Land Rent Flows In Economic, Political And Environmental Transitions:

An Inquiry Into Ownership Rights In Land Rent

By DAVID H. SMILEY*

ABSTRACT. Previous work (Smiley, 1995) attributed failure of development efforts to the injection of aid into societies where landed institutions may absorb this aid, block growth and maintain inequality. An interactive simulation model was built (Smiley, 1996) to explore the effects of land rent flows under alternative transition strategies. In these simulations, the public collection of land rent was found to be superior to all other third world development and reformist strategies in achieving growth with equity. The underlying ethical and economic arguments are here examined in more general classes of transitions: economic transitions involving industrial and post-industrial societies, political transitions involving territorial conflict, and environmental transitions involving adverse externalities. Recommendations are made for collective action to improve both efficiency and equity outcomes from these transitions.

I

Introduction

DEVELOPMENT ECONOMICS deals with efforts to increase economic growth and reduce poverty, primarily by capital accumulation from external sources. In a now famous example, Marshall aid programs effected Europe's recovery from a post-war condition of destruction and poverty. Since then, much larger aid programs have attempted for much longer, but with far less success, to assist the transition of the third world from stagnation and poverty to growth with equity. Paradoxically, the successful transition of a few third world countries has not only far exceeded the performance of the others, but even that of Europe itself (World Bank, 1991: 3). A cardinal fact stands out in the notable cases of Japan, China, South Korea and Taiwan and, to a lesser extent, Hong Kong and Singapore. They all addressed their land problem as a precondition for economic takeoff and social justice.

This observation prompted a conjecture on the relevance of the usual capital-labor transition models to states where both growth and equity are institutionally constrained by a third factor, land. Anywhere its rent is appropriated by a small,

* [David H. Smiley, M.App.Sci., is research associate, Walsh Bequest, Macquarie University. His home address is 33 Morton St., Wollstonecraft, NSW2065, Australia.] Considerable help in text restructuring and editing from my fellow research associate Dr. Ihor Gordijew, is appreciated and acknowledged.

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traditional minority that place is hereinafter referred to as a feudal state. This conjecture was articulated in a critique of development economics and then explored in a pedagogical computer simulation model by the author in this *Journal* (Smiley, 1995 and 1996).

In that model each development simulation commenced with a stagnant feudal state. This state had been generated by driving a "golden age" economy down to subsistence, at which point land rent consumed 50 percent of Gross Domestic Product, simply as a result of rising population (see Samuelson, 1964: 726-27). From that point, surplus rural population migrated to regional cities whose public spaces it occupied. In spite of the informal economies which emerged and expanded there, all new all new urban economic growth was absorbed in rising civic infrastructure, law and order, and welfare costs. Thus all three sectors: rural, urban and informal, became economically stagnant. Using these results as the basis for the model (Smiley, 1996), all development strategies known to have been applied to the third world, such as coerced domestic saving, foreign loans (AID), and foreign direct investment (FDI) were then simulated and found to have unintended consequences in land rent flows between classes, with adverse implications for efficiency and equity.

The literature search for these simulations, and the simulations themselves, led to three observations which could not be explored sufficiently within the scope of the research project as then formulated. It is the intention of the present paper to address itself to a more detailed consideration of these observations.

1. "Land" defines the surface of the globe and all natural resources either side of this surface. The rent of this surface and associated resources change with economic, political and environmental transitions, invariably accompanied by secondary, often unintended, impacts upon efficiency and equity.
2. Economic transitions arise from changes in demography, technology or land rights. Many political transitions arise from conflict over actual or surrogate land rights. Adverse environmental transitions arise from uncertainty over land rent obligations.
3. Rent-seeking, an activity associated with all these transitions, is any attempt to capture an unearned surplus by persuasion, bribery or corruption. In economics, rent and rent-seeking are not confined to land, and the effects of rent-seeking can be large (see for example "The Rise and Decline of nations", Mancur Olson, 1982). In this paper rent and rent-seeking are confined to land and, in political transitions, rent-seeking will be referred to as "coercive".

These three observations raise two questions. First, does a property right in land which decouples public rental obligation from private rights of use encourage both efficient and equitable outcomes in any economic transition? And secondly, does such a property right encourage both efficient and equitable outcomes in political and environmental transitions?

Parts II and III attempt to answer question one. Parts IV and V attempt to answer question two. The conclusions from parts II, III, IV and V lead to a revelation of internal inconsistencies amongst the 30 articles of the Universal Declaration of Human Rights of the United Nations (UN). Since the Declaration should be, but is not, useful to UN initiatives in economic, political and environmental transitions, these inconsistencies are set down, together with supplementary articles seen as necessary to any resolution of these inconsistencies, in an Appendix.

II

Property Rights And Land Rent Flows

THE SOVEREIGN STATE consists of a population, a defined territory and a form of government maintaining property rights as they extend over the state's land, labor, capital, the goods and services created thereby, and related obligations imposed by law. While ethical theories on property rights range from "property is theft" to "property is sacrosanct," corresponding political theories range from advocacy of public ownership (Marx) to private ownership (Nozick). In the typical sovereign state substantial proportions of its labor output, land, and capital are public property. A state where at least the rent of land is public revenue has been suggested at various times, for example by James Mill, J. S. Mill, Marx, George, Tolstoy, Sun Yat Sen, and recently by Solow, Tobin and Modigliani (1991). The model of this state is derived from an analysis of the impact of property rights in land on efficiency and equity outcomes of production.

Property rights in capital, the buildings and plant which occupy land, are relevant here only at two points of intersection with property rights in land: the diversion of savings from capital investment to land speculation, and the vulnerability of capital to territorial conflict, examined in part IV.

Property rights in labor, for example rights of the state to a portion of the labor of its citizens, are also beyond the scope of this paper. However, it may be useful to approach the analysis of property rights in land by way of an extreme example of property rights in labor: namely slavery. In slavery, labor is removed from alternative employment (its land) by conquest or expropriation. With the exception of South Africa, slavery was legally abolished in the 19th century. But, under regimes of comparative landlessness, in the large estates of Latin America, in Apartheid and its successor, and in the selling of child labor in South and South-East Asia, labor conditions may still resemble slavery. Perhaps the most succinct illustration of the nexus between rights in land and rights in labor occurs is Bernard Shaw's single sentence parable in *Fabian Essays*: "Imagine a small island to which castaways swim as ships are successively wrecked on a nearby reef; eventually the earlier occupants will be able to present new castaways with the choice: be our slave, or keep swimming."

Shaw's parable, the seed used to germinate other parables later in this paper, essentially describes the property rights in land and hence labor upon which the polities of Greece and Rome were based, and from which feudalism evolved. By the 17th century, Locke had attempted to "fix a property", that is to define a property right in land by virtue of the labor which can be imprinted upon it by one man. By the 18th century, Adam Smith had defined a landlord as someone who "reaped where he did not sow," and rent as monopoly price. By the 19th century, David Ricardo had laid an economic basis and J. S. Mill an ethical basis for two political programs which included the public collection of land rent: the Communist Manifesto of Marx and Engels, and the Single Tax movement of Henry George. That Marx and George, with diametrically opposed views on market capitalism, should both embrace the same idea is as surprising as the speed with which capitalist and socialist economics, increasingly preoccupied with conflicting views on the interests of capital and labor, were to drop the idea in the 20th century. Recently, the taxation of land values has been recommended again, for example by King (1977) for the third world, by Harrison (1983) for the capitalist world, and by Solow et al. (1991) for those parts of the world emerging from Socialism.

Property rights in land, either private or public, do not normally distinguish between rights to use, and rights to receive rent. This distinction is, however, made in a taxation system referred to historically as Land Value Taxation, incompletely as Site Revenue or, as preferred here, Land Rent Taxation (LRT), establishing a social right to land rent only, leaving all other rights intact. LRT is defined as the collection, by some taxation authority, of the rent of land. Land includes all the natural environment and is exclusive of capital improvements. LRT thus excludes all interest and other payments for the use of capital occupying land. In some countries, a small percentage of land rent is collected by local government using simple, well-established methods of assessment. By increasing the percentage collected, other forms of revenue can be correspondingly reduced, according to the following comparative taxation criteria of efficiency and equity.

LRT efficiency can be comparatively evaluated under several headings.

Resource allocation. Unused land is taxed back into use. Underused land is forced into more productive use. The funds used for speculative investment are diverted into productive investment.

Income distribution. Unearned income is available for redistribution. This may be 50 percent of GROSS DOMESTIC PRODUCT in the feudal state. In industrial societies, the income shares to rent and speculative gain are not measured but surely, are substantial.

Stabilization. Where a combination of inflation and faulty taxation laws encourages diversion of national saving from productive investment to the pursuit, by individuals, firms and banks, of unproductive "capital" gain in land, the results could be expected, from economic theory, to reduce economic activity and increase unemployment, to reduce housing affordability and increase inequality, to directly increase private debt and indirectly increase public debt, and to increase the frequency and amplitude of recessions.

Growth. In the third world, computer simulations (Smiley, 1996) LRT was found to provide larger, less encumbered and more certain investable savings for economic growth than those from other sources. Taxation of labor, capital and consumption is said to discourage all three and hence growth. LRT claims to positively encourage growth through better resource allocation, reduced factor cost, and reduced business cycles.

Neutrality to business or consumer choice. LRT does not place excess burdens upon labor or capital, as do taxes upon labor and capital.

LRT equity can be comparatively evaluated both horizontally and vertically. Horizontal equity, the principle of equal treatment, is achieved if the same LRT percent of assessed land rent is applied to all land users. Vertical equity, the principle of ability to pay, though a generally accepted principle, differs widely in its application from state to state and from time to time. Since LRT may not be progressive in all cases, vertical equity may rely on other instruments of redistribution. However, the implementation of LRT might achieve both a large once-only and then continuing vertical equity shifts not easily measured by conventional accounting. In the third world this shift would likely to be massive.

But landed property appears to be the main source of wealth and power in developing economies and an important one in developed economies. Therefore great pains are taken, not only in its acquisition and retention, but in its private intergenerational preservation. These activities may occur legally in the taxation systems and tax avoidance industries of developed economies, informally in the class and caste systems of developing economies, and by force between groups of differing ethnic, religious or national backgrounds. Mainstream economics does not make it clear that these transactions and transitions are determined by institutional histories. It appears to consider the past simply as a brought forward item designated, in welfare economics, as "initial allocation" or "endowment." Only far below the surface apparently do any notions exist that previous wealth allocations may be embedded deeply enough in what passes for the social contract to constrain production and distort distribution.

Here however, institutions which influence production and distribution are seen as instruments for both contemporary rent-seeking and the preservation of historically accumulated rights to rent. It is important to recognize how widespread these institutions are, and how relevant is LRT to their reform, within economic, political and environmental transitions.

III

Land Rent Flows In Economic Transitions

SHAW'S PARABLE can be adapted to illustrate both the genesis of the feudal state and some unintended consequences of attempts to develop it. Consider a case in which an individual A first occupies an island, to which population is then added. Rent will increase absolutely with population and, if labor's marginal productivity is declining, rent will also increase relative to wages, creating a class system of landlord and peasants as wages drop to subsistence (Samuelson, 1964: 727, 730). Now freeze population size and start injecting capital. A's share will continue to increase absolutely. Land's share relative to labor will depend on whether capital is labor-saving or land-saving (Samuelson, 1964: 727). Now shift the population into half the island. Share to rent could double (depending on marginal product assumptions), and the vacant land can be sold or rented by A to foreign investors.

Are these parables applicable to any economic transition? There seem to be three broad groups of contemporary transition: from the remnants of feudalism, for example in Latin America, Africa, South and South East Asia; from the remnants of socialism, for example in Eastern Europe and Asia; and from the remnants of industrialism in the post-industrial economies, for example of the Organization for Economic Cooperation and Development.

One example of feudal transitions is provided by China in the 1950s. China then socialized its land rent, thus increasing equity, and socialized its capital and labor, replacing inefficient feudal incentives with inefficient socialist ones. LRT outcomes might have corrected regional imbalances and might have greatly improved resource allocation within the state planning system. At about the same time, non-socialist development projects started pouring capital into other parts of the third world, leaving feudal institutional structures, and thus both production inefficiencies and distributional inequities, largely unchanged. And so, a recent UN report on urbanization (UN, 1995) claims that 500 million people are homeless or living in life-threatening housing, and that urban populations will double from 2.4 billion to 5 billion by 2025. LRT outcomes, as explored in previous papers (Smiley, 1995, 1996), might have greatly improved equity and production incentives while leaving undisturbed the property rights essential to encourage productive investment.

In 1978 by starting to privatize land and labor, China initiated a socialism to market transition. Production incentives increased, regional inequality remained, and rent-seeking exploded. LRT outcomes would have removed some of this inequality, much rent-seeking corruption and inefficiency, and would have permitted economies of scale without disturbing productive property rights. With reduced sources of government revenues LRT would have provided much-needed savings for infrastructure development. Since then the industrialized socialist economies have attempted to privatize all three factors, with disappointing results. In 1991 Solow, et al. warned that "there is a danger that you may follow us in allowing most of the rent of land to be collected privately." Dornbusch (1993: 116) argues for a simple, high-yield tax system, noting that capital gains in transition periods will be extravagant, and Kelly (1994: 330) argues that "these transition countries are in an ideal situation for property tax reform."

Post-industrial transitions have been characterized by the growth of an underclass with declining employment opportunities (World Bank, 1995: 119-20) and hence declining disposable income (excluding welfare benefits). This phenomenon is linked with economic globalization, economic restructuring, technological and demographic changes. Far less closely analyzed, though frequently asserted, has been a link with deteriorating housing affordability, perhaps because of the scarcity of land rent data, due to the "labor-capital inheritance" (see Smiley, 1995). One long term Australian empirical study (EPAC, 1995: 31) shows percentage of Gross Domestic Product to imputed rents doubling while that to labor starting to decline within a 30 year period. If it is true that housing affordability is deteriorating then this suggests that the decline of land's share of Gross Domestic Product during our industrialization phase is now being reversed. This could be the case if land-saving inventions, in agricultural productivity and urban concentration, now are being more than offset by labor-saving inventions, in computer applications.

Any strategy reducing incentives for rent-seeking would improve efficiency and equity outcomes. Therefore we need general models of economic transitions which account for land rent flows and can predict outcomes from strategies such as LRT.

IV

Land Rent Flows In Political Transitions

POLITICAL TRANSITIONS almost invariably involve conflict over territory. Political conflicts have their origin, ultimately, in direct perceptions of territorial rights, or those projected from historically accumulated perceptions of previous territorial wrongs. The conquered face expropriation of their land. Those fleeing conquest or natural disaster seek homes elsewhere. Those seceding to form a new state perceive increased comparative advantage in natural resources and positional goods arising from that action and worth the cost of that action. Shaw's parable can now be further adapted to the transitions of conquest, secession and exodus.

Thus let state A conquer a very similar state B whose land rent forms 30 percent of its Gross Domestic Product. From the expropriation of land rent alone, A would be 30 percent better off, B 30 percent worse off, assuming a costless transition. The incentive for conquest may be the ideological conversion of labor, or the economic expropriation of land and capital. Ideological conversion is much facilitated by territorial expropriation and may often be its rationalization. Capital is dependent on the land it sits on and is vulnerable to other lands from which its inputs are derived and through which these inputs pass.

To illustrate civil war and secession let class C rise up against a historically oppressive class D (e.g. feudal Tutsis), or let region C within state A secede, perceiving advantages in natural resources and positional goods (e.g. in former USSR or former Yugoslavia). In both cases there will be a transfer of rent.

Finally, to illustrate exodus, divide the world into two similar states, A and B, each with two homogeneous classes. Assume landowners make up ten percent of the population. Now inflict a crippling natural disaster upon B such that total evacuation is essential to survival. Assume A now faces three choices: seal the border with B, admit B as slaves, or making an apparently Rawlsian-just and humanitarian offer, it admits B's population with equal opportunities of employment and equal shares in all man-made property. Assume it rejects the first two options and selects option three. Ignoring considerations of labor absorption and marginal product, we could expect a doubling of the rent of land in A, say from 20 percent to 40 percent of Gross Domestic Product (see for example Samuelson, 1964, 726-27). B's population would be 20 percent worse off, though alive, 90 percent of A would be 20 percent worse off but 10 percent of A's population would be potentially 20 percent better off. But with increased rent, costs of production and social inequality would both increase.

To date, political problems of conquest, secession and exodus have been addressed by spectacularly unsuccessful mobilizations attempting to reverse territorial property encroachment, by an unenforceable UN Charter of Human Rights (see Appendix), and a backup for the failure of both in the form of trade sanctions which invariably damage those least well endowed with human rights or property (Economist, June 3, 1995: 13, 58). Any strategy reducing incentives for the coercive rent-seeking which characterizes conquest, civil war and secession could be expected to reduce the frequency of these transitions. Therefore we need models which can impose political shocks upon underlying economic transitions, to predict their costs and hence the benefit of strategies such as LRT which might reduce or prevent such shocks. But benefit data do not exist. Some cost data have been published, for example the tabulations of frequencies of irregular executive transfers, such as military coups, civil wars and international wars (World Bank, 1991: 129) and some corresponding direct casualty data (World Bank: 141-42).

V

Land Rent Flows In Environmental Transitions

"When People Have Open Access to forests, pastureland, or fishing grounds, they tend to overuse them" (World Bank, 1992: 12). This much is well understood. Less well understood are the signals of overuse: that natural resources are being privately consumed and, when exhausted, may be irrecoverable by society. And far less well understood are the implications of the creation of natural resource rents. If the rent of natural resources (land) in one state is created by market demands in other states, to whom should that rent belong?

Let state A discover immensely valuable natural resources within its boundaries. Trade will offer a positive externality to the rest of the world (ROW). But A may exploit its monopoly position, for example for economic, political or ideological gain, eventually providing opportunities for ROW to intervene in A, under a variety of pretexts. Rent transfers and associated transaction costs of coercive rent-seeking can clearly be extremely large.

Therefore we need the ability to impose environmental trends and shocks upon underlying economic models, to predict the costs and benefits of strategies such as LRT. But the labor-capital inheritance has left us with "No conceptual framework that integrates natural resource and traditional economic data" (World Bank, 1995:245).

VI

Conclusions

John Stuart Mill said it well, "The social problem of the future we consider to be, how to unite the greatest individual liberty of action, with a common ownership in the raw material of the globe..." (Mill, 1873). As a pioneer of LRT, he would have agreed readily that common ownership of land rent alone would be sufficient for the collective control of rent-seeking in economic, political and environmental transitions. But, though these rent-seeking costs have now become enormous, much contemporary collective intervention, be it economic, political or environmental, depends upon strategies seen as increasingly inappropriate to the realities of rent-seeking and therefore often ineffective. This paper concludes with a conjecture on how Mill, somehow seconded to the UN, might react to our progress in the twentieth century and how he might try to achieve his goal in the twenty-first century. He might perceive in LRT an equity component discredited in Marx, unattainable in Rawls and irrelevant in Nozick, and an efficiency component absent from all three. He might say that the answer to both questions put in this paper's introduction is sufficiently positive to suggest a set of recommendations to which, though radical to the point of extreme difficulty, he might nevertheless, given foresight, attach extreme urgency.

These are the recommendations:

1. Set up machinery for an evaluation of LRT alongside complementary or alternative theories of development, territorial conflict resolution, and environmental protection.
2. Set up machinery to examine contradictions between many of the articles of the Universal Declaration of Human Rights and an almost universal but increasingly inappropriate property right (see appendix). Combine its findings with those of (1) in order to draft guidelines for LRT implementation practices and standards appropriate to field testing.
3. Test 1 and 2 in limited, controlled experiments as follows. For the third world extend IMF conditionality to include loan servicing from LRT. As well as putting in place the first controlled experiment in LRT, this would greatly reduce risk of default and achieve goals which have evaded development economics. For the "second world" actively encourage existing Russian tax reform initiatives (Banks, 1994: 7). For the "first world" encourage increase of the rate percentage in those local government areas where unimproved values are already taxed.
4. Set up databases for monitoring land rent flows in economic, political and environmental transitions. Supplement inadequate government data with more appropriate spatial methods (Banks, 1989). Supplement both by using emerging satellite technology to map and account for land rent (rural land yields, urban population and infrastructure concentrations), potential land expropriation (changes in labor and capital concentrations), and potential and actual degradation of the natural environment.
5. Use these databases to link the social opportunity cost of negative environmental externalities with a legal entity (a company, industry association, or government department), to determine an appropriate LRT as a global revenue item or transfer payment, the entity answerable to an international court with powers to place a lien on the assets of that entity.
6. Use these databases to support short and long term conflict resolution strategies. Short term strategies might link the social opportunity cost of territorial transgressions with a legal entity (usually one or a few political or military persons) to determine extent of liability before an international court and to forecast the net present value of domestic or international initiatives for extradition and delivery of the said entity to the said court. But Mill might favor long term, and ultimately far more effective strategies, such as the international LRT he hinted at and which has subsequently been developed into a general territorial conflict resolution proposal by Tideman (1991).

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Appendix

A CRITIQUE OF THE UNIVERSAL DECLARATION OF HUMAN RIGHTS.

An extreme case can be derived from Shaw's parable that its article 17 is capable of negating all the other 29 articles. In many real life situations article 17 may give rise to significant constraint upon articles 1 to 5, 12, 13, and 22 to 26. Some rights, for example those of articles 22 to 26, seem difficult to secure by law, but easily implemented as a byproduct of LRT. Thus the utility of this declaration is seen as dependent on the nexus of property rights and human rights, in clarification of which two supplementary articles are attached below.

THE 30 ARTICLES ABBREVIATED

1. Born free and equal.
2. No discrimination in rights.
3. Right to life, liberty and security.
4. Freedom from slavery and servitude.
5. Freedom from torture or degradation.
6. Rights of person before the law.
7. Equal protection of the law.
8. Rights of recourse to national tribunals.
9. Freedom from arbitrary detention or exile.
10. Right of fair and public hearing.
11. Presumption of innocence.
12. Rights against arbitrary interference.
13. Freedom of movement.
14. Right of asylum from persecution.
15. Right to a nationality.
16. Right to marry and found a family.
17. Right to own property.
18. Freedom of thought and belief.
19. Freedom of opinion.
20. Freedom of assembly and association.
21. Right of participation in government.
22. Right to social security.
23. Right to just and favorable remuneration.
24. Right to leisure and paid holidays.
25. Right to an adequate standard of living.
26. Right to education.
27. Right of cultural participation.
28. Entitlement to all rights via an international order.
29. Rights and freedoms are subject to those of others.
30. No right to destroy any of the above rights and freedoms.

PROPOSED SUPPLEMENTARY ARTICLES

Article A. The following rights to be within the jurisdiction of the sovereign state, subject to a (revised) universal declaration of human rights:

(i) Rights to the ownership of physical capital and property.
(ii) Rights to the wages of labor.
(iii) Rights to the ownership, use and enjoyment of land.

Article B. Rights to all land rent to belong to the community which creates this rent, ultimately the entire population of the globe, i.e. regardless of where in the world the rent is created.