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# Land Rent, Ethics, and Capitalism's Gestation Crisis:

*A Jerome Levy Economics Institute Paper*

By JAY LEVY\*

**ABSTRACT.** As population increases land rises in value and this causes greater and greater payments to land owners without any contribution to production by them. This wrongly deprives producers of increasing amounts of income that they produced and are entitled to. As the process proceeds, it threatens the viability of capitalism itself as it lowers profits for the prime movers in the economic system. Home ownership in the US is becoming increasingly difficult for young people as the price of land keeps rising. Economic progress has been very fast in countries that tax land and seek its equitable distribution and is lagging in those that do not. The high unemployment rates in Europe are related to this unfair distribution of income.

In almost all of the leading industrial economies unemployment is too high; the rich have been getting richer and the poor, poorer; governments have huge debts that keep ballooning.

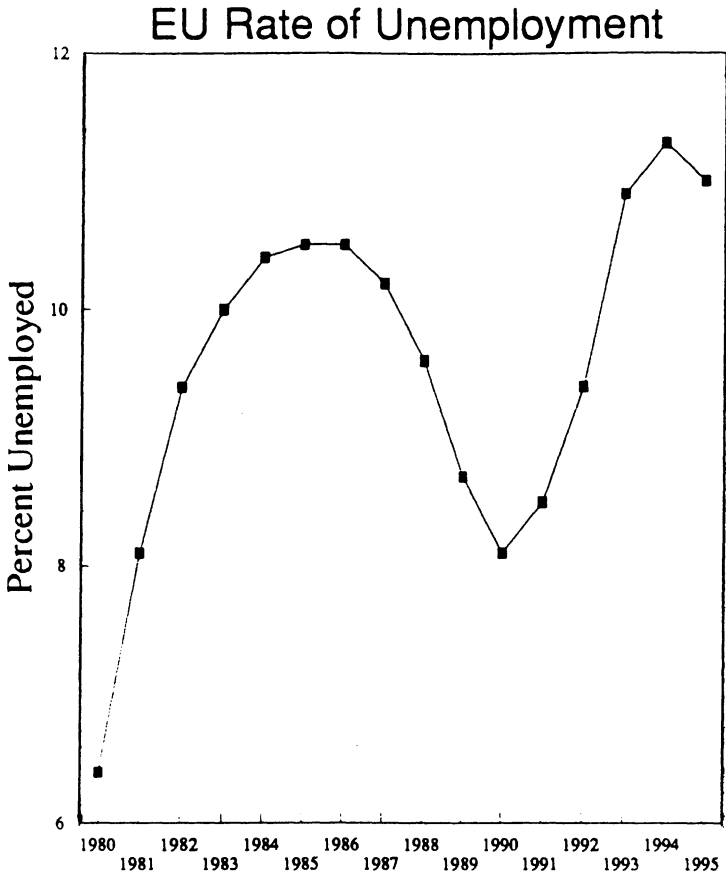
The hypothesis I am discussing this morning relates serious economic problems in the United States, and even more so in other industrialized countries, to the high and generally rising value of land. Increasing demand for land against its static supply are going to raise its price further. The 11% unemployment rate in the European Community, the decline in the purchasing power of American workers during the past two decades, and the epidemic of homelessness in the industrial world may have roots in the rising cost of land.

The purpose of an economy, be it hunter-gatherer, socialist, capitalist, or anything else is to produce goods and services. Since any system wants people to produce, it should reward them for their contributions to production. Indeed, any economy has this inherent ethic: to each according to his contribution to production. In the hunter-gatherer economy, the effort that is made to produce, to bring dinner home, is quite directly rewarded. In a modern, advanced econ-

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omy, this relationship is not always so visible. Nonetheless, the operation of any system that ignores the ethic is inconsistent with that system's goals.

If an economy rewards those who are not productive, it is wasting the incentive to produce. It is giving away something for nothing, it is violating its own ethic. Most people, assuredly all of you in this room, believe that burglary is not ethical and that burglars should not be rewarded. Successful second-story men receive gains although they produce nothing. In our society, many people who are not felons, receive income that has nothing to do with a contribution to production. Some of that income comes from the ownership of land.

I hasten to make a distinction between income from the use of land and income from mere ownership. Farmers, builders, producers of electricity from

water power, office building managements, and many others use land and are entitled to the opportunity of a profit. Absentee owners, rentiers with tenant farmers are not.

The land that supports the RCA building in New York does so because of John D. Rockefeller's and his associates' vision and initiative back in the early 1930s. He leased the land and proceeded to erect this monument. The lessor, the recipient of the rent for the land under Radio City, did not conceive of, design, or in any sense build this complex. Whether Columbia University's, Herbert Hoover's, Al Capone's, or the City of New York's name was on the deed was immaterial to the actual building of Radio City. Was rewarding the owner of that land consistent with compensating people in accordance with their contribution to production?

Often landowners are fortunate beneficiaries of the constructive efforts of others. One landlord may have dreamt up a new shopping mall and acted on his inspiration. His venture in great likelihood increases the value of the property across the road. Or the state may have built a new super-highway. Those who own land near the interchanges are likely to find that the value of their properties has soared. The venturesome landowners who build shopping malls, theme parks, and other improvements that increase the value of their land are certainly entitled to the increased incomes that the projects bring. And they are arguably entitled to the increase in the value of the land that their enterprise has created. But those fellows on the other side of the road who are benefiting from the creativity and willingness to take risks of the venturesome builders—what is their claim to increased wealth?

Most people agree that persons should be rewarded in accordance with their contributions to production. Yet societies, ours and most others, have another ethic that often contradicts the first. Private property and especially private ownership of land is sacred. The idea of government impinging on the right to own and profit from land is widely viewed as wrong, even sinful. Indeed, human beings may have been designed with the inherent concept that owning land is a God-given right.

Owning land may be divinely sanctioned, and if it is, it also is a right that manifests itself widely in nature. I do not believe that many serious students of animal behavior doubt that some species tend to stake out territories and attack trespassers. Certainly our species has done so for millennia. Indeed one of the first sciences was geometry, a prerequisite for surveying.

The power of the concept of private ownership of land is apparent. Time and again, land reform, that is modification of land tenure, is prescribed to improve the lot of poor people in countries that provide little more, and sometimes less, than subsistence for most of the population. Although the constituency for reform

is often overwhelming, land tenure is altered rarely. Thus although land reform has been widely favored in the Philippines and sometimes clearly advocated for that nation by United States government officials, nonetheless, a few wealthy families still own much of the acreage in that archipelago and masses of indigent farmers pay rent to them. The Philippine standard of living is to Americans a tragedy.

The socialist-oriented political parties that governed several European countries in the decades after World War II eagerly advocated and succeeded in the nationalization of major industries. But they barely touched land.

Soon after Margaret Thatcher became Prime Minister, I met a leading member of the Labour Party. He and I fell into a discussion of the economic policies that led to her triumph. I chided, "Your party nationalized all the wrong things and did not nationalize what you should have nationalized, land."

The former eminent Labour MP, who had become a Lord, looked at me earnestly. "You can't," he said, "take a man's home away from him."

I thought to myself that it is often acceptable to take a person's business but something sacred makes taking land a taboo. But I pressed on, "I am not talking about taking a man's home from him," I said. "I'm talking about vast holdings of land, about, for example, those few people who own most of the land here in London."

"Uh," said my new acquaintance, "my landlord, the Duke of Westminster, has just demanded an unconscionable, twenty per-cent increase in rent."

I may have invited you to misunderstand me. Let me make my position clear. I emphatically do not believe in or advocate the socialization of land. But I do believe that tax and other relevant policies should aim at relating income from land to its use. Successful efforts toward such a goal did occur after World War II in three countries, in Taiwan, South Korea, and Japan, all of which still have private ownership of land. Land reform was imposed from outside.

Of the four Pacific rim nations I have mentioned, the Philippines at the end of World War II had the best prospects for growth; it had ready access to American capital and strong economic and other ties to the United States. Yet while most Filipinos remain impoverished the prosperity now enjoyed in the three nations in which farmland held by absentee landowners was sold to the farmers is not an accident.

Many of us meeting here can lament the injustice of unearned income including the income from the increasing value of land. We can conclude that the inevitable rising demand for a fixed supply of land unjustly enriches some but hurts a great many more people. We may sympathize with young families whose standard of living has been pinched by excessively rising rents. We can cite the consumer price index which indicates that consumers who devoted

24% of their expenditures for shelter a quarter of a century ago currently, are earmarking 28% of their outlays to keep a roof over their heads. These data fail to note that younger people are especial victims of the rising cost of housing. Many older people have burned their mortgages and have been enjoying a decline in annual outlays for shelter. On the other hand, younger persons are often paying rents that have had to rise because of the increased value of land. They have had to defer purchases of their own dwelling.

We may well believe that something is out of kilter when young people find it much more difficult than the previous generation to own their own home. The high cost of shelter undoubtedly contributes to the growing population of homeless persons.

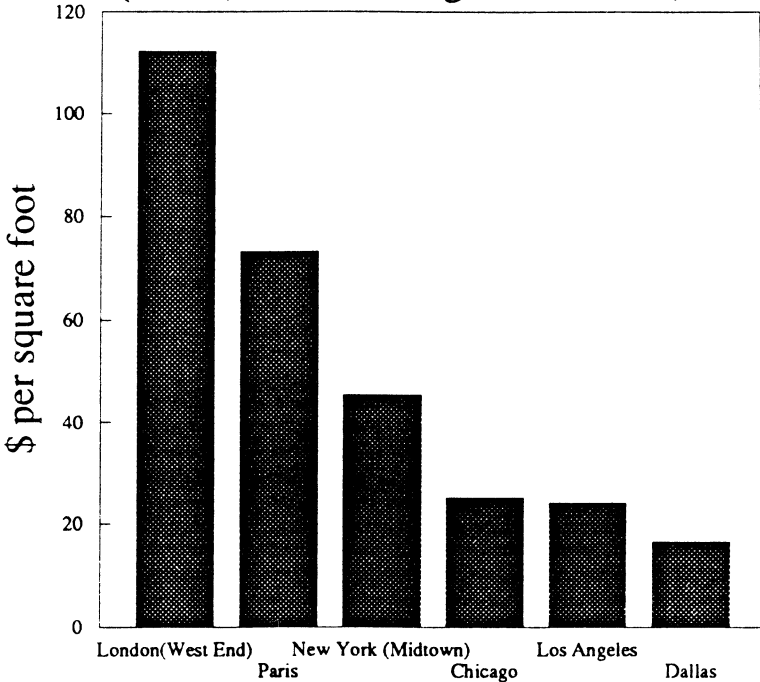
Landowners in the United States constitute a formidable bloc with great political clout. Two-thirds of the households own their own dwellings and the land under them. Thus a substantial majority of Americans are landowners. Some landowners in our country have acquired great wealth and with it, power. We may think that major reforms in the taxation of land and in the taxes on the capital gains from the sale of land are in order. We should also recognize that no such changes will be made; the political power of both an overwhelming majority of the voters and of the wealthy is an insurmountable barrier to such a change.

Yet I am about to explain why a change in the politics affecting land may well occur within a few decades. The United States will be virtually forced to take steps to limit the negative effects of rising land values if its capitalist and democratic systems are to flourish. I suggest that most of the countries in the European Community, where the unemployment rate averages 11%, should recognize a connection between their unacceptably high numbers of jobless and the value of land. Land prices are much higher in Europe than in the United States.

The accompanying chart concerning annual occupancy costs is adapted from one which you may have seen about a month ago in *The New York Times*. (It accompanied an article on the high cost of office space in Tokyo.) It shows that office space in London's West End costs \$112 a square foot, about two-and-a-half times as much as in midtown New York and four-and-a-half times as much as in Chicago. In Paris, office space at \$73 a square foot costs more than one-and-a-half times as much as in New York and almost three times as much as in Chicago. While these data apply to commercial, not residential space, they serve as a proxy for the prices of household shelter, prices that have soared as a result of land costs that have appreciated enormously since World War II.

To overcome the reluctance to interfere with the status quo regarding the taxation of land profits and related issues, we should view our economy in a way that differs from usual perspectives. Indeed, a fundamental and necessary

## Total Annual Occupancy Costs (Rents, Service Charges, Local Tax)



insight into our economy will some day become necessary if we are to avoid the chronic high rate of unemployment that plagues western Europe. Our allies across the Atlantic, if they are to maintain democratic, private enterprise institutions, should understand what is fundamentally wrong with their economies. To do so we, and they, need to think about profits. Yes profits.

Profits in any economy result from certain flows of funds. Profits are a small part of national income, about 11% at present in the United States. They are a limited and precious component of national income—precious because they are the inducement for private sector production and employment.

Profits are hidden in the well known equation, saving = investment. Barely anyone doubts that saving equals investment. It somehow leads people of almost all political orientations to argue that we need more saving if we are to have more investment. Yet, few pay attention to the profits component of the saving

= investment identity. Investment equals saving, and saving includes business saving. Corporate profits after both taxes and dividends is the major component of business saving.

Because some of you have heard me run through the exercise before, I will not repeat the steps by which we transpose the terms of the saving-investment identity and arrive at the profits identity. This procedure is mapped in the supplement to this paper called "Profits!"

The lower portion of the table headed "Sources of Profits" shows the components of the profit identity and their values for the years 1969 and 1994. The data are from National Income and Product Account table 5.1, which has the title, "Gross Saving and Investment," and is a representation of the "saving equals investment" identity. Because the changes in the sources of profits listed at the top of the table in the quarter of a century between 1969 and 1994 are startling, I am taking a moment to show them.

Three changes that have occurred in the sources of profits during the past twenty-five years are striking, indeed, alarming. First, net fixed investment, investment in fixed assets, in plant and equipment, less depreciation, has suffered a large decline relative to the rest of the economy; its importance as a source of profits has crucially diminished. Second, net foreign investment, which is dominated by the balance of trade, has switched from a small source of profits to a vast drain on domestic profits. And, third, the public sector, which was \$10 billion in the black in 1969, was \$133 billion in deficit in 1994. As you can see in the table, this deficit, which is entirely accounted for by the federal government, has become a huge source of profits, one that is essential to offset negative net foreign investment and the weakness in private fixed investment.

My primary purpose for showing the sources of profits for two different years is to emphasize that profits are created from specific flows of funds, and that although these flows change over time, they are always limited. The aggregate amount of profits in any period is finite. Therefore, the incentive for private enterprise to produce goods and services and employ men and women in the process is limited. Under these circumstances, who gets profits is important. Those organizations and persons who receive rents on the appreciated value of their land are obtaining a share of the limited amount of profits without producing anything or employing anyone.

Forty years ago I bought the land on which my house sits. The rise in the market value of this piece of real estate is striking, not unusual, but greater than typical. This land is worth sixty times what I paid for it. Meanwhile, the cost of replacing the house has increased about six times, the same as the consumer price index.



Sources of Profits	Billions of \$\$	
	1969	1994
plant & equipment	102.9	667.2
residential construction	42.6	287.7
capital consumption	-79.5	-678.7
<i>net private fixed investment</i>	66.0	276.2
<i>change in inventories</i>	9.5	59.5
<i>net foreign investment</i>	1.8	-139.6
<i>gov't saving + deficit</i>	-10.0	162.5
<i>personal saving</i>	-46.9	-207.1
<i>corporate profits tax</i>	39.7	195.3
<i>dividends</i>	25.2	211.0
<i>statistical discrepancy</i>	2.2	-31.3
<i>Profits Before Tax*</i>	87.5	526.5
Gross Domestic Product	982.2	6931.4
	% of Total Profits	
<i>net private fixed investment</i>	75.4	52.5
<i>change in inventories</i>	10.9	11.3
<i>net foreign investment</i>	2.1	-26.5
<i>gov't saving + deficit</i>	-11.4	30.9
<i>personal saving</i>	-53.6	-39.3
<i>corporate profits tax</i>	45.4	37.1
<i>dividends</i>	28.8	40.1
<i>statistical discrepancy</i>	2.2	-5.9
<i>Profits Before Tax*</i>	100.0	100.0

Forty years ago, the land was worth one eighth as much as the house. Today it is worth as much as the improvement. The lender who finances the purchase of a house in my community is making a large loan and receiving a sizable amount of interest on the appreciated value of the land. This income has nothing to do with building a house or employing carpenters and plumbers. The interest on the appreciated value of land beyond the general inflation is income that is unearned. It is not a reward for the production of goods and services.

Lenders who finance real estate purchases, and firms that are lessors are taking some of the finite amount of the economy's total profits. The inducement for those who would produce goods and services is reduced by the profits both of landlords and of the financiers of land ownership.

In early postwar Japan, South Korea, and Taiwan, the former landowners had little choice but to invest the receipts from the sale of their acreage in industry. In some cases, they were given state-owned industrial enterprises in exchange for their land. The landowners became industrialists. As they pursued profits in their new role, they developed highly efficient, productive industries that created vast numbers of jobs.

Economists recognize the profits identity but pay little attention to it. Yet, if they focus on profits, their influence may avert a crisis. Such a focus should appraise non-financial business and working people that an increasing flow of the economy's profits is going to those who are benefiting from the rising price of land, not from a contribution to the production of goods and services. The more profits non-productive enterprises receive, the less available for productive enterprise, the smaller the incentive to produce goods and services and, in the process, to employ workers.

Because neither professional nor lay people have spent much time thinking about aggregate profits in the way I have been discussing them, they are unlikely to readily change their perspective on the economy. Nonetheless, every consumer knows that if he or she spends an increasing portion of income for shelter, less will be left for TVs, sweaters, movies, and so forth. Consumers and the businesses that are deprived of sales and profits because of the growing claim of landowners on profits, are potentially a powerful constituency for change. This constituency includes, but is larger than the landowner bloc.

I strongly suspect that the stubbornly persistent 11% unemployment rate in Europe can to a great extent be blamed on a growing share of profits being secured on the appreciated value of land. Not enough profits remain as an incentive for industry to employ workers in the production of goods and services. Certainly, the necessity of spending large portions of household incomes for shelter leaves less to spend on the product of the industries that produce and distribute food, apparel, appliances, and entertainment, and smaller profits for these industries. Consumers can understand the "rent squeeze."

Europeans generally are deeply troubled by their ongoing rate of unemployment which has doubled in two decades. Yet I hear little about the cause of this phenomenon and less about how they can increase employment. Meanwhile, populations grow restless and disillusioned. The system is failing them. Unless their economies can reverse or even halt the trend of the past decade and a half, capitalism and democracy as we know them may begin to crumble.

So far Americans have seen only a small, long-term rise in unemployment. They have seen a skewing of the distribution of income in a way that hurts at least half the population. These developments have contributed to dissatisfaction and, with increasing frequency, an ugly national mood.

To understand the importance of addressing problems associated with land tenure, I recommend paying attention both to profits, the finite fraction of national income that the economy creates, and to who gets those profits. In this era, when hanky panky in high office is frequently reported on the nightly TV news, when prison construction is a growth industry, and many persons feel that the highly publicized incomes of CEOs, entertainment stars, and professional athletes are obscene, we may begin to discern a constituency that is receptive to the idea of an ethical basis for compensations.

You may be interested in relating income to economic contributions; you may believe that democracy depends on a successful capitalist system; and for these reasons you may want to see ours and other profit-motivated economies thrive and survive. If so, I urge you pay attention to the sources of that crucially valuable component of national income, profits, with an eye to seeing that profits reward only those who take risks in the production of goods and services.

### ***Freedom of the Press and Criminal Instruction***

THE PRESS pointed out that it was the mistake of their use of the car telephone which lead to the apprehension of the killers of the father of the noted athlete, Michael Jordan. This should help future miscreants from making the same mistake. Chalk one up, not for responsibility, but for freedom of the press!

The media explained what ingredients were used to make the enormous bomb which took so many lives in Oklahoma City. The earlier accounts of the bombing of the World Trade Center in New York city and the careless use of a rented truck in carrying this out might have given some useful information to the Oklahoma City criminals.

Instruction has been provided on how to cause a train to derail without the break in the tracks being detected until after the derailment has occurred.

Law officers must be somewhat chagrined to note the media's helpfulness in explaining how to make and obtain bullets which penetrate bullet-proof vests; those which shatter on impact and those that explode.

Then, accounts have been given of how a serial firebug was identified, how a stolen social security number or credit card can be used, how a false identity can be established, and the myriad benefits that might be obtained by filing a false change of address form.

At what point does freedom of the press become the "aiding and abetting" of crime, or "collusion" or "conspiracy" or "complicity" in it?

F. C. G.