Old Words, New Pictures

by Lindy Davies

Why do we have business cycles? Economists have debated this question for at least a century, offering theories upon theories—but the boom-and-bust cycle persists. Considering that a conclusive answer to this question is one of the main things that *Progress and Poverty* promises (and that the answers provided by mainstream economics have been so lackluster) you would think that our lessons on the business cycle would be one area where our curriculum would truly shine. Yet, somehow, the analysis presented in Book V, "the primary cause of the recurring paroxysms of industrial depression," is apt to strike many students as, well, quaint. A great deal of theoretical water has gone under the bridge since 1879, after all; modern students want the kind of updated macroeconomic analysis presented by, say, Samuelson's *Economics*, in neat, scientific-looking charts. Mightn't it be interesting to combine the two? How about if we try illustrating *Progress and Poverty* with the graphic tools of modern-day macroeconomics?

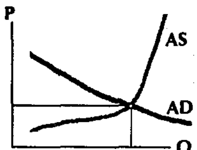

Fig. 1

We are dealing here with an **aggregate** supply-and-demand chart. The equilibrium point is the level at which unemployment is as low as it can get without inducing an unacceptable increase in inflation: the economy has reached a state that is called "full employment." That would seem to be good news. Unfortunately, though, it does **not** mean that everyone who wants to work can find a job; modern economics has given up on **that** utopian ideal. A look at the shape of the aggregate supply (AS) curve will help to show why.

Up to that point, anyway, an increase in demand will bring on a very moderate rise in prices. But once existing production facilities are working full tilt, it will cost more to meet increasing demand, and the supply curve turns sharply upward. Further increases in demand (which we can expect, because unemployment is low, the economy is growing and people have money to spend) will tend to sharply increase prices. This dynamic—what economists call **demand-push** inflation—is the main reason why we (apparently) must accept a trade-off between inflation and unemployment.

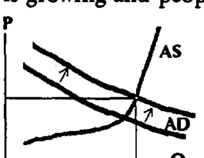

Fig. 2

Shifts in the supply curve can also change price levels, as one might expect. In fact, we have to look to the supply curve to understand the mysterious phenomenon of **stagflation**—a condition of simultaneous high inflation and growing unemployment. One thing that could bring about such a woeful state of affairs is a "supply shock"—a sudden increase in the cost of some very important resource. Classic examples of supply shocks are the mid-70s hikes in the prices of grain and oil, due to cold-war political conditions. There, the entire AS curve shifted; supply was more expensive at any level of demand.

If we were to face a situation in which a growing economy with robust demand happened concurrently with a supply shock, we would see both curves move at once.

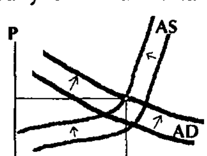

Fig. 3

Enter Book V of *Progress and Poverty*, for this is exactly the situation George describes. He shows how a growing economy tends to increase land values and the return to land speculation, because of high and growing demand for a fixed amount of natural opportunities. Land is, undeniably, a very important resource, vital to production; the increase in its value due to prosperity and speculation has the character of a supply shock, raising prices and dampening economic growth.

Henry George also has a few things to tell us about the shape of the AS curve. The fact that prices increase rapidly once the economy gets past the point of "full employment" is usually interpreted as something like the phenomenon of diminishing returns—if production reaches the capacity of existing plants and work forces, the marginal cost of increasing production goes up rapidly. But that's not all there is to it. Pressure on existing labor and capital isn't the only thing that pushes costs up. In a growing economy, existing workforces will be forced do make to with **fewer** resources than before, because of the increased incentive to hold land for speculation. That makes the upturn in the AS curve more abrupt than it has to be—increasing the inflationary effect of prosperity!

Would it be possible for us to postpone that ominous AS upturn? Yes—by making more efficient use of existing resources. Improved technology is one thing that will do that; a better educated labor force is another. Both of those things, however, tend to increase rent in the long run, leading to those inflationary/recessionary effects we've seen already. Is there any way to use existing resources more efficiently **without** spinning out on the sharp curve of supply?

Yes—there most certainly is, and it is the remedy proposed by Henry George. By creating an incentive to put land—particularly the most valuable—to its most efficient use, we can reduce unemployment **while** reducing inflation. It is by no means a natural law that wages must stagnate while prices increase. That distortion is the work of powerful vested interests: land speculators and their finance-industry jackals (aided, of course, by the tax system).

In inflationary periods, not all of the increased buying power comes from production; a great deal of it comes from the ability to collect rental income on necessary resources. That is why wages do not keep pace. The increased demand is coming from an unproductive transfer of wealth, or what Henry George called "value from obligation." Nevertheless, this extra buying power results in higher prices which must be paid by everyone. On the other hand, if the rent of land went to the community, thus stimulating efficient land use and removing land speculation, the great structural cause of "price shocks" would be removed. In our healthy, single-tax economy the demand shift seen in Fig. 2 would have this effect.

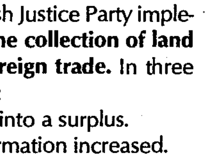

Fig. 4

TEACHERS' CORNER

Mere theory? The principles described here have had at least one convincing large-scale demonstration. In Denmark, the Danish Justice Party implemented a platform in 1957 that included **the collection of land rent, a tax freeze and liberalization of foreign trade.** In three years' time the effects of their reform were:

- A balance-of-payments deficit turned into a surplus.
- Interest rates declined, and capital formation increased.
- Unemployment was nearly eliminated, and production increased along with wages across-the-board.
- There were no new taxes and no strikes from '57 to '60
- Inflation was brought to a standstill.

In the 1960 elections, however, a well-financed campaign led by conservatives and real estate organizations mounted such an attack that the Justice Party was unable to hold enough seats in Parliament to stop the repeal of its reforms. In 1964 the land tax law was fully repealed. In 1965 Danish inflation stood at 8.6%.
(from "Economic Liberalism" by Knud Tholstrup, Copenhagen, 1974)