including the seas and the atmosphere, fees for pollution are in effect rent paid for dumping on that land, which when added to the rent of surface sites more than adequately covers public expenditures. Given a certain budgeted amount of spending B , and an amount of funds raised from other rents R , the amount charged for pollution can be $B - R$.

If industries are to take full advantage of the economies of scale which exist within cities, the revenue from land rent must be used to supplement the fees charged by these decreasing cost activities, such as busses and subways. This is not a subsidy, since the transportation, street, park, etc., induces that very rent that is then used to finance it.

The reason lies in the important distinction between marginal and average cost pricing. Marginal cost is the increase in costs due to the expansion of production by one unit. Average cost is the total cost of production divided by number of units. Since the marginal cost of an increasing-return (or decreasing-cost) industry is below its average cost, if its prices are set at the short-run marginal cost, the revenue will not cover the fixed costs of production.

Thus, revenue derived from land rents is efficiently used to supplement the revenues of decreasing-cost industries raised by pricing according to the marginal costs, to defray those fixed costs of services which are not marginally attributable to the amount of output. The funds from land rent are, however, only efficient if the service generates such rents in a free market.

An illustrative example would be the case of mass transit and other forms of transportation. If transportation is funded by land rent to cover its fixed costs, it can afford to price its output at levels which represent the marginal cost of supplying the service. In some cases, the provision of transportation is not even funded by marginal pricing at all, or else the marginal cost is free. Hotels, for example, do not charge for the use of the elevators, the cost being included in the room charges, which amounts to a type of rent. As demand increases, the producer can expand output, thereby allowing the service to take full advantage of its economy of scale. Finally, with lower prices and an expanded service more people would be encouraged to use mass transportation and thereby reduce the diseconomies of other modes of travel, such as congestion on the roads.

In a society which seeks to limit government involvement in the market place, subsidies would be shunned as producing waste and inefficiency. But if the funding is derived from the rent generated, then no subsidy is made. Projects which increase site rents transfer tax-payers' money into the land-owner's pocket. The provision of such public services financed by land rent conforms to the benefit principle of public finance, and is similar to the market provision of services, being neither an arbitrary cost nor a subsidy. Such services can be and have been provided by private organizations as well, along these very principles (see Foldvary, 1994).

2. The outcome of a pure market economy

In a pure market economy, there are no restrictions or taxes on productive effort, including labor, enterprise, sales, and profits. Community services, whether provided by government or by private firms or associations, are funded by user fees and land rent, including charges for pollution. How would such a world differ from ours?

The claimed benefits of the **community collection of rent (CCR)**, often under the rubric of land-value taxation, have been regarded as exaggerated. Not only have the proponents of CCR

pointed out its efficiency and equity relative to taxation, but they have also claimed that it would greatly reduce if not eliminate unemployment and poverty, and with them many of our social problems such as crime, drug abuse, and urban sprawl.

Perhaps it will cure cancer too!

These benefits do not stem only from sharing rent, but from eliminating the barriers that now intervene between enterprise and resources. If CCR is a panacea, it is only because there is one universal anti-panacea, a universal cause of social distress - the use of force to prevent labor from freely accessing natural resources. Removing this barrier is like taking down a dam - the waters of enterprise will come gushing forth. We see this time and again when countries have liberalized their economies. Is it not interesting that when the rulers of socialist economies wish to perk up their economies a bit, they reduce, not increase, taxes and restrictions.

As Henry George (1879, p. 433) states, "

With all the burdens removed which now oppress industry and hamper exchange, the production of wealth would go on with a rapidity now undreamed of."

It would be, he said,

"like removing an immense weight from a powerful spring.... The present method of taxation operates on exchange like artificial deserts and mountains; it costs more to get goods through a custom house than it does to carry them around the world" (p. 434).

Government punishes people with taxes for building and producing as though they were crimes. It is the removal of burdens, of restrictions and taxes and other imposed costs, that would stimulate production, increase employment, and raise wages. Exactly how much, no one can know. But with over 90% of workers employed even with these burdens, it is reasonable to conclude that the remaining 10% would be in demand with the abolition of taxes on labor and enterprise. As evidence, we can see the prosperity of Hong Kong and the high wages in Switzerland, which have relatively more freedom than other countries, yet are also far from pure market economies.

As George put it (p. 461):

"Give labor a free field and its full earnings; take for the benefit of the whole community that fund which the growth of the community creates, and want and the fear of want would be gone. The springs of production would be set free, and the enormous increase of wealth would give the poorest ample comfort. Men would no more worry about finding employment than they worry about finding air to breathe; they need have no more care about physical necessities than do the lilies of the field. The progress of science, the march of invention, the diffusion of knowledge, would bring their benefits to all."

This progress has two benefits, the direct and indirect. We already benefit from the direct effect, from the knowledge itself, but the indirect effect is to raise land rent. With CCR, we would all

equally benefit from this second effect as well, rather than it going to landowners who contributed nothing to the progress of technology.

Even if unemployment is not totally eliminated, eliminating much of it will also have positive social effects, just as high unemployment has negative effects, increasing crime, drug and alcohol abuse, and generally demoralizing communities. As George says, "Every productive enterprise, besides its return to those who undertake it, yields collateral advantages to others" (p. 435). These benefits are called "**positive externalities**" or "**external effects.**" If you plant a tree, the whole neighborhood benefits from its beauty. And as George recognized, these territorial externalities increase rent: "And in the value or rent of land is this general gain expressed in a definite and concrete form."

As noted in Chapter 3, the community collection of rent reduces the selling price of land, the formula being $p = r/(i+c)$ where p is the price of land, i is the real interest rate, and c is the collection rate, the percentage of the land price p being collected. For example, if $c = .5$, then the annual assessment equals half the price of land. As c goes up, p must go down.

This decrease in selling price implies that enterprises do not have to borrow large sums of money to acquire land. The rental payment to the community takes the place of a mortgage. This frees up loan funds for paying for capital and labor. Interest rates would then drop, since there is much less demand for loans for real estate, and the decrease in interest rates stimulates enterprise even more. The elimination of land speculation also decreases the cost of land for both enterprise and home owners, and, combined with a sound banking system, would dampen if not eliminate the business cycle and depressions. Land being held for speculation would be put on the market for immediate use, and the more efficient use of land would again increase productivity and increase employment and wages. CCR would put in motion an upward spiral of ever increasing productivity and employment.

"Consider the effect of such a change upon the labor market. Competition would no longer be one-sided, as now. Instead of laborers competing with each other for employment, and in their competition cutting down wages to the point of bare subsistence, employers would everywhere be competing for laborers, and wages would rise to the fair earnings of labor. For into the labor market would have entered the greatest of all competitors for the employment of labor, a competitor whose demand cannot be satisfied until want is satisfied - the demand of labor itself. The employers of labor would not have merely to bid against other employers, all feeling the stimulus of greater trade and increased profits, but against the ability of laborers to become their own employers upon the natural opportunities freely opened to them... [T]he spectacle of willing men unable to turn their labor into the things they are suffering for would become impossible."

Although the extent of these benefits cannot be forecast, the direction towards substantially reducing unemployment and poverty has a sound theoretical basis, and we need only compare those countries which have tried economic freedom even on a small scale - such as the growing East Asian economies - to those which have not, to see empirical verification of the benefits from freeing enterprise from imposed barriers and costs.

And these benefits also had advantages for the distribution of wealth. Much of the unequal ownership of wealth stems from a highly unequal ownership of land. The pattern typical in much of Latin America, for example, is for much of the farm land to be owned by a small number of wealthy families. **But even in the United States, land ownership is highly concentrated, especially commercial land.**

The collection of land rent by communities and governments, its benefit shared equally by the population, would eliminate one of the greatest causes of inequality, one which does nothing to further production. On the other hand, inequalities of wages due to different talent and effort would be left undisturbed, so that those with the greatest ability, education, and determination would have the full incentive to produce and create wealth.

As an economy grows, land rent tends to increase more than proportionately, so the equalization of the benefits of the rent equalizes the benefits from progress that spill over to a community as a whole.

Henry George recognized that the removal of barriers would stimulate technology as well. "It is mind, not muscle, which is the great agent of production" (p. 444).

"The increase in the reward of labor and capital would still further stimulate invention and hasten the adoption of improved processes, and these would truly appear, what in themselves they really are - an unmixed good. The injurious effects of laborsaving machinery upon the working classes, that are now so often apparent, and that, in spite of all argument, make so many people regard machinery as an evil instead of a blessing, would disappear" (p. 445).

George, as a social philosopher as well as economist, recognized that CCR would have profound effects on social life beyond the advance of material welfare.

"Noticeable among these is the great simplicity which would become possible in government. To collect taxes, to prevent and punish evasions, to check and countercheck revenues drawn from so many distinct sources,"

all these complications would be dispensed with (p. 454). CCR would also eliminate much of the transfer-seeking, the lobbying of government for favors, since first, there would ideally be constitutional measures preventing such privileges, and secondly, the absence of taxation would make this seeking more difficult politically. Because, as local officials know, few taxes get so much resistance to increases as a charge on real estate. Because CCR gets capitalized into lower property values, any extra government spending would imply funding from land rent, which would stir an opposition from landowners. And if CCR was a fixed amount, then this cap would also limit privilege-seeking.

The rise in wages that would flow from increased prosperity would reduce the economic causes of crime. The elimination of complex taxes and of much crime would then reduce "the great host of lawyers who are now [even in 1879!] maintained at the expense of producers; and talent now wasted in legal subtleties would be turned to higher pursuits" (p. 455).

While government as a repressive power would be reduced, governance as such would not be limited in a free society. People could join voluntary organizations, including civic and residential associations, which would provide whatever the members wished. Many of these would be territorial and collect the rents generated by their own services (see Foldvary, 1994). "Government would change its character, and would become the administrator of a great co-operative society" (p. 456).

In George's vision, social behavior would become transformed by universal prosperity. Human nature itself would not change, but the changed economic environment would induce the more benevolent aspect of human nature to become more dominant and the more greedy and apathetic aspects to become less so. Adam Smith in *The Theory of Moral Sentiments* (1790, p. 9) recognized that

"How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure in seeing it."

These principles he called "sympathy" by which he meant "our fellow-feeling with any passion whatever" (p. 10). Sympathy is a feeling of affinity and empathy with another person, group, culture, or project. Henry George (1879, p. 458), in words similar to Smith, stated: "The desire for approbation, the feeling that urges us to win the respect, admiration, or sympathy of our fellows, is instinctive and universal".

George felt that greed need not be "the strongest of human motives" (1879, p. 457). Often, greed comes from poverty or the fear of not having enough in the future. When prosperity assures all who wish to work a well-paying wage, greed would be replaced by benevolence (p. 461): "With this abolition of want and the fear of want, the admiration of riches would decay, and men would seek the respect and approbation of their fellows in other modes than by the acquisition and display of wealth." George was perhaps too optimistic about the reduction in the desire for wealth, which is anyway not necessarily harmful to others. **The more important point is that the prosperity assured by the pure market economy would reduce greed - the desire for undeserved gain - and promote sympathy with one's community and with fellow human beings.** Economics alone would not do this, since upbringing and ethical education are also needed in order to instil sympathy among the population. But at least the economic incentives would be in the direction of benevolence.

Neo-classical economics is based almost entirely on the premise of self-interest. But to George (p. 462),

"Shortsighted is the philosophy which counts on selfishness as the master motive of human action... If you would move men to action, to what shall you appeal? Not to their pockets, but to their patriotism; not to selfishness, but to sympathy. Self-interest is, as it were, a mechanical force - potent, it is true; capable of large and wide results. But there is in human nature what may be likened to a chemical force; which melts and fuses and overwhelms; to which nothing seems impossible. 'All that a man hath will be give for his life' [Job 2:4] - that is self-interest. But in loyalty to higher impulses men will give even life."

Whereas in modern neo-classical thought, even when sympathy is acknowledged, self-interest is seen as the dominant motive, George (p. 463) thought the opposite:

"Call it religion, patriotism, sympathy, the enthusiasm for humanity, or the love of God - give it what name you will; there is yet a force which overcomes and drives out selfishness; a force which is the electricity of the moral universe; a force beside which all others are weak... And this force of forces ... we may use for the strengthening, and building up, and ennobling of society, if we but will, just as we now use physical forces that once seemed but powers of destruction. All we have to do is but to give it freedom and scope."

Though a society in which goodwill and benevolence are the norm seems utopian to some, George showed how circumstances can make it so in his example of a dinner party. In a company of "well-bred men and women dining together," where the food is plentiful, the people don't greedily grab food away from others. "On the contrary, each one is anxious to help his neighbor before he partakes of himself." Indeed, if anyone behaves greedily and disregards others, "the swift and heavy penalty of social contempt and ostracism would show how such conduct is reprobated by common opinion" (p. 464). George noted that this behavior is common at such parties, and if social conditions were like the party, with enough wealth for all to live adequately and equitably, with no fear of want, society would be like that too.

George adds that eliminating injustice and poverty would not destroy the "stimulus to exertion," because "desire would remain" (p. 466). "It is not labor in itself that is repugnant to man" (p. 467). Released from poverty and fear, people would work harder and better, motivated not so much by necessity but by the pride and satisfaction of producing, creating, and contributing. Great artists do not create for bread. Lesser artists too are motivated by more than groceries. As George said (p. 468), "the work which improves the condition of mankind ... is not done to secure a living... It is the work of men who perform it for its own sake... In a state of society where want was abolished, work of this sort would be enormously increased." People would be able, both in work and in leisure, to develop their minds - George recognized that many people have latent abilities that lie dormant due to lost opportunities (p. 469).

The elimination of restrictions and taxes on enterprise has a cascading effect, one benefit leading to another. Universal prosperity will have more than material consequences; it will improve the moral and social life of humanity. This does not imply that there will be a utopia. There would continue to be problems of personality conflicts and cultural clashes. Bias and negative attitudes are not so easily eliminated. But the gross economic problems and the social problems stemming from them would become history, just as chattel slavery has been eliminated from much of the earth. We cannot have utopia, but we can have a much better world, and the economic knowledge required to achieve it is known.

The question in achieving a new world of prosperity, justice, and harmony is: how do we deal with the ultimate problems blocking the way? The ultimate causes of social problems are ignorance, apathy, and greed. Education will overcome ignorance, movements for reform informed by proper education will overcome apathy, and then a sound economy and government will overcome greed.

