Henry George Schools of California
Box 655 Tujunga, California 91042

InterStudent Supplementary: #6

"HOW AND WHY ENVIRONMENTAL POLICIES FAIL"

LAND SPECULATION AND ECOLOGY

by Harry Pollard

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Summary: Increasing market demand is matched by increasing price. This brings production to market which cause prices to drop. Land does not behave in the market as do the other Factors – Labor and Capital. Land – which is fixed in quantity and position – neither can be produced nor brought to market. Thus, prices continue upward and a spiral of land speculation begins.

The Market and the Speculator

The price mechanism, the actual process of the marketplace, has fallen from favor in environmental matters. This has led to continual demands for government action to short-circuit the market process, even though such intervention is marked by singular lack of success.

Yet, the environmental market place can be as effective as other markets, if its apparent failure is understood and corrected. Environmental quality and high productivity can be ethically optimized by using price mechanism guidance and control.

The market is an arena of human action. To discuss properly the environmental market, we must pay close attention to its most important component – Man. This paper uses two assumptions based on observation of human behavior: "Man's desires are unlimited" and "Man seeks to satisfy his desires with the least exertion". The first describes why Man acts; the second points to the direction of his activity. *

Private and Public Futurists

It is normal for Man to speculate on future occurrence. In fact, his progress may be measured by observing his capacity and desire to conjecture ever further into his tomorrows. Planning ahead is a characteristic of an advancing civilization. Establishment of a market and its concomitant division of labor, implies future thinking. And environmental impact studies have been with us since the dawn of history. Perhaps, the 20th century has contributed little more than formality, complication, and a certain element of hysteria.

'Futurists' may be divided between dreamers and activists. The principal activist is not the environmentalist, but the market speculator. His job is to wager that his understanding of the futures market will approximate reality. His effect on the market is to smooth supply fluctuation.

A speculator's income is directly proportional to his ability to forecast future trends, which means the direction of human desires. The market is disinclined to forgive error and speculators who survive tend to be effective at prediction, which is good reason to endorse market, rather than government, planning.

Modern politicians rely heavily on the advice of tenured civil servants. These are relatively immune to, and somewhat disinterested in, the results of their decision-making. As a consequence, they are likely to stress safety and avoid responsibility for their conclusions. Lessened involvement is also likely to be accompanied by lessened ability, simply because better speculators are lured to the lucrative rewards of the marketplace.

For the able private forecaster 'windfall profit' is the entire name of the game. It is unfortunate that the warm windfall is chilled by the threat of bankruptcy, but this close partnership of carrot and stick acts to concentrate the attention of the private speculator. He must be good – or he will be broke.

The Land Market and Economic Rent

Whether selling long or short, speculation in products is beneficial to both producer and consumer. Yet, one never sells land short – which offers a clue to the peculiar nature of the land market.

We must remind ourselves of the price mechanism process. When demand rises, prices rise, encouraging producers to produce for, and supply,

* Similar assumptions in common usage include "Man always tries to do what is profitable" or "Man looks for things which are to his advantage". Assumptions precede every formal science. Needless to say, they should be kept to a minimum.

the market. Movement of goods satisfies demand and prices drop. This market action is so familiar to us that we sometimes forget that its efficacy depends on free production and free movement. Anything that impedes manufacture or delivery of goods to market in response to price fluctuation, obstructs the process.

The market for land can only be at its location. It doesn't come to market. It's already there. But, other land can't be 'brought to market', so each location is free from competitive pressure. If one is dissatisfied with the price of a downtown site, one cannot haul in a cheaper site from the desert. Movement to the market is 'naturally' obstructed. However, as we are aware that asking prices for land sites vary considerably, an argument that competition is absent may demand explanation.

The 'equalizer' is Economic Rent. Rent is the classical term for the 'market return to land'. Rent is related **in toto** to the 'Margin of Production' – locations that yield no Rent –and expresses difference in productivity between a location and the Margin. *

Thus, locations of very different productivities compete equally in the market. You can pay a weekly $X Rent for a location, or $X plus $1,000 for another of higher productivity. The higher Rent is the measure of greater productivity. In other words, you may pay $1,000 less each week for the poorer location but, for the same effort, your return is $1,000 less. Your net return will be the same. Choice of location will depend on your peculiar circumstance and the price mechanism will act, not on the gross productivity, but on marginal differences of specific attractiveness.

Such as causes wholesalers to gather in the 'wholesale district', or lawyers with other lawyers. Retail stores are inclined to cluster, and cities highlight their 'Restaurant Rows'.

Economic Rent is a differential between land of different productivities. It can be defined as the sum of advantages, less the sum of the disadvantages that attaches to a specific location. Land price is simply capitalized Rent. A land buyer buys a potential income. However, Land does not behave in the market as do the other Factors of Production (Labor and Capital).

Land Speculation and Its Effects

(a) Inelastic Supply

Classical Economists assumed that Rent was measured by free market action, as were returns to the other Factors – Labor and Capital. This was an error. Market response to a price rise is to increase production and supply. When land prices rise, more land cannot be produced to satisfy demand. Even if it could, it would be unable to 'muscle in' on an existing high priced location. Land price rise is not reversed by a flood of competitive locations to the market. It cannot be.

Land price relates a fixed supply of land to an increasing supply of people – who exhibit an increasing demand for land. When land supply is fixed, but demand is increasing, prices will rise. In economic texts, this will be referred to, in footnote fashion, as an interesting theoretical supply/demand curve, in which the supply curve is vertical. But, the trouble with theory is that it sometimes bears a disquieting relationship to practice. The specific 'inelastic supply' example of the text is the general case of land in the real world.

(b) Ricardian Pressure

Land in short supply exerts Ricardian pressure on Wages. Ricardo's 'iron laws' (rather more like the iron jaws of a vice) close on the market. When someone pays Rent (or its equivalent capitalized

* Today, where for practical purposes there is no 'free land', the theoretical margin is the human level of subsistence. This contention is not only denied, but recognized by a host of government programs designed to counter it, such as minimum wage laws, food stamps and other income maintenance polices. A study from Pace University estimates that some 69% of the Federal budget goes to income maintenance of all kinds.

price), he pays for something he gets. If a location is appropriate to his need, the $1,000 a week he pays is balanced by $1,000 per week of advantage.

If the asking price rises to $1,100 per week, he cannot recover the extra by increasing his own prices. The market won't allow it. The additional $100 must come from elsewhere. If he is an able producer, he might take a wage cut. The marginal producer is out of luck. He cannot pay the piper and must go out of business. *

(c) Non-Committment

An advancing market economy tends to reduce costs (and therefore prices) of products. Their continuing price trend is down. Yet, the continuing trend of land price is up. A market item that can be expected to increase by virtue of mere existence is happily noted by the able speculator. Land becomes something to hold for the long haul. But, market value is determined largely by availability to the prospective buyer. So, land will be held in 'cash crop' fashion – without deep commitment.

'Cash crops' are diverse and include city parking lots, suburban service station corners, and rural billboards. Cash crop mentality is equally harmful to both environmental quality and higher productivity, but the single cause is obscured by bickering between ecologists and developers.

Meantime, the cash crop allows the landholder more easily to keep sites off the market. When anything in limited supply is kept from the market, the price mechanism properly does its job and increases price. But, the expected response (production and supply) cannot occur and Land prices are pushed ever higher in effort to bring forth new supplies. So long as the 'cash crop' provides an income to offset carrying costs, committment to more economic, useful and societally attractive planning is unlikely.

(d) Reluctance to Sell

One might expect that a declining neighborhood would reduce demand and consequently reduce land prices. Certainly, when products suffer reduced demand and shelves begin to fill, a sale is called. Lower prices clear the shelves and production resumes. This happens because the job of the producer is to stay in production. He must clear inventory in order to restock it.

A landholder bears no such imperative. Once he sells, he is no longer a landholder. His 'production' doesn't resume. His job is finished. Therefore, his motivation to sell is weakened. He can always find excuse to wait for a better price.

Even where a drastic change takes place – a freeway re-routed, or a naval base mothballed – land prices remain somewhat firm. The holder of a million-dollar location struck by the lightning of government edict, continues to believe his retirement bonanza has met no more than temporary setback. He really doesn't want to face the reality a lowered expectation. *

(e) Timing of Sales

The plot thickens. Yet, it's a plot without scenario or conspiracy. Any land sale fixes prices at that time. Landholders expect a price for their land. But, it is only expectation until a sale is consummated. At that time the asking price is confirmed, to be noted by other landholders who promptly raise their asking prices. If you want $100,000 and a comparable site actually sells at

* As might be expected, industries most directly concerned with land, such as construction and agriculture, are first and most visibly affected by Ricardian pressure. State reaction at every level is pervasive, whether with specific legislation such as Hill-Burton (hospital construction), or general programs affecting agriculture (price supports, food stamps, soil bank), or construction (urban renewal, home-buying subsidies).

All this legislation – including actual land purchases – is intended to soften the impact of Ricardian land prices. But, none of it prevents the continuing upward pressure on land prices.

* You may count the ways on edicts. An up-zoning can provide a retirement income.

that price, your inclination is to ask $110,000. If you don't get it at once, it doesn't matter. You get on with your affairs, allowing the land to sit, perhaps garnished by a 'cash crop'.

The producer, or service giver, is not so lucky. Last year's work won't buy this year's breakfast. One has to hustle for business. The landlords, as said John Stuart Mill, 'grow rich in their sleep'. No imperative to take action need disturb the tranquility of their slumber.

Timing of a sale is crucial to return in any market. When increasing demand for their goods raises prices, producers rush to market. Their sales cool demand and reduce prices. The producer who arrives late finds a depressed market. In the product market, the race goes to the swift.

The land market process is exactly opposite and underlines the problem. Each sale raises the expectation and prices of the rest. The first to sell gets the lowest price. The landowner who can hold out longest is rewarded most. The land market becomes crowded with suppliers, all of whom are trying to be the last one to sell!

(f) Unstable Economy

Paralysis in the land market does not stop all activity. As land prices increase, land may well transfer to producers who cannot recover immediately in Rent the price they have paid. Their chance to survive rests on the shifting expectations of increasing business activity, or a fortuitous and appropriate government policy, such as inflation.*

The producer becomes a reluctant speculator, relying on the economy to behave in a manner that will recover his investment. (This risky endeavor is likely more to be successful at the beginning of a business cycle. Larger corporations, who frequently buy sites well ahead of need to avoid an inevitable price escalation, may well discover their profit picture enjoys significant contribution from their later real estate department sales.

(g) The Amateur Speculator

It should be noted that professional speculators often do less harm than does the amateur. The professional, who depends on turnover to make a living, does try to move land to the market. The amateur can be more troublesome, for he earns most by doing least. His potential profit is not regarded as income. Rather, it is a hedge against the future, a nest-egg, a pension that will provide for senior years.

The attitude is reasonable. If the probable rate of increase in land price is higher than the probable rate of interest return, there is little incentive to sell for reinvestment cash –particularly as a capital gain is rewarded by more favorable tax treatment. So the cooling land market does little to relax his tight grip on his warm expectations.

Environmental Impact

(a) The City

Altogether, the environmental impact of this land market 'paralysis' is extraordinary. Uncommitted vacant and underused urban land produces a crisis situation in our cities. When, in the 22 county tri-state metropolitan region of New York City, 4 out of 5 acres are "undeveloped for urban use"; when close to half Los Angeles downtown is parking lot; when Bartholomew's land use study of 53 central cities finds an average 29% undeveloped (and 28% for streets and alleys); one may accept that our 'crowded' downtowns are relatively empty.*

* A major analysis of the business cycle names land speculation as a primary cause of economic crash. Land market paralysis creates an unstable condition which needs only a relatively minor nudge (a presidential heart attack, a threat of peace or war, a stock market crisis) to send the economy over the brink. There appears to be heavy historical evidence to support this argument.

* These figures and their sources, along with most others quoted, can be found in the 1958 Yearbook of Agriculture, (Urban expansion, will it ever stop? – M. Mason Gaffney). These mid-50's figures are not likely to be much different in 1981.

To this obvious emptiness must be added underuse, mis-use, and blight, where land remains uncommitted by a combination of low land taxes and high improvement taxes. Slums persist because they can return costs while their valuable sites await condemnation (and ample compensation) from earnest urban environmentalists.

Sensible economic policy for slum and blighted areas would suggest higher land taxes (to push sites into the market) accompanied by lower improvement taxes (to make building more attractive).

Almost everywhere, present taxation seems bent in the opposite direction. Low land taxes fail to prod sites into the market, while high improvement taxes depress the will to build.

(b) The Suburbs and Beyond

The suburbs provide an escape hatch for defeated central city developers. Fleeing the paralyzed urbiculture, developers head outward to the country. At first land is cheap. Then, the 'last to sell' syndrome blooms and the developers resume their enforced trek toward the redwoods.

Which are likely already to be apportioned to residential acreage – even though the chance of live people appearing is no more than an anticipatory twinkle in the speculator's eye.

For example, in 1954 a subdivision occupied every one of the 200 square miles of the Santa Clara Valley around San Jose, south of San Francisco. Yet, by one estimate, their total area covered only 7 square miles. The interlaced service and communication network crossing the 200 square miles had somehow to be financed by people occupying 3½% of the area.

Santa Clara is the rule rather than the exception. It is not altogether surprising that throughout the land can be heard the keening of overburdened homeowners as they demand state and federal help.

A final perspective of population/land use ratio is provided by the land use survey made by the engineering firm, Parsons, Brinckerhoff, Hall & MacDonald, for San Francisco Bay Area Rapid Transit. They found sufficient suitable acreage in the Bay area for the entire projected 1990 population of California (22 - 31 million). They allowed ample space for recreation and industry.

(c) Rent and Land-Value

Rent, which measures the worth of a location in a free market, is not encountered by those eager to improve environmental quality. The non-competitive land market, bolstered by the 'last to sell' syndrome produces only "land-value" – which may be described as the price of a location in a market unencumbered by the discipline of the price mechanism. Land-value is capitalized Rent plus a 'natural monopoly premium' caused by the special behavior of land in the market. *

In a competitive market, the Rent of a properly built-up, fully used, city would be very high in the center, where productivity is high, but would drop rapidly away toward the outskirts. Suburban Rent would be relatively low (perhaps not much more than would pay the cost of services) and farm land would be lower yet. A 'Rent curve' for such a city might look like (fig. 1).

The Rent curve for a contemporary city is something like (fig. 2). Rent is lower in the center because land use is so poor. Vacancy and mis-use keeps Rent low all the way out to the suburbs. **

However, the land-value curve – which represents asking price – is very different. It looks like (fig. 3). The curve is high in the center and remains high out to the wilderness. This combination of lower Rent with higher land-value (less return with higher price), makes proper rehabilitation of the city difficult, or impossible, and use of suburban land unattractive for farming.

* Renoirs and Goyas exhibit similar behavior. This was noted by Winston Churchill, who drily remarked "pictures do not get in anybody's way".

** Suburban sprawl so reduces residential density, that newcomers are welcomed less as sharers of a common tax burden, than as interlopers who need more services than they can properly finance.

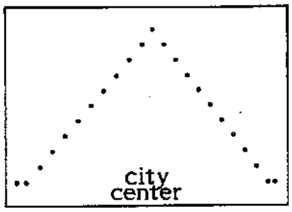

fig. 1

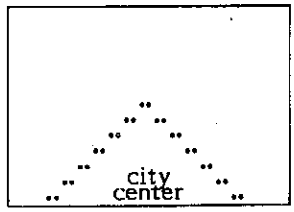

fig. 2

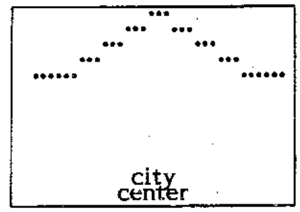

fig. 3

Governmental schemes to remedy the problem rely on tax money to purchase sites at 'land-value prices'. The sites are then passed to builders at much lower 'capitalized Rent prices'. (Or even lower, with appropriate political pressure!)

The high land-value curve bounds across farming fields and sylvan retreats. This warms the heart of the veteran farmer who contemplates his nest egg with a certain satisfaction, but it's tough for the apprentice yeoman, for whom purchase is impossible. Meantime, long-range planning becomes difficult, for no farmer will tie ripe land to the long term. The rented cash crop farm joins the 'cash-crop' service station of the suburbs and 'cash-crop' parking lot in the city.

The suburban grower may not even bother with a cash crop. Rocking on the porch, while he calculates his rising land-value, is gentler to the arthritis than is setting out smudge pots in the freezing pre-dawn hours.

Ecologist Versus Developer

Massive mis-use of land provides an arena for environmental conflict where resolution depends rather on political maneuvering than the best interests of the citizen.

And the environmentalists will probably lose, for their proposals are usually expensive and obstructionist. To win, their opponents need do no more than point out that modest improvement will be paid for by lost jobs and heavier taxes.*

And while environmentalists are right to protect those aspects of nature that could be lost forever, also right are the developers. High productivity is vital to any advanced posture such as protection of the wild habitat. Environmental caring is a function of high living standards.

When land is used properly, which means efficiently, huge areas become available for all our needs. Compact cities, with close-by suburbs and close-in farming, could free great areas of land for use other than the basic servicing of people.

It is not inconceivable that so much unused wilderness would exist in the United States that wolves or grizzlies might become a dangerous nuisance to us. But, this not so impossible dream is unlikely to be experienced until the ogre of land speculation is killed by ecologists who understand the peculiar behavior of land in the free market.

* It is a sobering irony that in land controversies, all too often, the competing advocates are both right, but oblivious to their common problem. For example, land speculation paralysis prevents inexpensive building on close-in land that would provide cheap homes and lower rents to the poor. Thus, advocates of rent-control are right. Rental housing cost is tied directly to paralyzed land-use not regulated by market forces. This would seem to make it an apt candidate for intervention.

Yet, anti-control advocates are also right – for rent control, by limiting profit potential, makes less attractive residential construction.

Plentiful housing for the poor is a consequence of a fluid market in general construction. It is an axiom of the market that increasing supplies of any desirable thing improves the lot of those who earn least. Rent control fails to address the problem, even as it closes off a possible avenue to solution.