REVIEW

Stephen R Lewis, Jr (ed), *Henry George and Contemporary Economic Development*, Williams College, Williamstown, Mass., 1985, pp.95

Master realist

By **DR ROGER SANDILANDS**, senior lecturer in economics at the University of Strathclyde, Glasgow.

THIS slim volume arose out of a conference organised by the Center for Development Economics at Williams College to assess the relevance of Henry George to fiscal and trade policy in developing countries. To this end four papers are presented. Roger Bolton, of Williams College, assesses the attitudes of economists, politicians and interest groups to Georgist rent theory and tax policy. Robert Conrad (Duke University) and Malcolm Gillis (Harvard) review developing country experience with mineral resource taxation and attempt to compare Georgist and "modern" concepts of land and natural resource rents. David Holland (M.I.T.) appraises the recent experience of Jamaica with land value taxation. And C. Lowell Harriss (Columbia) assesses the relevance of Henry George to the contemporary debates on protectionism versus free trade and the "incentive taxation" ideas of modern "supply-siders".

All of the contributors are sympathetic to the basic proposition that land and natural resource rents can be a more efficient and equitable source of state revenues than taxes on output and work. However, some contributors do not always do full justice to George's ideas. In particular, he is disparaged for failing to understand modern "marginalist" principles in economic analysis; for insisting that land is monopolised when we are all supposed to know, thanks to Alfred Marshall, that there is a competitive market for land; for failing to understand the modern "opportunity cost" concept whereby land has many alternative uses; and for not understanding modern portfolio theory in which land is only one of many assets that individuals can hold as wealth and which therefore must be given the "normal" rate of return earned on competing assets.

I believe Henry George would have had little difficulty disposing of all these criticisms, though it is true that George's famous debate with Alfred Marshall at Oxford in 1884 on land monopoly was unsatisfactory because of disruption from a disorderly undergraduate audience.

On the question of marginalism it should be noted that the essential feature of George's theory of rent, following Ricardo, is the declining marginal product of land which gives rise to a surplus over the costs of cooperating factors of production, labour and capital, on intra-marginal land where yields are relatively greater.

Competition ensures that the returns to labour and capital are equalised except for differences in skill, effort and risk. The general wage rate and the general interest rate tend to reflect what can be earned by the labour and capital that work on the least productive (marginal) land in use.

It was this analysis that inspired John Bates Clark to develop his famous marginal productivity theory in 1899, though unfortunately Clark saw no generic difference between land and capital. Bates thus missed the crucial point in George's theory that land is inherently non-homogeneous and fixed in supply whereas capital goods can be reproduced and moved around to ensure that the return to capital tended to be equalised at a level that just covered the real costs of production.

In this volume Conrad and Gillis, and Holland, both reflect the confusion Clark's approach engenders. In both papers there are diagrams that purport to show that "the" price of land is determined by the intersection of the downward sloping land demand curve and a fixed land supply. However this would only be "the" price of land if all land were homogeneous, like sacks of wheat or barrels of refined oil. Because these modern economists understand marginalism less well than George they then claim that land or natural resource rents can be measured by this same price for each unit of land, or the rectangle under the price line.

By contrast, Henry George explained that the last unit of land in use was capable of yielding only enough to pay the cooperant factors of production, labour and capital, their necessary competitive wages and interest, leaving zero surplus as rent on this marginal land. The area under Conrad and Gillis' "price" line is not rent but the total wage and interest payments to labour and capital. Rent is then the remaining (triangular) area under the demand curve because, with land in fixed supply but with heterogeneous attributes, each plot commands a different price.

Unless this is understood it is impossible to understand why a tax on rent will not directly affect the returns to labour and capital, which will continue to reflect their productivity on marginal land where rent, and hence rent taxes, are zero. (David Holland also has a misleading diagram that shows a land tax reducing the price of marginal land by shifting the land demand curve parallel downwards.) There would indirectly, however, be positive incentive effects for labour and capital if the rent tax replaced taxes on labour and capital.

It is also true, however, that Henry George was far less mechanical and mathematically rigorous than J. B. Clark in his approach to the marginal productivity of variable factors of production as their supply expanded while the supply of land remained fixed. But some would claim that

● Henry George

◄ Continued from Page 5

benefit is not uniform and significant intraclass shifting would occur to the poorer property owners, making it more difficult for them to retain and maintain their properties."

Assessments show utilities — gas, electric, oil, phone — reflecting 11.27% of Rochester's taxable property. Because utility value is mostly in improvements, not land, the simulation shows utilities as "the major beneficiary" of a two-rate tax.

Economists like Harriss and Cord expect this would lead to reduced utility rates, benefitting consumers. Farbstein, however, George's approach gains from greater realism what it loses in mathematical precision.

George emphasised the dynamic economies of scale and technical progress which could offset the tendency to diminishing returns and raise the productivity of labour as population expands. However, while George did not use the term explicitly, a sympathetic reading of *Progress and Poverty* or *The Science of Political Economy* show that he was well aware that it was the average product of labour that is increased by technical progress while the marginal product of labour tended to be little changed. For this reason the gap between average and marginal product widened, thus increasing the absolute level of rent and, though less inevitably, also the relative share of rent in national income. In the absence of measures to redistribute rent progress would march hand in hand with poverty.

However, George, following the French physiocrats, was aware that ultimately taxes on labour and capital reduced rents payable to landlords. This did not, however, mean that rents did not exist, only that they could be transferred indirectly to government through a roundabout, inefficient and stultifying system of taxes on labour and capital that were eventually passed on to landlords who were forced to charge lower rents in order to sustain wages and interest at their natural levels. (A *direct* tax on rent would transfer rents to the community far more simply and efficiently. Thus Roger Bolton, for example, is unfair to castigate George for failing to predict a falling and relatively low share of *measured* rent in national income as development proceeds. George was more interested in the underlying, natural shares of national income than with the surface phenomena measured by national income statisticians.

On the question whether the land market is monopolistic or competitive, the answer depends very much on whether one approaches this issue in terms of "classical" real costs (the labour theory of value) or "neo-classical" opportunity costs. George would say that land and natural resources were created not produced; they are the free gifts of nature. There were no costs of production. In the modern economic theory of the firm a market is said to be monopolistic if the product price exceeds its (marginal) costs of production. In the case of land there are no costs of production yet intra-marginal land does command a positive price. Why then object to this rent element as a measure of the degree of monopoly in land?

Modern neo-classical economists reject this view because they emphasise opportunity costs as the measure of value. If a central city site would yield #100,000 a year rent as a cinema but #101,000 as a disco then "economic rent" or "transfer earnings", on modern definitions is a mere #1,000 and George's radical view of rent conveniently disappears.

Similarly, in order to equalise the returns on various assets it is necessary that the value of land be capitalised and exchanged at the normal rate of interest. Otherwise there would, claim Conrad and Gillis, following Feldstein, be a "distortion" in the allocation of investible funds, or savings, or between land and other assets in individuals' wealth portfolios.

In *The Science of Political Economy*, which Lowell Harriss alone among the contributors to this volume appears to have read, Henry George devoted around 200 pages to explaining that what is wealth for the individual is not necessarily wealth for the society. In modern jargon land is not a currently produced article of wealth but a stock which can only be exchanged through "transfer payments". It is a fallacy of composition to state, as do Conrad and Gillis, that when an individual "saves" is income by buying land rather than, say, ICI shares then society has also saved more in this form. It is thus unfair to claim that George forgot the "general equilibrium effect" of individuals' portfolio choice.

The appeal of the modern theory of rent stems, I believe, from a fear that if rents are taxed away there would be no pricing mechanism to ensure that land is allocated to its most efficient uses. This fear is groundless if rents, as defined by Henry George and Ricardo, were all subject to the same percentage rate of tax. The decision whether to operate a cinema or a disco would then be unaffected by the tax since the relative operating costs would be unaffected.

Land value taxation does not remove the rationing function of rents as prices that reflect the relative scarcity or desirability of different types of site. It does, however, fundamentally alter the role of rents in the distribution of income in society between landowners, workers and capitalists in favour of the latter two. Rent taxation does not abolish rent, it merely changes its beneficiaries. In so doing, as Lowell Harriss is particularly eloquent in explaining, this change removes the shackles on industry, enterprise and thrift and promises a fairer and more dynamic society.

called utilities "one of the biggest problems we ran into — if utilities didn't lower rates, citizens and taxpayers would be up in arms against anybody suggesting this tax reduction."

The simulations "revealed significant, unpredictable class tax shifts would occur . . ." and that some of these shifts "may run counter to state programs." Of course there are tax shifts, taking away privileges afforded to those who use productive sites inappropriately.

Why, if the Commission designed the simulations properly, are the shifts called "unpredictable"? As to state programs, they surely are not designed to favor blight and sprawl, as present taxes do.

Under the impressive heading of "Analysis of the Economic, Socioeconomic, Legal and Administrative Arguments . . .," the report states:

"It is uncertain whether the alleged benefits of land value (or two-rate) taxation are worth the possible trade-off disadvantages of the arbitrary losses landowners and other [sic] could suffer as well as the general confusion of transition to such a study."

Far from arbitrary, the tax losses are shifted off good land users to land abusers. A clear virtue of the two-rate tax is that it avoids "confusion"; it is imposed gradually and works so smoothly that, as Scranton's mayor said of the two-rate tax, "We're really used to it — people don't even realize we have it."

Farbstein insists the study was undertaken with no hidden pressures. Its point on equitable assessments is well taken. Perhaps the discussion it engenders will let legislators reach a clearer perspective than that presented in the report.

---

* *Copies available at no charge (in U.S.) from Temporary State Commission on Real Property Tax, 74 State St., Albany, NY 12207.*