Edward J. Dodson

A FEW THOUGHTS ABOUT INFLATION

It is important to explore the reasons for supply shortages and rising prices beyond the impact of changing monetary policy or changing rates of taxation. We learned from political economists going back to Adam Smith and his French contemporaries, the Physiocrats, that the evolution of socio-political arrangements and institutions have a direct impact on the production and distribution of wealth. The problem with economic theory as it developed in the early decades of the twentieth century is the failure to acknowledge that nature (i.e., the factor of production always referred to as 'land') is not production; rather, nature is the source of production, the source of tangible wealth.

It was David Ricardo who was the first to attach scientific analysis to the role of nature and the markets for nature. Ricardo explained how locational advantages made it possible for some locations to yield greater production over other locations with the same quantity and quality of inputs by labor and the use of capital goods. And, as a result, political economists were armed with a scientifically-verified 'law of rent.'

Ricardo's focus was on natural advantages, rather than on those associated with the quality of societal infrastructure and public goods and services brought to locations. The industrial revolution had arrived, of course, but most of the British Isles were still devoted to agricultural production. However, Ricardo's work set the stage for Henry George later in the nineteenth century to develop a closed system analysis of economic cycles, showing that a society's method of raising revenue to pay for public goods and services – its taxing structure – determined much about how the economy of any society performed. To achieve the highest, best use of land and other natural assets, George argued the case for the elimination of all taxation in favor of a reliance on the public capture of rents from all sources.

The knowledge painstakingly accumulated by the political economists over more than two centuries was deliberately discarded by the new generation of economists who emerged in the late nineteenth and early twentieth-centuries. There is considerable evidence that the leading members of the new neo-classical school of economists wrote land out of the economic equation in service to the wealthy rentier elite who endowed university chairs in the subject. One book that provides much of the evidence, published in 1994, was authored by the former editor of Land & Liberty, Fred Harrison, and two economics professors in the United States – Mason Gaffney and Kris Feder. They titled their book The Corruption of Economics.

Prior to beginning work on a master of liberal arts degree, I took several advanced courses in economics at the University of Pennsylvania. One of those courses involved an extensive analysis of supply-side economic theory. The course raised more questions in my mind than were answered.

So, I decided to correspond with the economist credited with bringing supply-side economic theory back into the public dialogue - Arthur Laffer. I wrote him a long letter in an effort to obtain answers to my questions. As a result of that exchange, it became clear to me that Professor Laffer had spent very little time and energy examining the impact of taxation on the different factors of production and on commerce. He simply saw sufficient virtue in the reduction of marginal tax rates on income, regardless of how the income was derived. He believed that the outcome would be such an increase in economic output that the revenue steam to government would increase even as rates of taxation on individual income and business profits was lowered. As events turned out, the federal government in the United States experienced ever-increasing budget deficits and continuous cycles of boom and bust. All signs are pointing to yet another cyclical bust on the horizon.

For a bit more than two decades, I worked as a group manager and market analyst at Fannie Mae, the nation's largest investor in residential mortgage loans and a primary source of finance to this segment of the U.S. economy. One of my responsibilities was to track what was happening in the nation's residential housing markets. These markets are uniformly subject to a high level of speculation in both vacant (but developable) land and in improved properties. What is rarely discussed by mainstream economists and other analysts is that housing units are depreciating assets. They require continuous expenditures for maintenance. Then, every decade or so housing units require significant expenditures for systems replacement. As someone schooled in the political economy of Henry George and his predecessors, I came to understand that if it makes sense to tax housing, which is arguably a household's most important asset, then communities ought to impose an annual tax on other types of depreciating assets (e.g., our automobiles, our computers, our telephones, our refrigerators, our lawn mowers, etc. etc. etc.). Would any reasoning person think that taxing such depreciating assets is an appropriate way for the community to raise needed revenue? And yet, there is broad acceptance to the taxation of our housing units.

Henry George reached the appropriate conclusion based on the facts of how people behave and influence markets. The value of a location has nothing to do with individual production. Communities provide the infrastructure and public amenities that make it possible for development to occur and for location rental values to exist. Societally created location rental values must be publicly captured in order to tame land markets and to remove one of the most significant drivers of inflation from the economic system. Economic theory tells us, in fact, that if the full potential annual rental value of land and other natural assets is publicly captured, the price of land will fall and potentially fall very close to zero.