

Economics, History, and Land
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ECONOMICS, HISTORY, AND LAND

PREFACE

In 1956, Woody [Woodrow Wilson} Guthrie wrote these now-famous lyrics:

This land is your land, this land is my land,
From California to the New York Island,
From the redwood forest to the Gulf Stream waters,
This land was made for you and me.

It is the purpose of this book to make you appreciate these words in a new way.

What is land? Is it the ground beneath your feet? Is it the "property" that would have given you the right to vote in 18th Century America? Is it what Nature (or the Creator) has freely given to all of us? All natural resources, the economic value of which expands with technology – in other words, not just soil and location, water and oil, sun and minerals, but also the spectrum and other dimensions beyond the reach of all but the most visionary of scientists and the most limitless of dreamers? Is land the basis of the most pervasive form of power, the most pervasive form of prosperity, the most pervasive form of poverty? It is the purpose of this book to persuade you to answer all these questions of definition in the affirmative.

It is also the purpose of this book to help you understand Economics in both a new and an old way.

The first section of this book will put us back in touch with old ways of thought. It will do so because the past informs the present, credentials the present, explains the present. It will do so because past economic thought sets the stage for current economic thought. It will do so because Land is also power – power that asserts itself in profit and loss but also in thought. As our first section, our History of Economic Thought section, will amply demonstrate, the most brilliant of economists considered Land the important third factor (with Labor and Capital the other two) from the earliest days of the discipline until the earliest decades of the 20th Century, when Americans began to dominate the theoretical development (or do we mean "devolvelopment"?) of the field. At this point, most Economics became "Two Factor" Economics, with "Land" slurped up into the expanded category of "Capital".

There is irony in the fact that this absorption occurred in the Land of the Frontier, the country where abundant land and a happy ratio of land to population is often credited with empowering American Spirit and American Century. But, as you shall see, there is also explanation.

The second section of the book restores Land as a third factor of economics. It explains the various sources of its uniqueness and the various sources of its power. One of the most important conclusions of this book is the effect of its analysis on one of the most important problems of this and earlier ages: poverty. Although its roots, as will have been uncovered, go back a fur distance, the insights in this second section contain much that is new. They do so because the world is "new" in many ways. Technology, as

mentioned above, has extended our reach – our intelligence, as it were. The purpose of this book is to extend our grasp – our wisdom, as it were.

The end result is also irony of sorts. We authors are Americans. We free land from its capture into capital, a capture made mostly by earlier Americans. But we also bring Economics much more into the American fold. Americans are, mostly, optimists. The conclusions of this book are, mostly, optimistic. Economics has been called the "dismal science" for many years. The more recent basis of the gloom has been the concept of "tradeoffs" and how they limit policy objectives. "You can't redistribute wealth – or income – with the tax system without seriously dampening growth!" "The poor are ever with us!" "'Equity' is always in conflict with 'Efficiency'." We say it ain't so. We show that taxing the "privilege" of private use of public or common resources can advance both equity and efficiency, addressing both poverty and growth.

It is the purpose of this last sentence to make you read the book.

DEDICATION

To those who

seeing the rich and misery that spring from

the unequal distribution

of wealth and privilege

feel the possibility of a higher social state

and would strive for its attainment.

Henry George

"Progress and Poverty"

San Francisco, March 1879

As our case is new, so must we think anew, and act anew.

We must disenthrall ourselves, and then we shall save our country.

Abraham Lincoln

Historical

INTRODUCTION

Society can be organized in three ways, purely or in combination: by *tradition*, by *authority*, and by the *market*. All three seek to resolve, or at least to accommodate, the tensions inevitably occasioned by the given that human beings are both social and self-seeking in nature. According to tradition, people are born into their status, and the *matier* that goes with it. Organized by authority, they are supposed to behave in whatever ways the king or dictator and the associated bureaucrats command. When the dictates originate in market forces, individuals can pursue their own self-interest, however they define it, within these confines and subject to reasonable rules, an important one of which is the enforcement of contracts.

There are also three factors of production: *land*, *labor*, and *capital*. *Land* here stands for everything not produced by people. Exemplified but not limited to "space on the surface of the earth," this is a concept perhaps better captured by the phrase "natural resources," but we shall stick to the label "land" because of a linguistical history that is both rich and connecting. *Labor* is defined as human effort devoted to producing goods and services, whether directly or indirectly. *Capital* is valuable human products that are not yet used up. It is formed by saving and investing, maintained by self-restraint, and kept in existence by perpetual reproduction (or turnover). Capital is a product of labor, and a particularly interesting subcategory of capital is *human capital*, or the investment of labor in the quality of labor itself.

Europe was once linked by commercial leagues of cities, networks of powerful international banks, and a common religious alliance centered in Rome. (The energetic reader should reword this mixed form of organization – and those that follow -- with the vocabulary given above.) Any sense of stability or equilibrium herein achieved was summarily and hideously destroyed by the Black Death in the mid-14th Century. The bubonic plague wiped out nearly half the population of Europe, so drastically reducing the supply of labor that real wages for the fearful lot that remained rose to record levels, resulting in a century and a half "Golden Age" for those English (and other European) workers who survived and had issue. (Indeed, 19th Century historians were shocked to discover in old records that the general standard of living was higher in the 14th Century than it had become by the 19th.)

We take nationalism for granted today, but most modern European nations barely existed before the 16th Century. Germany and Italy emerged as national entities only in the latter 19th Century, although the former had been somewhat unified in the 16th Century before being shattered by the Thirty Years War. In the prefatory studies that follow, we shall focus on England; but do note that other nations that were unified in the 16th Century included Austria, France, Poland, Portugal, Russia, Spain, Sweden, Switzerland, and Turkey, and that England was to learn much from their experiences in economic development. Indeed, it was Turkey's conquest of the Levant that forced Europeans to look to the oceans. Relative power shifted to the Atlantic nations, England in their number; in their explorations, they discovered great riches often enjoyed as a result of

conquest and theft. On more legal lines, Italian, German, and Dutch influences were also strong, especially as channeled through their bankers and traders.

Henry Tutor (also known as Henry VII) unified England politically in 1485. In the next century, successor Henry VIII and his daughter Elizabeth I further consolidated the country. First triumphing in battles over domestic rivals, they extended the conquest to the acquisition of Ireland and Scotland, and thence overseas. Expansive, imperialistic, emigrating Europeans gradually either settled or intruded into much of the world. Their dominions extended into North and South America, Asia, Africa, Australia, even Oceania. Ultimately, only Japan avoided being violated, and even it was "opened up" by threat of naval action.

You should know the rough outlines of all of the above from your basic history courses. Here, now, I suspect, is new terrain: in most early societies, both before and after the fall of the Roman Empire, many or even most people enjoyed extensive common rights to the land. In the Near East, a sedentary culture, their form was one of periodic redistributions and forgiveness of accumulated debts. One example is the Hebrew "Year of Jubilee" described in the Bible (Leviticus 25). In the migratory Teutonic cultures, the forms were more direct. In feudal times, survival of the nobility depended upon retainers numerous, loyal, and on hand; land rights kept them thus.

In the 16th Century, however, not only nation building but also enclosures proceeded apace. This was a movement of privatizing and engrossing (or fencing in) the land. In England, not only the nobles, but also their traditional allies, the kings, abandoned the peasants. The former were spurred on by their discovery of expanding markets for raw wool. Sheep need lots of land, but few shepherds. With national unity, the nobles had less use for armed retainers and archers, so they evicted them; the effect was something like the "downsizing" movement today. In the latter category, Protestant Henry VIII, had, shall we say, "ecumenical" as well as "economic" motives: he confiscated extensive (and Roman Catholic) church lands, in the process diverting the income that had constituted the bulk of the welfare system of the nation to his own coffers. (In Germany, the Catholic Charles V slaughtered 100,000 "Anabaptists" who claimed their traditional common rights to the land.) Thus, as Robert Heilbroner has written, was a new age "born in agony" – a phrase worth remembering. Although the process began in England and continental Europe, as they expanded around the world, emigrants from these countries took with them their new concept of land tenure and dispossessed natives. The privatizers were "equal opportunity" evictors, also fencing out proletarians of European descent, just as they had in Europe itself.

Some of the dispossessed had enough gumption – or despair – to take drastic moves to recreate their lost societies, at least in part. The result of great emigration, the Puritans in New England, the Quakers in Pennsylvania, the French in Quebec, and the Spanish in Costa Rica and the mountains of northern New Mexico and southern Colorado (site of Robert Redford's movie,"The Milagro Beanfield War") are important examples. Most, however, lost their old economic roots in the land without finding new. Three economic classes were thereby created: proletarians now landless, landowners now freed from their

traditional obligations to society, and industrial employers now hiring the rootless workers to process the increased supplies of wool.

Not all change, however, was tragic and agonizing. The spirit of rationalism was growing, with its cognates of science, invention, technology, and exploration. The idea of progress, so natural to us, so alien to most of our ancestors, gradually worked its way into common thought. People came to accept reason as a guide and change as a norm. They developed faith, or hope, in the ability of the mind to unlock the secret laws of nature, and then to apply this knowledge to better their lot. New inventions – printing, the compass, mapping, clocks, paper mills, windmills, spinning wheels – not only multiplied but began to work together synergistically to accelerate the process of change, and to stimulate the minds of those who invented all of them and those who used some of them.

With rationalism came the growth of trade and the power of merchants. Conquering the open seas called for a much higher level of naval technology than what people could make do with on the sheltered Mediterranean. Merchants need arithmetic and accounting to calculate profit and loss, and to divide up their gains after winning them. The laws of accounting and the turnover of capital are much like those of physics and physiology: everything must be reckoned for, including metabolism.

Trade entails speculation: one must sink money in a cargo, at risk not only on the high and stormy seas, but also from pirates, pilferage, and, at the end, markets that may turn bad. This kind of speculation is on balance good, creating gains at both ends. But it is not always good. Ill-advised speculation sometimes leads to cycles of boom and bust. Some early crashes occurred in 1619, 1670, and, especially, 1720, the end of the "South Sea Bubble," which followed the Peace of Utrecht (1713).

As Europeans moved into this new era – one of new mobility, new ways of earning a living, loss of old forms of security, new forms of misery to endure or try to escape – they tried to understand what was happening. What did it all mean? How did the pieces fit together? The old certainties were sick and dying; confusion reigned. What could one believe in now?

The following chapters are a journey for both reader and writer. We shall explore the discourses of a host of intellectual adventurers our modern minds now call "economists" (and Heilbroner called "worldly philosophers"), and we shall see how, time and again, the questions they ask have changed with their times. We shall pay, in our peregrinations, especial attention to the role of land in this history both intellectual and not.

INTRODUCTION

Economics, in the authors' opinion, is at core no more than structured common sense. The study of decision-making, it takes as key assumption (which holds up well in testing with large numbers) that human beings act as if they are purposeful. They have goals, in both consumption and production, and they pursue them to the best of their abilities – one of which, critically, is how well they can gather and decipher information. "Scarcity" is another central concept. Without scarcity, decision-making is not particularly interesting. What, after all, does it mean to "choose" A if you can also have B (and C and D and well beyond Z)? Choice becomes meaningful only when it involves forsaking other options. People are constrained from unbridled choice in a variety of ways, of which time becomes even more important than money in the most economically developed of communities. "Opportunity cost," the value of options necessarily forsaken, is the best measure of "price" – as well as the most demanding. Individuals advance their interests when they chose only those courses of actions where the anticipated extra benefits exceed the anticipated extra costs, and the same rule applies to firms.

Ever mindful, as Thomas Paine once said, that "Common sense is not common," the authors also hold Economics to the standard of being no *less* than structured common sense. Within the discipline, Economics sometimes devolves into common sense structured to a nonsensical degree. As in all professions, the precision of the vocabulary serves both to clarify and refine study and to serve as a barrier to entry, thereby increasing the prestige – and the income – of those already within the fold. Mathematics in particular serves both purposes. Without the discipline, the language can be sloppy and contradictory, with bold assumption and assertion of The Facts substituted to an alarming degree for their careful assembly and examination. The style with which we have written this book, the degree of detail and coverage we have chosen with an eye – and an ear – to helping you advance your ability to address and analyze problems and prospects in the world as we shall also help you see it.

One of the rawest recruits in academic inquiry, Economics finds its way as human practitioners respond to the problems of their day. Economists themselves chose their research topics in response to the concomitant costs and benefits they perceive. The current authors, as you shall see, are no exception.

Classical Economics developed as Three-Factor Economics – the study of how land, labor, and capital can optimally combine to produce goods and services. Defined far more broadly today than when "land" was almost synonymous with "farmland," today the term stands for everything not produced by humankind – the earth's surface, such subsurface elements as coal and natural gas and minerals, airwaves... While "natural resources" might be far more apposite, we shall stick to "land" because of the rich linguistic history behind the term. Labor refers to human effort devoted to producing goods and services, directly or indirectly. Indirectly, labor helps produce capital, human products created to produce other human products more cheaply than without them. Capital is formed by saving and investment, maintained by self-restraint, and kept in

subcategory is "human capital," the enhancement of labor through investment in education and on-the-job training.

Neo-Classical Economics developed when the category of capital expanded to engulf land as just another asset, eliminating it as a special factor of production. Two-Factor Economics asserts that an asset is pretty much an asset is an asset. Its distinguishing feature is that it persists past one time period, and its value is ascertained by discounting back to the present all future streams of benefits it's predicted to yield. Although human capital can no longer directly be "owned" like, say, computers, long-term contracts create indirect ownership, serving much the same purpose as outright possession, especially when interest rates (the discount factors) are high. Natural resources, in the neoclassicists' view, don't suffer from even this problem of law and ethics. They can be owned, they can be sold, they can be leased, they can – and should – be treated as capital.

The authors of this book disagree, and their goal is to convince as many readers as possible that Three-Factor Economics provides a much better tool kit for analyzing the world as it is and how it could be. The first part of the book provides a history of economic thought. Suggesting how often theory develops as response to current events and the theorists' relationship to them, it both helps readers develop their skills in economics and also reveals the deep and rich history of treating land as a distinct factor of production, followed by the wheres and wherefores of its absorption into the category of capital. The second part of the book focuses on land – natural resources -- and the many implications of its distinctive characteristics for economies and societies as a whole. It advocates taxing the private users of land for its full benefit to them and then using the tax revenues of these resources given to all for the benefit of all. Chapters asserting the importance of land in history and the technical ease of appraising it for tax purposes comprise the Appendix, along with reprints of articles not easily accessible to the general reader.

Rights over land convey not only income but economic and then political power, concentrated power, power that can create more income and change the rules about how that income is distributed. Humans are both social and self-seeking in nature, and they organize Nature to industrialize and greatly increase output. The same interest in getting ahead that creates innovation and gain in the private sector also plays its way out in the governmental sector. Neither the principles of Economics nor the rules of Law (and their interpretation and enforcement) have been handed down to humankind in inalterable form. Rather, they come into being to benefit certain powerful and organized groups. But those groups change with the times, and so too do our senses of ethics and environmental dependency. Human nature is the same in both private and governmental sector, and, over time, what really matters is in what direction incentive structures will predictably harness individual energies. The ownership of land is even more concentrated than the ownership of wealth as a whole. Concentrated power affects votes, laws, and the implementation of these laws. It also affects research, the analysis of taxes, the recommendation of policy. Is it any wonder that land is undertaxed and that suggestions to increase its burden have been ridiculed and resisted? So important and

existence by reproduction or turnover. An important subcategory is human capital, the enhancement of labor through investment in education and on-the-job training.

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Not just individual choice but the aggregation of individual choice falls under the purview of Economics. The latter, Macroeconomics, is a field in less disarray than might appear from casual reading of the newspaper. Differences in policy recommendation are due less to controversy in theory than to disagreement over three basic matters. First, the impact of a policy is often quite different from its long-term results – an increase in the money supply may decrease unemployment in the short run, but affect only inflation in the long run; flood relief helps victims who build in flood plains, but encourages their re-building; welfare helps poor children but increases the population and discourages families from remaining intact. How do we value the short run (now) versus the long run (at least five years away)? Second, the best teacher may be experience, but it can be painful. Should we give individuals freedom and choice or guide and even dictate their behavior – should there be a negative income tax that just redistributes money or should there be a bureaucracy which administers food stamps and housing assistance?

Much of history, including the rather recent emergence of nationalism, involves the basic theft of land, often through mass murder or war, with ownership then "legalized" and recognized through the tincture of time. Although most land is now privately and individually owned, both before and shortly after the fall of the Roman Empire, many people enjoyed extensive common rights to land. Sedentary cultures of the Near East, for example, engaged in periodic redistribution and forgiveness of accumulated debts, one

lengthy is this tradition that the authors have dedicated the first half of their book to proof that it has not always been so.

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We submit to you that Land is one of, perhaps *the*, key factor in understanding history. We ask you to open your mind to the possibility that, just as the elimination of legal slavery pushed humankind to a new ethical frontier where the only people we can "own" are ourselves, so should we now move to another ethical frontier, eliminating legally private ownership of the Earth. It is properly a common resource, the privilege of whose use should be leased privately, with payments for the benefit of that use returned to community coffers.

Thomas Paine remains our inspiration throughout this volume. Not only does he remind us of the uncommonness of common sense but his clarion call to the New World applies today with equal freshness: "We have it in our power to begin the world over again." Our power being in pen and insight, to Thomas Paine we dedicate this book.

MERCANTILISTS

We begin by surveying the attitudes of the "Mercantilists", a loosely similar lot of writers like Mun, Locke, Malynes, Child, Misselden, Serra, North, Davenant, and, perhaps most importantly, Colbert. None of these individuals integrated their thinking into a grand, definiitve synthesis as had St. Thomas Aquinas before them and Adam Smith afterwards; indeed, they neither called themselves "mercantilists" -- this generic term was a later epithet -- nor even thought of themselves as a group. They did, however, share many of the attitudes prevailing from 1500 to 1800, the vast stretch of time during which they wrote.

This was an age of nascent nationalism, supplanting a previous age of agricultural feudalism, semi-independent city-states, and a unifying or mediating universal church with strong political powers. The scientific universalism of the Age of Reason had yet to come. In this time of transition, each mercantilist was likely to be pragmatic and to focus on specific current issues, leaving philosophical generalizations, consistency, and system to later generations.

Far from being in conflict with nationalism, mercantilism is the narrow business side of this developing "ism". The aim of each mercantilist is to grow and benefit his own state at the expense of others, without much apology to religion. The previous idea of a unified "Christendom" is discarded as an incubus, and each city-state is now advised to gain at the express expense of rivals and dependencies. Nations are formed and nations are destroyed, and, foreshadowing "Social Darwinism", mercantilism relishes the brawl. The moral level, in brief, is that of Machiavelli.

Mercantilism is, as indicated above, far more dynamic than feudalism. It sees human economic relationships, previously governed by inherited "status" becoming governed instead by "contract," terminable and renewable. Sanctity, once defined by the church, becomes, in this framework, a matter of contract and property. Rather than disappearing, it now adheres especially to that subcategory of property, land, which has been inherited, passed on for centuries, protected, and venerated like an icon.

Mercantilism is even more dynamic than some of the classical and neo-classical economics that follow. It knows no concept of "equilibrium," let alone the permanent one of Mill's static state or the sustainable one of today's "green economists". With each nation ever needing more "lebensraum" to populate and tax, in the form of colonies, fishing grounds, trade privileges, and even pieces of one another, boundaries remained in constant flux.

There now follow seven pieces of the tenets of mercantilism.

1. The gains from trade are not mutual: one party gains what the other loses. It's a jungle out there. No nation accordingly benefits as a whole from fostering domestic exchange, so it should endeavor to regulate and control international trade in ways that take advantage of other nations. Let us have none of those sentimental "good neighbor" policies!
2. This rigging of trade takes three basic forms, according to whether the outside partner is a peer and rival, a dependent nation and colony, or all others. For the first, terms of trade should be rigged to favor the home nation, which should sell dear and buy cheap. Exporters in this nation should be organized as a monopoly, and its importers as a monopsony; there should be no home competition to benefit foreigners. The second group, on the other hand, should be cast as providers of raw materials for home manufacturers. In this "policy of provision," they should be precluded from tertiary activities like finance and insurance, trading with any other nations, or even using those other nations' shipping facilities. For the rest of the world, the goal should be to have exports exceed imports, and the more, the merrier.
3. Freedom from medieval church morality is good, but individualism should be modified by alliance to the state. Sheltering trading and banking and landed privileges is far better than

freeing up markets. (The more recent resemblance here is not only to the American Whig Party of Henry Clay but also to Republicans and Democrats alike in1877, when both parties were controlled by former Whigs (what's in a name?) and Hayes "won" the presidency in 1877.)

4. Trade is a form of warfare, and military and naval power should be assigned high priority so that lands, ocean routes, and privileged access to ports can be secured. The merchant marine and the navy are co-dependent (as James Monroe, John Quincy Adams, and Theodore Roosevelt would well have appreciated).

5. National liquidity -- both the quantity of gold and its rate of circulation -- is prized. Inflation should be tolerated, sometimes even encouraged, because brisk trade and prosperity are equated with rising prices. Some mercantilists even care about full employment, regarding the importation of gold and inflation as a means towards its achievement. ("Bravi!" might later Keynesian economists cheer, but, lest these mercantilists seem like champions of labor, read on.)

6. Low wages and privatization of common and church lands (and their engrossment by a handful of royal favorites and Parliamentary leaders) are all to be encouraged. Keeping wage rates low will help exports and hurt imports: exporters' costs will stay moderate without having to lower rents, and domestic demand for both exportables and imports will also be depressed. The labor supply can be employed fully without damaging the trade surplus. The poor, in sum, should be kept poor, to provide cheap labor. Workers, of course, thought otherwise.

7. Finally, from the perspective of foreign land speculators and investors, the emigration of labor is good; from the perspective of home employers, it is bad. Populating new ports and plantations is laudable; depleting the domestic labor pool is deplorable. This dilemma can admirably be solved by shipping off the more troublesome elements -- jailbirds and dissenters -- often as indentured servants, sometimes as convicts.

Responding to specific problems as they arose over a three-hundred-year period of profound transition, and writing as individuals rather than as members of a "school", these "pre-economists/proto-economists" the modern world has chosen to call "mercantilists" are easily prey to accusations of inconsistency, outright contradiction, and tomfoolery. In closing, we shall examine two of these charges, their merits and demerits.

First, the "bullionist" side of mercantilism is easily open to ridicule, but rightly so only under limited circumstances. We have seen that mercantilists prize trade surpluses. For some under this tag, the focus is so strongly on the importation of gold through these surpluses that maximizing gold reserves becomes their chief ambition, and gold becomes equated with national wealth. These individuals are now called "bullionists". Later critics of mercantilism, Adam Smith chief among their number, lampoon and overstress this aspect, to such a degree that some students learn that it is the essence of mercantilism. Not so. This is a caricature. Most mercantilists aren't that stupid. A determined critic can ferret out unfortunate sayings by individual members of any group, and this is a "group" formed only by later historians. The best of the lot never fall to this level. Take note, as well, that a nation can use export balances to build up assets abroad. Residents of successful mercantilist nations became absentee owners of colonial assets on a large scale. Even when force is a prominent factor, the planting of settlements takes a lot of capital as well, and gold was a splendid form of money.

Second, the mercantilist concern with full employment may seem inconsistent with their interest in enclosure, privatization, and engrossment. Do remember, however, that, even today, the mysteries of unemployment remain just that to many. Like later Keynesians, mercantilists may well have wanted a way to keep the system working without challenging, or even examining, the basic distribution of property and power.

All this slack, however, is insufficient to bring the essential ad hoc'ery of mercantilism up to the challenges of the "Age of Reason" and "The Enlightenment" emerging in the Eighteenth Century.

Physicists, biologists and chemists began to popularize thinking that linked complex details into scientific systems, unified by a few general principals. In this politico-economic world of new puzzles, a new group of economic thinkers stepped up to the plate, pioneering ways to sort out the pieces and fit them together. We turn now to them, the French "Physiocrats".

THE PHYSIOCRATS

Like worldly philosophers before and since, the Physiocrats address problems specific to their own place and time: France, during the reigns of Louis XV and, briefly, Louis XVI. Men of influence in the French court, they had motives both benigh and idealistic: to shape royal policies to solve real social problems at home. Yet, while the Mercantilists are a collection of ad hoc thinkers, loosely grouped by posterity into the linguistic convenience of a "school," the Physiocrats both pioneer applied economic analysis and develop general principles applicable to all times and places. They are indeed a "school;" they do indeed deserve their group name.

The France of their time was simply not living up to the potential its greatest resources and population and resources would surely indicate. Patriots motivated to strengthen their nation and raise the welfare of its people, the Physiocrats were also sufficiently practical to realize they could learn from the experiences of England, whose progress and power they admired, particularly given its relative disadvantage in native endowment. Although their country was economically well behind England, they advanced past any Brits in analyzing and articulated what the English, to some extent, practiced, and in showing France how to improve on this practice. There follows a narrative that first sketches the cast of characters, second describes the environment and the problems they addressed, and third discusses their impact on economics and the policies they championed.

The Cast of Characters

Francois Quesnay, the Physiocrats' leading thinker, was a physician who became personal doctor to Mme. Pompadour. (To understand French policy at the time, a good rule was "*Cherchez la femme.*") Not just the favorite courtesan to Louis XV, Mme. Pompadour also did most of his heavy thinking – his preference being for hunting stags as well as chasing skirts. Quesnay's influence grew even stronger when he saved the life of Louis' son (a life later lost to the guillotine). Quesnay was a deep thinker and a creative theorist. He explained matters in plain French, exploiting and augmenting the clarity and utility of that sophisticated tongue; but he also used intricate diagrams and equations in the language of mathematics that still beguile economists today.

Marquis Viktor de Mirabeau, a rich nobleman, was also a humanist whose book title, *Friend of Mankind*, bespoke his benign attitudes (similar to those of William Godwin, whom we shall meet later, in England). Mirabeau was also a "pro-natalist:" he favored raising the population of France, which had been falling. Quesnay persuaded him that a stronger farm economy would best achieve this ambition.

Pierre Samuel du Pont de Nemours was a cagey politician and publisher who got the Physiocrats a lot of good ink. He was later to participate in the French Revolution, support a losing faction, and yet still manage to survive. In 1799, he left France for America, where he befriended Thomas Jefferson, reinforcing this Founding Father's belief in Physiocratic ideas. With his son, a chemist, he established the Du Pont firm in

Delaware, now America's most enduring family-business dynasty. (His namesake, P.S. du Pont IV, had a run at the presidential nomination in 1988.)

Baron A.R. Jacques Turgot was a skillful and honest administrator. Louis XVI, when newly crowned in 1774, made him Minister of Finance, at a time when most people saw that France needed saving from itself. Turgot proceeded vigorously both to implement Physiocratic reforms and to weaken special privileges, but Queen Marie Antoinette, who had liked him once, fired him in 1776 for refusing to hire and promote her favorites. That political mistake led him to a comfortable early retirement, and her to a most uncomfortable one later, as indeed he had warned.

Vincent de Gourney was a wealthy merchant who also served the government as "intendant of commerce" from 1751 to 1758. Gourney, not Quesnay, is the thinker whose influence persuaded Turgot to come to Physiocracy, and neither he nor his disciple bought into the quirk for which later critics have faulted Quesny – that is, the notion that commerce and industry are "sterile." Their minds, however, were one on all practical policy issues. De Gourney's favorite phrase was "*Laissez faire, laissez passer*," and he is generally credited with its creation.

The Environment and the Problems They Faced

France, as we have already noted, was economically behind England, even though its resources would indicate the contrary. The explanation lies in part in problems France had inherited from previous regimes.

Vast lands held by nobles (the "First Estate") and clergymen (the "Second Estate") were exempt from taxes. Businessmen, workers, and plain folks (the "Third Estate") were not exempt from taxes, and had to be more heavily taxed because of the exemptions there brethren enjoyed. Most revenues came from taxes on consumption and exchange (excise taxes) and from forced labor (*corvée*) on public works and in the military. (Similar forced labor in Bohemia was called *robot*, whence cometh our figurative word for a mechanical slave and our literal word for some actual machines.) The *corvée* amounted to a tax on rearing children, thus helping to explain the falling population in France. We return to a somewhat similar tax system in America today. We call it "tax reform," but, although we no longer have forced labor, except in prisons, we do force people to pay special taxes for working, and again when the spend to support their families.

In addition, French Provinces regulated and taxed interprovincial trade, so that France itself did not comprise one common market. Actual tax collections were handled by "tax farmers," each of whom was sold (or corruptly given) a contract for a certain region, and allowed to collect as much as could force from the people there. This kind of "farmer" had the power of the state, without clear rules or restraints. No one had ever heard of a merit system in the French civil service.

Colbert, Mercantilist advisor to Louis XIV, had left France a legacy of paternalism (or, more accurately, *dirigisme*, which is the same buttinsky policy but without any fatherly solicitude for the poor, the infirm or aged), whereby the state micro-directed many

business and manufacturing affairs. In a clumsy effort to share rural bounty with urban poor, one of its policies was to control farm prices below market levels, reducing farmers' incomes much as if they had been taxed again. To keep the poor quiet, the state tried in this small way to appease them for the many wrongs it did them. A harmful byproduct was to discourage and reduce farm production.

Intellectually, France was in the midst of the ages of "The Enlightenment" and "Benevolent Despotism," both offshoots of "The Age of Reason." Reform was in the air in every court in Europe. Soi-distant benevolent despots, its monarchs vied both to patronize artists, scientists, and intellectuals and to show their modernity and their compassion by helping (or, at least, ceasing to abuse) the poor and oppressed. Frederick the Great of Prussia, Charles III of Spain, and Catherine the Great of Russia, among others, imported French intellectuals and savored their ideas – French being the universal court language, and Paris being the accepted center of European intellectualism. For a time, Quesney was its reigning guru.

Above all others, Joseph II, Holy Roman Emperor and ruler of Austria, bought into Quesnay's ideas, and set about enacting them with conviction, determination, and the power of royalty. His related reforms included freeing serfs, abolishing torture, allowing freedom of worship, basing civil service on merit, and letting peasants marry whomever they wished. His domestic policy battles were all up hill: Austria was just emerging from the long night of tyranny and oppression, and the ancient oppressors, including his own family, did not appreciate Joseph's efforts. Only the people loved him.

Partly to help you place and remember Joseph's time in history, I note that he was, inter alia, the patron of composers Gluck, Salieri and Mozart. Much has been made of the suspicion that Salieri may have poisoned Mozart, himself embittered by professional jealousy. That may be a coded surrogate for the more plausible suspicion that someone did in Joseph himself, who died at a young age in 1790. Privilege plays rough. This is the more important point.

Joseph's keystone reform was enacting Quesnay's central proposal, by having all lands valued, in order to tax them "ad valorem" (in proportion to value). This policy aroused fierce opposition from the First and Second Estates, who had been riding on the Third Estate gravy train for so long that they regarded this free transportation as a sacred right of property. When Joseph died prematurely in 1790, his brother and successor, Leopold II, aborted his reforms, and joined the entente against the French Revolution, then just beginning. The establishment forthwith did its best to wipe out any positive memory of Joseph II, retaining only the jeers. Not until the uprisings of 1848 was there an effort to revive some of Joseph's reforms, and by this time Austria had fallen permanently behind rival powers.

As we have seen, Louis XVI, King of France from 1774, appointed a Physiocrat, Baron Turgot, as his Minister of Finance. Turgot was a seasoned administrator. With a "bias for action," he got right down to it, pushing through new laws ending the corvee and

subjecting the vast estates of the nobles and the clergy to taxation on the Net Product. He freed trade among the provinces, and let prices seek their own levels in free markets. He also proposed to end tax farming and to wipe out many other abuses and special privileges.

Turgot also refused to let Queen Marie Antoinette (ironically, the sister of Joseph II of Austria) pad his civil service positions with her friends. As noted, she got him sacked in 1776 and – again, cherchez la femme – then his laws repealed. The consequences of her power were tragic, and remain so. Turgot might well have been one of the great lawgivers of all the ages, like Moses or Solon [~~Solomon~~? ~~Simon~~?] Well might he have said, "*Rude prendr'essor avec les aigles et travaillant avec les dindons*" ("It's hard to soar with eagles when you work with turkeys"). Marie, meantime, began a long journey that ended on the guillotine. Her best known legacy for us is her lamentable dismissal of the poor, "*Qu'ils mangent de brioche*" (Let 'em eat cake). She was seriously out of touch, and was to pay the price.

During this period, France got revenge on Britain by helping us with the American Revolution. Or perhaps it was, as some say, the French who did the heavy lifting, and the Americans who just helped. This victory did not, however, placate the suffering French masses. They took their own special revenge starting on July 14, 1789, when they stormed the Bastille, and may have been more inspired than placated by the outcome of the American Revolution: scatter diagrams show that the rural areas most active in the French Revolution were also those with the greatest number of men sent over to help in the New World.

<u>The Policies They Championed and the Theories Behind Them</u>

As you have already seen, the Physiocrats were men of both power and practical bent, so, in reviewing their times, you have already witnessed some of their positions – the policies they not only championed but put into practice. Our tripartite division of subject matter is more than a tad artificial, but it does have its uses.

Physiocrats were first determined to reform obvious abuses like corruption, favoritism, undue influence, graft, and tax farming. This stance was far more novel and shocking in 18th Century France than it doubtless appears today. Indeed, the Physiocrats got so far "ahead of the [French] curve" politically that they lost power in France after 1776. (In Austria, as already noted, their influence lasted, even grew, as long as Joseph lived – until 1790.)

The Physiocrats adopted as a group de Gourney's slogan, amplified as "*Laisse -faire, laisssez passer, le monde va du lui-meme*" (Let things work, let them happen, the world goes by itself). This advice is aimed at control freaks in government. It bids them resign as general managers of the universe, and let people produce and trade freely, guided by market prices. Adam Smith was also to adopt this concept, and time has coupled it with his name. In one version of the splendid T.S. Eliot quotation, he pronounces, "Good poets borrow; great poets steal." The same could clearly be said about economists.

Recall that at this time the spirit of Colbert was ascendant in France. Physiocrats were reacting against his brand of extreme dirigisme, and it is unlikely they would have gone so far to the other extreme as today's anarchists, libertarians, and Ayn-Randians. Quesnay, like Adam Smith later, explicitly acknowledges the need for *advances souveraqenes*, for the state to supply capital for public works.

Laissez-faire meant letting prices seek their own levels, free on controls. In France of that age, the focus was on letting the price of grain and flour rise. This was the people's bread, but Quesney et al. reasoned that they would be more than compensated for this rise in the cost of living by their relief from oppressive taxation. The Treasury, in turn, would be more than compensated by a higher tax take due to the resulting increase in land rents, part of its revenue base.

In England of that age, in contrast, laissez-faire meant letting the price of grain fall – for, while France exported grain, England imported it. In crossing the channel, the generic concept of laissez-faire had also to pass from the particulars of an exporting nation to those of an importing nation.

Because the Physiocrats are pro-natalist, they also propose ending the corvee, encouraging subdivision of large estates by taxing the land, and ending consumption taxes like the *gabelle* (salt tax). Does this last seem trivial? To us, perhaps, but the living standards and technology of that time and place were so low that salt was a big item in family budgets, just as it was later in Gandhi's India, its role being more preservation of victuals than promotion of taste.

Indeed, Physiocrats propose eliminating all taxes that are contingent on production, labor, and trade. Distinguishing it clearly from land, they want to nurture the creation, conservation, and turnover of capital. To them, taxing trade is as bad as regulating it -- they correctly perceive taxes as a form of regulation. They favor completely free trade, including freedom from excise taxes, both domestically and internationally – but with emphasis on domestic trade (unlike today's free traders, who slight domestic trade as they hype international trade).

Instead, Physiocrats want to focus taxes on the *produit net*, or net product of land after deducting all costs of improvement and production. (*Net* is French for "clean" or "clear," and morphed into English accounting, pre-Arthur Anderson.) We shall see that the classical English economists translated *produit net* as "rent." Today, "rent" has taken on so many confusing and conflicting meanings, even among economists, much less outside their number, that you may find it useful to think of economic rent as the "net product" of land.

Physiocrats embrace this rent for two reasons. First, it enables them to reduce other sorts of taxes that they find noxious. Second, it asserts a sort of "co-proprietorship: with the state. Physicrats do not view this tax shift as a real shift that would raise the tax burden on landowners, because they believe that other kinds of taxes are in fact shifted to landowners already. You can't squeeze blood out of a turnip, they reason, and there is

only one true taxable surplus: rent, the net product of land. As acronym, we shall employ ATCOR (All Taxes Come Out Of Rent) for this Physiocratic doctrine of tax incidence, which was spelled out in Mirabeau's *Theory of Taxation* in 1760. Lowering the corvee, poll and consumption taxes, and replacing them with taxes on the net product of land will not raise the end-result tax burden on landowners, even if the tax switch raises the same amount of revenue as the package it replaces (in today's parlance, "revenue neutral" would be the phrase). Rather, it will lower the total burden on landowners.

How's that again? LOWER the total tax burden on landowners? Yes, by unleashing the great power of market incentives – to work, to save, to exhange, to produce, and to direct resources to their best uses. Such forces are now twisted and suppressed by taxes on capital, labor, and exchange, and the result is an "excess burden" in the current farrago that disappears with the simplicity of a tax on net product. This is the distinctive doctrine of the Physiocrats, one we shall see most fortunately repeated by Adam Smith, David Ricardo, John Stuart Mill, and Henry George. Smith actually traveled to France and studied for a time with Quesnay, to whom he credits many of his best ideas. Neither was the first to write on political economy, but most economists look back to Smith as the father of Anglophone economics, and the shadow he casts is a long one. Few realize his (and their) debt to the Physiocrats, who passed him their baton – he published *The Wealth of Nations* in 1776, the same year France lost Turgot.

Physiocrats also give a lot of thought to the role of capital in production. They think of capital as *advances*, or what we today call "front money," and stress the importance of getting it back, in a reflux called *revenue* (French for "comeback"). This reflux is recycled (reinvested) to create new incomes, and the quicker the better. One of the main reasons for eliminating the taxes on capital and focusing them instead on the net product of land, this part of their analysis was gradually lost, except among Austrian economists, who are still trying – with little success – to reintroduce it into Anglophone economics. The thread is important, complicated, and beyond the purview of the current text.

Were the Physiocrats narrow nationalists? You should now be able to answer, "Patriots, yes; narrow, no: although they studied problems specific to France, they developed, in the process, general principles applicable to all times and places." And not just in matters economic, as you shall now learn. *The Wealth of Nations* was not the only important literary event of 1776 – that was also the year Thomas Jefferson wrote *The Declaration of Independence*. You should all know how much Jefferson drew from the ideas of Locke. Know now that he, and many the other Founding Fathers who wrote the US Constitution, also owe a lot to, and were even steeped in, Physiocracy. Jefferson, Franklin, Adams, and Paine, among others, spent a lot of time in Paris; Jefferson later kept company with Du Pont and other transplanted Frenchmen in the United States. So powerful was this school that even Alexander Hamilton, that champion of commerce, found it necessary, in his *Report on Manufactures* (1791) expressly to try to refute the Physiocratic position on taxes. He does so rather clumsily, feeling his way through new territory – no one at that time had articulated the reasons for the tremendous productivity of land. This task would wait almost a century for Henry George to tackle and address.

At this time, Physiocratic ideas, especially about land reform, enjoyed a worldwide revival. Their practical import was especially strong both in Jeffersonian land policies, the basis of western settlement in the 19th Century, and in the notable rise in the nation's dependency on the property tax, rising to a peak in about 1920.

It was Quesnay's quirk to undervalue commerce and industry. He found them "sterile," meaning that they produced no net product. This quirk found its way into English thinking, too, and took nearly a century to be eradicated. Across the Atlantic, Jefferson as well even shipped on a bit too much of it. Acting like captious critics, judging and rejecting the whole school on the basis the errors of this one member is, as we shall see, like rejecting all Luddites because of the eponymous – and crazy – Ned Ludd. As noted above, de Gournay and Turgot were devoted Physiocrats who did not buy into the fallacy; nor should we. We may appreciate Quesnay's positive achievements, and forgive him this trespass, as we sometimes ask God to forgive ours. As Newton knew, we all stand on the shoulders of the intellectual giants of those who went before; of course our perspective is heightened.

Let us then focus on their positive and enduring contributions to economics: the value of taxing rent and its basis in the value of laissez-faire. You may have noticed that the Physiocrats appear "radical" in terms of raising taxes on the rich, and lowering them on the poor; at the same time, they appear "conservative" (in modern terms) by favoring free markets. Their genius is in showing how to accomplish both aims at once, by focusing taxes on the net product of land. This concept is one that most of the polarized pundits of today still fail to grasp. Laissez-faire has never been stronger than in some of current oratory, but unfortunately only in a hypocritical form that endorses taxes on production, labor, and trade, and leaves out the taxation of land rents. Well more than 220 years after Marie Antoinette axed Baron Turgot, this combined concept is tragically absent from most modern discourse. It is one of the main ideas you should take away from this text.

ADAM SMITH
(1723-1790)

Like the Physiocrats, Adam Smith both responded to specific problems of the day and, consistent with the Age in which he lived, tried to develop a system of thought that not only explained the existence of these problems but also made possible at least their partial amelioration or solution. The problems that cried for attention, explanation and care were those of the desperate poverty and exploitation of the landless proletariat in England, as the Enclosure Movement proceeded apace. The Age that set the framework for their study was that of "Reason" and "Enlightenment", as physicists, biologists and chemists popularized new thinking that linked complicated details into *systems*, unified by a few general principles. Just as Linneaeus showed how all living things are related in a grand and regular way, just as von Jumboldt explored the dynamic interactions among all living creatures, pioneering what we now call "ecology" (and he called "Kosmos"), and Newton reduced the previous confusion of physics and astronomy to a few simple, consistent and universal rules, the laws of motion and gravity, so did the Physiocrats begin the quest to accomplish the same for political economy in France and Adam Smith continue the process or quest for political economy in England. Published the same year as the Declaration of Independence, his *Inquiry into the Nature and Causes of the Wealth of Nations* became and remains a classical landmark of the discipline.

Smith borrows from the Physicrats their slogan, *laissez-faire*– or, perhaps, in deference to T.S. Eliot's distinction between the good and the great, we should say he *steals* it. Smith has a colorful way with words. He states that the market has an *invisible hand* that guides each private party to act in the overall public interst, "even though that is no part of his intent." Each is selfishly seeking his own interest; yet, together they serve the public interest for the most part far more effectively than any king or government could command them, because the market is an overall system that organizes economic life dynamically and efficiently. The market regulates itself through flexible goods prices. These prices act like *thermostats*: with competition, higher prices induce suppliers to make more available to buyers, who want less as prices go up. In this fashion, overpricing cures itself, and vice versa for underpricing. (Today, we talk about *negative feedback* more commonly than we speak of *thermostat effects*, but you should remember both terms.) Profits for producers are likewise held in check, or regulated, by competition. Smith addresses explicitly only goods, or output, markets in these terms; it remains for J.S. Mill, as one of his many seminal contributions, to extend the analysis to the input markets of land, labor and capital, and the basic idea has been, and remains, enormously influential in our world.

Smith goes well beyond the Physiocrats in observing that the gains from trade include a greater ability to specialize, summing up his view thusly: "The division of labor is limited by the extent of the market." Because he views specialization as an unmixed gain, this position propels him domestically to the position of ardent urbanist, a great advocate of population density instead of dispersion. Unlike Quesney et al., who are suspicious of cities, seeing them as sterile at best and parasitic at [more likely] worst, Smith sees them affectionately as centers of specialization, fermenting ideas and technological advance,

and making more trade possible by concentrating populations. Because he favors widening markets as much as possible, in this particular like his mentor Quesnay, Smith believes trade should be free, both domestically and internationally. Those Mercantilists who assume and assert that one party always exploits the other, and that tariffs should be imposed on international trade to keep English gold from leaking abroad, are therefore in error. Both sides must gain for trade to occur voluntarily. Trade is therefore good, and should not be discouraged through taxation. Smith would doubtless dislike what passes for "free trade" today, when internal or domestic trade is heavily taxed. As for outsourcing to low-wage countries... well, he never has to face that issue.

Taxes on rent are vastly superior to other sources of revenue. We can do no better than recite the wherefores here in Smith's own words:

> Both ground-rents and the ordinary rent of land are a species of revenue which the owner, in many cases, enjoys without any care or attention of his own. Though a part of this revenue should be taken from him in order to defray the expenses of the state, no discouragement will thereby be given to any sort of industry. The annual produce of the land and labour of society, the real wealth and revenue of the great body of the people, might be the same after such a tax as before. Ground rents, and the ordinary rent of land, are, therefore, perhaps the species of revenue which can best bear to have a peculiar tax imposed upon them.

Smith addresses general welfare more completely than any previous writers. He says that the objective of policy should always be to enhance the wealth of the whole nation (hence the title of his major opus), rather than a segment of its society – like gold hoarders, the Treasury, landowners, or the stock market.

Smith is very optimistic about the prospects for growth. He sources these possibilities in capital accumulation, thinks they can make steady advance possible for all parts of society, and sees no upper limit set by the constraints of Nature.

In Smith's view, capital creates jobs for workers, rather than displacing them, and can therefore ameliorate the desperate poverty of his age of enclosure. Capital formation, you see, drives down interest rates in his model, and hence the need for returns to capital, thus letting labor have more of the product. Nature, and the ownership of such of its components as land, set no upper boundary to this progress.

Later economists have less sanquine an approach to both growth and its distributive consequences. Marx and George think capital often substitutes for labor, and cite the results of enclosure as illustrative support. Smith also errs in overlooking the effect lower interest rates may have on land rents. If rents rise (and Smith does characterize these as "unearned income"), land, not labor, may be the beneficiary of the change. Malthus, Ricardo and Mill soon correct this oversight, and Henry George even predicts that landowners reap most of the gains of progress (those readers who have tried to buy a home lately, or to rent a store, will find yourselves siding with George). Although Smith

does -- at least in the case of the Spanish colonies -- observe that the concentration of land ownership sets a bar to their prosperity, on the matter of concentration of landownership in England itself he is not so strangely silent: he needed a patron, and had one in the person of the wealthy Duke of Buccleuch. It is always safer to dump on foreigners. It is also more attractive, in general, to be optimistic, and most modern economists, following Clark, Walker and Ely rather than pessimists Malthus, Marx, et al, have chosen to embrace the sunny errors of Smith rather than the somber truths of some of the successors who stood on his shoulders.

Smith's contributions to our understanding of the market, its self-regulation, growth and the general welfare were brilliant and influential in the 18th Century, and remain brilliant and influential as we start the 21st. The perversions peddled in his name, alas, share mostly only the influence and the longevity, being dangerously deficient in the genius. All great thinkers, alas, are prey to being "kidnapped" by lesser sorts who willfully bend their ideas to their own purposes while exploiting the imprimaturs of their originators. (For this reason, as we shall see, Marx once declared that he was not a "Marxist".) Interested parties ever since Smith have used his name to use *laissez-faire* both selectively to intervene on the side of property, and aggressively to talk down labor organizations, public services of all kinds, public education and welfare. But Smith's espousal of *laissez-faire* is more balanced and moderate than what is often preached in his name today. He abhors monopolies, the concentration of wealth, and unearned income. He does not favor privatizing public utilities. Humane, practical and reasonable in his approach to life, he is anything but an ideologue or extremist libertarian. On the contrary, he always tempers his generalizations with common sense and frequent references to historical experience and real life. It is not until Edgeworth that we find a "Dr. Strangelove" of an economist who carries abstract ideas to their logical conclusions, however absurd these may be.

THOMAS MALTHUS
(1766-1834)

Thomas Malthus cut his intellectual teeth in a time when the prevailing sentiment about population was one of "Pro Natalism." The three legs supporting this position are Militarism, Godwinian Perfectionism, and Smithian Optimism. A bigger population provides more able-bodied soldiers; Godwin's utopia (literally, "no place") is one of such harmony, light, and abundance -- absent disease, crime, war (so much for Militarism), even government and marriage – that an ample population can and should exist; and Smith's predictions about capital accumulation are so sunny that the economy can amply supply more and happier workers and their dependents.

Malthus, however, does not share this optimism. On the contrary. Not only perhaps our first professional economist (training employees of the East India Company at the college it founded), he is also the inspiration for Carlyle to describe this profession by coining the phrase, "dismal science." While Smith focuses on the role of capital, which can be augmented indefinitely by human actions, Malthus focuses on land, whose supply is fixed. For Smith, then, the relationship between the landed and the landless can be harmonious, and the prospects for growth are virtually limitless, with harmony between the landed and the landless; for Malthus, the gap between landowners and their workers shows more, if lamentable, growth potential than does economic production, the limits to which are both severe and soon in coming – at least for certain kinds of activities.

One such activity is the production of food. Malthus forecasts arithmetic growth of the food supply: land is fixed, and the ability to substitute labor or capital for land is limited. Arithmetic growth proceeds in equal steps, like 2, 4, 6, 8, 10,... .

Observing that in America the population had doubled every twenty-five years for the last one hundred and fifty, Mathus adds to this forecast the projection of geometric growth in the population. Increases in wage rates simply raise birthrates, and this result is quick and strong. Geometric growth proceeds in equal ratios, like 2, 4, 8, 16, 32, 64, ...

On a graph, arithmetic growth forms a straight line, while geometric growth curls upward. Regardless of how much the starting point for food exceeds that for people, the curve will quickly overtake and surpass the line. The inevitable result, then, of Malthus' two predictions is that the population will outstrip the food supply necessary to sustain it. Mass starvation among those not owning land will continue until such decimation brings the population back to subsistence levels, an equilibration reached both by the rise in food prices and by the decline in nominal wages.

Poverty, then, is the inevitable plight of the landless. Any time their wages exceed subsistence levels, the excess is simply bred away. The birthrate rises, the supply of those seeking work and food rises, and real wage rates are competed back down to subsistence. Famine can make this corrective mechanism swift, massive, and brutal.

There is no escape from this lamentable state of affairs. Efforts to help the poor are self-defeating. To the poor, then, Malthus poses a harsh choice: food or sex (birth control was not then an option). To the rich, he advises against charity, either public or private: it only raises the birthrate until there are more of the landless, all poor. Charity defeats itself. The ammunition Malthus gives reactionaries has always been mighty.

The facts history has given Malthus are also mighty, and they do not support his prognostications – at least in the developed world. Not only has the food supply in England and Europe increased more than Malthus thought possible, but birth rates there have actually fallen. The reasons for both phenomena are many.

Agricultural production has been a major beneficiary of technological change, much of it "land saving" and "labor using". The discoveries in genetics, biochemistry and agronomy proceed apace, as do advances in fertilization, pest control, and irrigation. Not only have higher-yielding crops like vines and fruit-trees taken the place of those with lower yields per acre, like grains and grasses, but new strains of grains and grasses have also been developed to produce more per acre. Draft animals used to occupy or eat the produce of one third of all the land in farming; animal traction has now been displaced, in the main, by machines. Synthetics have replaced wool and cotton in much clothing, freeing up the land on which the sheep grazed and the plants grew to produce human food, rather than feed or fiber. As Malthus suggests, new land has been brought into production, but production has also become much more specialized, better suited to local soils and conditions as trade has become truly international and less encumbered than in Malthus' day. Artificial impetuses, subsidies to farming, are also a worldwide phenomenon.

Are you aware that Italy has the lowest birth rate in the world? Italians do not come close to reproducing themselves. Religious attitudes have changed in practice, if not in official teachings, and, in any event, any preaching of the Papacy must be rather fully offset by urbanization: it works to lower the birth rate everywhere. If you are able to accept the idea that the number of children their parents end up with is a matter of choice, rational choice, especially in these days of easily available contraception, then you are now ready to consider the wherefores of this choice, which involve the changing costs and benefits of progeny. In former times, children provided their parents great benefit both as labor on farms and in shops and as social security in later years. The costs were largely those of feeding, clothing and housing them. As time and industrialization have proceeded, these calculations have tilted towards the deliberate choice to have fewer children. Child labor laws, better savings opportunities, and governmentally provided social security reduce the benefits, while publicly legislated and privately (voluntarily) extended education has increased the costs. Pace Malthus, in the crude "quantity" sense, children appear to be "inferior" goods: the demand for them goes down as incomes go up – although 'quality"-constant numbers may show less decline. High land prices have also inspired the export of thrift, long a French virtue, to crowded countries like Japan, with its high land prices. Delayed marriage, the decline of sexism, and the increasing participation of women in the workforce have also worked to decrease family size and can –and should --be analyzed in economic terms as well.

Is India an exception to the above, and a confirmation of the gloomy prognostications of Malthus? Opinion on this is divided. Suffice it to say, here, that there are many signs that population control is on the rise in India (with abortions of females as one sad consequence), and that there are many countries, like Japan, England and Belgium, that are crowded without being poor. By many metrics overpopulated for four to five hundred years, China has implemented a combination of strong rewards for families with only one child and penalties for those who have any more; for the last twenty years or so, its output per capita has risen much faster than has that of India's.

Yet, there remain important truths in Malthus. The first is that land is finite – "they ain't making any more of it." Creating capital, the panacea of Adam Smith, does not create more land. Considering for the moment, as Malthus did, land as important primarily as an input into the production of food, we can see that the implications of its fixity are not the dooming of labor to starvation in waves and subsistence wages as equilibrium. On the demand side, breeding and population growth are not a simple matter of geometric projection: they respond to prices (and the values implicit in them). On the supply side, the message is also not one of despair, but rather that we should make intensive use of the land we have, letting no one waste or hog it. This lesson remains important, and, as we shall see, will be the central message of Henry George.

Although Malthus overemphasizes food and farmland, to the neglect of other natural resources, yet, his highlighting of the limits to what we have naturally been given is the essential start of environmentalism, and for this we should also be most grateful. Whole, Small, Spaceship Earth concerns remind us of our ability irremediably to foul our nest – "land" as "natural resources" in their broadest sense. It is not, however, the Earth as a whole that is fragile, it is that particular Earth whose environment supports human life. We, in brief, are the fragile ones. Malthus tells us to husband our resources.

Beginning about 1890, with J. B. Clark, the economics profession was taken over by "neo-classical" economists who, in reviving Smith's idea that capital formation solves most ills, ignored, alas, the cautionary notes of Malthus. The important truth, the central point that the Earth has limits, had to be revived from outside the profession by conservationists, environmentalists, pacifists, nutritionists, anthropologists, ecologists, and nationalists opposing immigration. The struggle is ongoing, and one reason we have written this book is to encourage economists to provide their prodigious skills to the matter and rejoin the debate.

In this pursuit, we should also learn from Malthus' mistakes as well as from his insights. Many of us have not. When supply and demand have grown at different rates for a relatively brief period of time, and these rates are projected mindlessly and relentlessly into the future, collisions and disaster are mathematical certainties. *Limits to Growth*, that alarmist volume of the early 1970s, is just a rewrite of Malthus, with demand (population) growing exponentially instead of geometrically. Its predictions look just a foolish, with the tincture of more modest time.

DAVID RICARDO
(1772-1823)

Like most of his brilliant predecessors and successors in political economy, David Ricardo not only responded to the urgent problems of his day but did so by analyzing the system of which they were a part. In seeking to understand and ameliorate the acute poverty of the British masses, he too became a preeminent and pioneer *model builder*. Stripping his analysis of anecdote and telling detail, Ricardo lay bare the structure of 19th Century Great Britain, with lessons that extend far past that time and that place.

At century's turn, soaring food prices were exacerbating the already bleak conditions of the poor. Food being the major expenditure for the common man and woman, their real wages and standard of living were in decline. Notable amongst the factors contributing to this dismal state of affairs included increases in the population, the country's "Corn Laws," and Napoleon's ban on European food exports to England. But how exactly did this demographic and these policies make the poor poorer? The model Ricardo created to answer this question has so advanced our understanding of *rent* that, for economic literates at least, this concept and its alliterative expositor are rarely considered one without the other.

At the humble age of twenty, Ricardo entered the world of stocks and bonds. He was so successful in this sphere that he made the proverbial killing within five years, and then turned to more contemplative and less well monied matters, political economy in their number. Electrified by reading Smith's *Wealth of Nations* in 1799, Ricardo spent double his brokerage time in intellectual investment before his labors bore tangible fruit. Letters, pamphlets and tracts began then to appear, culminating in his major opus, *The Principles of Political Economy and Taxation*, published in 1817. Compensating in rigorous logic for what it lacks in Smithian detail, story, breadth and elegance of style, this text remains central to the development of economic theory. There follows a discussion of some of the more notable contributions of this seminal work and the problems whose creation and solution inspired the inquiry.

First is a fact: Nature supplies land in varying quality or grades. Second is a consequence of this fact coupled with humankind's desire to minimize costs at any level of production as an essential part of maximizing profits at the optimal level of production: the best land will be cultivated first. As the population rises, farmers will both use the already cultivated land more intensely, increasing their inputs of capital and labor, and resort to lower and lower grades of land. The first effect involves the *intensive margin* of cultivation; the second *extends* the margin of production. *Ceteris paribus* (an important Latin phrase that means "holding all else constant"), each addition worker will therefore add less to total output than the extra contribution of each previous worker. In economic terms, the *marginal product of labor* falls. Extra workers will be assigned to work the land rationally, so that their contributions to the old and the new land under cultivation are equal. To understand this point, simply consider the alternative: if A can add more to old land than new, A should be assigned to old.

The (*extensive*) *margin of cultivation* is that land just barely worth farming at any given level of product prices and production costs. As we hope you recall, rent being the *net* product of land, or the gross yield minus the costs of production, on this margin the costs eat up the entire yield, leaving no rent whatsoever. The land is still worth using: workers earn a living there, and capital gets the same return as on better land. There is nothing left over to pay rent, but the land is there whether its owner gets any rent or not. Uninteresting under these circumstances to absentee buyers, the land on this margin is usually owned and worked by the same person or persons.

Workers assigned to better land will receive wages no more, no less, than those assigned to land that is worse: competition and the profit motive create this conclusion. The marginal contributions of their labor must be equal on all grades of land, for reasons noted above, and so must their marginal rewards: migration and competition among workers keep rates at a common level for common skills. (The return to human capital – different skills due to different investments in self – will be discussed elsewhere.) Wages, then, will be determined by the value of extra output at the margin of cultivation. Higher prices for agriculture will raise the value of labor's and capital's marginal product (MVP), setting the signal for the cultivation of more, and lesser, land – land on which labor's physical marginal product is less. Land already in use will be used more intensively, also with the associated decline in marginal physical product.

The upshot of all these competitive forces is that the advantage of better land benefits not the workers but the owners of this land. Only when those who work the land also own the land, do they benefit from the superiority of some acres over others. In this special case, they receive rent payments in addition to earned income, but the two categories of income must be kept analytically distinct.

Land, in other words, emerges in Ricardo's analysis as a very special factor of production. The payment of rent is not necessary to call land into being, but it must be zero or above to call it into production. Rent is a *residual*, what remains after paying all the costs of the other two factors of production, labor and capital.

It is time, now, to look more closely at what happens to labor in this world. We shall start by examining anew the insights of the Rev. Malthus, whom we examined in the previous chapter. Malthus implicitly graphes the supply of labor as a line parallel to the x-axis, where the y-axis plots a continuum of real wages and the x-axis plots a continuum of workers (see appendix). This, in a vocabulary we shall develop in future chapters, is a situation where the supply of labor is *infinitely elastic*; in Malthus's world, it is such at subsistence wages, those wages just able to keep workers alive by covering their basic needs for survival. Any increase in wages above this level, due will only temporarily raise the standard of living of the masses: in short order, they will simply breed away the difference between subsistence and market wages. Supply increases, as it were and literally, will simply *eat* away the difference. Malthus and Ricardo were contemporaries, contemporaries who communicated persistently and deeply. They disagreed about almost everything, but, in the matter of labor's supply, their views are identical.

More than four hundred years earlier, the Black Death ravaged the population of Europe and England, by some accounts halving the population due to a bubonic plague now understood to be carried by rats which had stowed themselves away on cargo ships. Bleak as these years were, they did raise the real wage rates of the survivors. The forces of supply and demand are ruthless, but sometimes salutary. In the England of Shakespeare's days, pestilences and fires were still repeatedly swept through country- and city- side alike, and Malthus and Ricardo would both have analyzed these disasters as hideous but necessary consequences of humankind's unbridled fecundity. In their own days, however, inventions like the steam engine were beginning to open up the possibilities for economic growth of much greater and sustainable proportions that that envisioned by Adam Smith with his focus on the powers of specialization and improved productivity due to the division of labor. The inventions and innovations associated with industrialization lessened previous constraints on economic growth and therefore previous constraints on related growth in the population. These changes made the matter of *distribution* the key issue of his times, and rent was at the heart of its determination.

While *growth* refers to the overall size of the economic pie, *distribution* concerns division of that pie among its various slices – in Ricardo's case, to the three sets of economic actors: labor, capitalists, and landlords. We have already seen how, in Ricardo's world, the quantity of labor supplied will be set by how many can be employed at subsistence wages and that any increase in wages will be temporary: it will be bred away. (Any decrease in wages will also be temporary, causing starvation or migration.) In times of economic growth, more workers can find employment, but their wages cannot vary for more than the shortest of runs from that level that just keeps them alive. It is now time to distinguish sharply between *nominal* and *real* wages. A brief foray into history will show us just why.

In the early 19th Century, a higher population raised both the demand for food and the supply of cheap labor. The demand for food, in Ricardo's day, he sees as having mostly been met by bringing more farmland into cultivation. (The Green Revolution, which raised output/acre, substituting technology for land with high-yielding crops, is far in the future.) Because this "new" land is less naturally fertile than what has already been in use, the cost of producing food rises on the margin, and with it the price. Food being the major component in the spending of the poor, their nominal wages must rise to accommodate this extra cost and keep them alive. Labor, in brief, becomes more expensive to employ in the nonagricultural sectors of the economy. Labor, however, does not become better off: the rise in their money wage simply offsets the rise in the cost of food. Their wages are higher in the day's currency, but the buying power of these wages hasn't increased at all. In other, and modern, words, wages are *nominally* higher; but in *real* or *purchasing power* terms, they are unchanged.

The consequences for the capitalists, however, are real, extreme, and dire. Even as it is their embrace of new technology that propels the economy forward, they have to pay more for labor regardless of whether that labor becomes more productive. In other words, a key component of their costs rises. As the capitalists work hard, save and

invest rather than frittering away their profits in idleness, extravagance or show, they create growth in the economy. This growth has increased the demand for labor. This increase in demand has increased wages – but only temporarily: the better-fed populace has almost immediately responded with more babies, raising the supply of labor and, in effect, breeding away the rise in real wages.

Where do all the gains go? To the landlords. As land is pulled into production on the *extensive* margin, rent increases on land already cultivated and now used more *intensively*. Have the landlords done anything to deserve this increase? No. To the extent that they have improved the land, they have been acting like capitalists, and are rewarded as such. Mostly, however, they have just been sitting on an asset, enriching themselves in the process.

Ricardo therefore sees landlords as getting more and more enriched by the efforts and exertions of others. Labor works hard just to survive. There may be more and more workers, but none is individually better off. Capitalists work and invent and save and invest only to have their share of national output actually reduced. Landlords loll about and gain not only absolutely but also relative to everybody else.

While Adam Smith sees and anticipates a society where everyone gains from the extraordinary fruits of the specialization and division of labor, Ricardo sees a world of class conflict, with losers as well as gainers. Like Malthus, he thinks that workers simply breed away any gains, and, if they overbreed, they die of famine or disease. Unlike Malthus, however, he sees lazy landlords gaining at the expense of the hard-working and innovative capitalists responsible for most of the total movement forward. They employ the extra workers; they are able to do so because of all their saving and investment. And yet, they are squeezed on one side by the higher cost of labor and the higher value and share of rent. "The interest of landlords," he notes in brief, "is always opposed to the interest of every other class in the community." (page? 1817)

Ricardo has uncovered and then highlighted a major obstacle to growth: land. Labor can increase, capital can increase, but land cannot. Not only does it pose a significant limit to growth, it also redistributes the benefits of what ever growth continues to occur. It is this insight, coupled with the assumptions of population growth he shares with Malthus, that turned the burgeoning field of Economics from the sunny expositions of Smith to the "dismal science"* [fn: *a phrase Carlyle invented after reading Malthus] of Malthus, Ricardo, and many (most?) of their successors.

Oddly enough, some of the gloomiest of modern economists have trained and practiced in the United States, for so long nation of the "open frontier", so generous in land and other natural resources. We have several theories about why this situation both developed and persisted; here, we shall deal only with those directly derivative of Ricardo's work. The rest we shall save for later in the book.

Once again, we emphasize how much economic theory has developed to understand, address and ameliorate the central worldly problems of the day. It's time, now, to take a

closer look at some of the key events in Ricardo's Great Britain at the beginning of the 19th Century, the decades during which this great economist was formulating the model that would make his 1817 publication so formidable.

We have already seen that the population was rising, substantially, and with it, the price of grain ("corn" in Great Britain meaning "the most common of the crops"), the cost of labor, and the value of rent. We have seen the clear link Ricardo's model has drawn between the increased demand for food, its price, and land rent. It is now time to discuss three other important issues of the day and why they, as well, made Ricardo so aware that land is a major factor in both economics and politics.

First are the French Revolution and the succeeding Napoleanic Wars, these latter lasting from 1789 to 1815. The wars diverted men from farm fields to battle fields. They needed to be fed on both, so food prices had to rise. Embargoes and other disruptions of trade worsened the effect on the home supply of basic foodstuffs.

Second are the Corn Laws. "Corn" being, to repeat, the British term for "the most common grain", these were restrictions on trade that basically set a price floor on the domestic price of grain. The lower the price of imports, the higher the import tax, or tariff, on them. The scale was a sliding one, guaranteeing that the price British farmers could get for their grain never fell below a certain level. The Corn Laws also, then, if a tad indirectly, guaranteed that land rents would also never fall below a certain level.

Third is the political power of the landlords, owners of farms in the main. A "Rotten Borough: system prevailed in England at the time. Voting boroughs were not reapportioned as people moved from the country to the city, so farmers became over-represented in Parliament. Because no one could vote without meeting certain property qualifications, the proletariat wasn't represented at all – except by rioting. We have already seen that landlords liked high grain prices because they led to high rents. We are now in a position to see that they had the political power to keep these prices high. If population increases abated or wars ended, why, there was always the politics of international trade!

A brief history of the times shows just how powerful this last tool can be, and for how long a time it can be deployed in the hands of a major constituency in Parliament. As the population grew since Adam Smith penned his work, and the wars raged while David Ricardo considered and published his, the price of a bushel of wheat quadrupled. With it, rent at least doubled in a period of twenty to twenty-five years. Parliament's passing of the Corn Laws was able to continue the rise in farm rent that population growth, revolution and war had started. To understand its effect, we shall briefly discuss another major contribution of Ricardo's: his models of trade.

You see, Ricardo didn't confine his analysis just to rent. He also developed the theory of *comparative advantage*. Still the guts of all studies of the real (as opposed to monetary) aspects of international trade, it shows that what really motivates trade is *opportunity cost* -- how much cloth, in other words and in Ricardo's famous illustration of a two-country,

two-product world, England would have to forego by being self-sufficient rather than just buying the wine from Portugal and paying for it by producing more cloth and exporting some of it. England and Portugal *both* benefit from this trade (the market supports this conclusion, if the trade is voluntary, and informed). Even if England were *absolutely* better at producing both wine and cloth than Portugal (it took a less costly package of land, labor and capital to produce bushels of wine in England than in Portugal), England might still find out that it could consume more of both by exporting cloth to and importing wine from Portugal. Such would be the case if the cost of domestically producing wine were a greater reduction in the amount of domestically produced cloth than the cost of just buying the wine by exporting the cloth.

This analysis alone would make Ricardo a proponent of free trade. Both sides gain, even before we add Kissinger's theory of creating "a vested interest in peace" through economic connection (generally, countries gain from the absence of war). When our man adds to the model how interfering with the forces of international trade can raise grain prices and therefore the cost of labor and the value of rent, the case is strengthened. Virtually the only argument against free trade in Ricardo's world is *national defense*. Closer to our world, many Japanese nearly starved during World War II when their importation of rice was disrupted by battle. In the 1970s, price supports made rice four times as costly to the Japanese than it was internationally, but policymakers (as well as landlords) seem to have found this a reasonable cost for security.

With this theory, we now return to Ricardo's Britain, better armed to analyze how and why the farm lobby could and chose to push through legislation placing tariffs on imported wheat. By 1813, war, bad harvests, and lots of hungry mouths combined to raise the price of a bushel of wheat to almost **twice** the average worker's weekly wage. (In America, to provide context, before the 1970s, the worst comparable situation – from a worker's standpoint – was when wheat cost a little less than fourteen percent of his weekly earnings)* *[fn reference to Heilbroner, pg 80] After careful study, Parliament decided that the tariff should be increased. The stated reason was that even higher domestic prices in the short run would stimulate greater production in the long run. As farm prices and rents and urban costs would have increased even more while urban rents and profits would continue to fall, capitalists rallied forth to repeal the tariff. Ricardo's class analysis of growth and economic policy was clearly in full play.

The capitalists were politically strong enough that Parliament formed new study committees and decided to shelf the issue of wheat tariffs. The next year, Napolean was defeated, and grain prices and the associated political heat both began to decline. Wheat tariffs didn't increase, but the Corn Laws remained in effect until 1846. It took the scandal of the Irish potato famine finally to tip the scales for change and competition from abroad.

Although it was only later in life that Ricardo actually became a member of the House of Commons, the contemporary politics of economic power and redistribution clearly animated much of his theoretical work. The irony and, in our view, tragedy are that, at the same time they inspired him to develop lasting theories of rent and comparative

advantage, they probably also inspired him develop particularly the former with examples that that allowed later economists to trivialize, marginalize, and ultimately ignore the importance of rent in economics and therefore in politics and life.

Agriculture was an important part of the British economy, not only because of population growth and revolution, war, and Corn Laws, but also because of the country's stage of development. Indeed, one of the easiest, and most objective, ways to measure how industrialized a nation has become is to measure the percentage of its workforce in farming. Developing the concept of land rent through arithmetic examples of food production was therefore both pleasingly concrete and powerful in capturing the imagination and the concentration of his readers. Perhaps Ricardo found the farm situation a convenient one to illustrate his more general point, that land rents are unearned.

The redistribution that occurred as Ricardo was methodically working on his model also probably affected his choice to focus on farmland rather than extending the applicability of his analysis to the value of location, whether rural or urban. As we have seen, the economic power of farm owners increased in both absolute and relative terms as higher food prices raised the rent they received at the expense of both capitalists and urban landowners. As we have also seen, they were able to keep their political power in Parliament. Dollars and pounds talk, as do inertia and chicanery. The value of farm rent was one of *the* hot topics of his day.

Ricardo was definitely engaged in an active political struggle against farm landowners in particular, and he was probably willing as a consequence willing to sacrifice his general scientific point to his immediate political cause. Logical clarity is often sacrificed for oratorical effect in politics, and spokespeople for rent-takers could then seize on the confusion to trivialize or obscure Ricardo's main points.

The spokespeople for rent-takers continue to be many. And, particularly in countries as economically developed as the United States, where the percentage of the labor force in agriculture has declined to a mere [*fill in this blank*], it is very easy to say that, interesting as Ricardo's theory of rent may be logically and theoretically, it is of minimal importance to today's economy, today's world. After all, the natural fertility of land no longer matters much, these spokespeople continue: we now have chemical fertilizers and high-yielding designer crops a'plenty. Nature no longer has much to do with farming in America, at least in terms of soil quality. And soon we'll even be moving about and seeding clouds, the better to control rainfalls in total and in timing. These improvements are all about capital and technology. They are all about capital and investment and saving. And, so, it is useful simply to conflate the categories of *land* and *capital* into one: *capital*, an asset that exists for longer than one production period.

They are wrong. Dangerously wrong. Land remains an extremely important factor of production with characteristics quite distinct from capital. Marginal rates of return on capital, as well as wage rats, are equalized by capital and labor's ability to move among markets. Rents are not. A rising population actually raises the demand for all goods, and

raises the supply of labor in all lines of work, while all kinds of land remain fixed. German writers like von Thunen, who wrote about urban land, and Faustmann, who wrote about forest land, were well aware that rent isn't only interesting when it applies to agriculture. In our times, the rent of oil-bearing land is a critical issue in economics and world politics, war and peace, terrorism and quiet. Rent in cities and for land zoned industrial versus retail or residential is also a hot topic.

Land, as we commonly understand the term, is mostly about location. And, as we shall study in more detail later, the value of the location today has much more to do with advantages that are manmade, not natural. Soon after Ricardo, urban land soared in value in Great Britain, soon outvaluing farmland many times over. Industrial land of the highest grade commanded quite a premium, and its value, in the days of cotton mills, had less to do with soil than with access to pure water, free of lime to avoid matting, as well as proximity to water power and a port city. We see here a shift from the key variables of soil and climate to those of water.

The highest values, however, attached to prime sites in London, in and around "The City," Londoners' name for the financial district. A concentrated population here has become the key desideratum. "Ah," the more astute of our readers may exclaim, "but London itself became a big city because of the Thames, another natural advantage!" Our reply is one name, the two words Los Vegas!

In the 21st Century, the most valuable locations are those in centers with huge human investments in human amenities. Cities started next to rivers and bays, but along came railroads and airports to connect people and move their goods from sites of production to sites of consumption. As any real estate agent worth xer salt will tell you, the value of any property depends on three things -- location, location, and location.

The general theory of land must be freed from the particular example of farmland with different qualities of soil. Indeed, it must even be freed from the particular example of location. The concept must be expanded to encompass all of the resources Nature has given us freely. These resources become economically valuable due to technology, to be sure, but they originate in Nature. Just think for a bit not just about fossil fuels but also about the spectrum.

And then return for a moment to location. Natural advantages like beachfront continue to command major premiums. But land values also soar when manmade transportation makes previously remote areas effectively close to cities, with all their work opportunities and cultural amenities like museums, parks, sports arenas and restaurants. We shall see that, for this reason, an excellent way to finance new roads and rails is to levy a tax on the properties they connect. (Just consider providing light rail and better roads from outlying areas to New Orleans so that low-skilled and therefore low-paid workers can commute to the Crescent City rather than living in what are properly considered wetlands – like the 9th Ward, with or without spending at least $30 billion to build a better system of levies! And then tax the property abutters of this new transportation system for some (all?) of the increase in the value of their land due to these

public works, not to personal endeavor! Doesn't this approach seem both more sensible and more fair than taxing the citizens of Topeka to subsidize risky living in New Orleans?) The general point is to tax the beneficiaries. User fees have great value.

In addition to equity reasons of the sort adumbrated above, taxing land is better from an efficiency standpoint. As a surplus above the cost of production *and* as a factor immovable and fixed, it can be taxed without distorting incentives. When the government taxes work, it subsidizes leisure and other nonpecuniary returns and therefore affects choices. When the government taxes capital, it reduces the incentive to save and, because much technological advance is embodied in capital, the incentive to research.

Ricardo began down this path, but he pulled back. He says,

> A land-tax, levied in proportion to the rent of land, and varying with every variation in rent, is in effect a tax on rent; and as such a tax will not apply to that land which yields no rent, nor to the produce of that capital which is employed on the land with a view to profit merely, and which never pays rent; it will not in any way affect the price of raw produce, but will fall wholly on the landlords. [1911 [1821], p. 115]

But then he pulls back:

> It must be admitted that the effects of these taxes would be such as Adam Smith has described; but it would surely be very unjust to tax exclusively the revenue of any particular class of a community. The burdens of the state should be borne by all in proportion to their means: this is one of the four maxims mentioned by Adam Smith which should govern all taxation. Rent often belongs to those who, after many years of toil, have realized their gains and expended their fortunes in the purchase of land or houses; and it certainly would be an infringement of that principle which should ever be held sacred, the security of property, to subject it to unequal taxation... And if it be considered that land, regarded as a fit subject for exclusive taxation, would not only be reduced in price, to compensate for the risk of that taxation, but in proportion to the indefinite nature and uncertain value of the risk would become a fit subject for speculations, partaking more of the nature of gambling than of sober trade, it will appear that the hands into which land would in that case be most apt to fall would be the hands of those who possess more of the qualities of the gambler than of the qualities of the sober-minded proprietor, who is likely to employ his land to the greatest advantage. [1911, p. 131.]

Well, where you stand depends upon where you sit. It is highly likely that when Ricardo wrote these last words, he was thinking about himself, a man who made a fortune taking calculated risks in the stock market and then retired from his career as a financial wizard to become an intellectual wizard and major landlord. He wrote *The Principles of Political Economy and Taxation* after retiring to an extensive estate in Glouchestershire.

It is also true that when land changes hands it does so at a price that tends to capture all of its predictable superiority, at the time of sale and into the foreseeable future. (When markets work well, average costs for this reason rise to meet price.) Some landowners, in other words, have bought their land, with hard-earned savings, at a price that gives the seller, not them, the capitalized value of rent. This is a problem in equity. This is why laws, whether of taxation or of other matters, should be stable and themselves predictable. This is why we value *stare decisus*. To this, our best answer is to make readers reflect on one more word: slavery.

THREE UTOPIAN SOCIALISTS

The early 19th Century was not a happy time, particularly for working men and women. The glorious goals and ideals of the French Revolution – *liberte, egalite, fraternite* – were brutally suppressed in extreme political reaction. Beethoven tore up the page on which he'd hopefully dedicated his Third Symphony (the "Eroika") to Napoleon when this emperor's military campaigns began to reveal his bold anti-egalitarian stripes. Four years after the Napoleonic Wars ended with the Treaty of Paris and the Congress of Vienna in 1815, crisis marked postwar depression, and the economic conditions of the proletarians were frightful. It is no surprise that this environment bred and nourished not only Luddism and *sabotage* but also Utopian Socialism, especially as identified with the three reformers, Robert Owen, Claude-Henry Saint-Simon, and Charles Fourier. Except by historians, this trio is perhaps united only by their striking impracticality and because they envisioned reform coming from the top down. "Proto-Marxists," they are not at all. Rather, sorts of mini-Teddy Roosevelts, minus the big gun.

Luddism is the belief that machines substitute for labor and therefore destroy jobs. To discredit the idea, it is deliberately identified with one of its least edifying adherents, Ned Ludd, a village idiot who smashed knitting machines in the name of saving knitters. The broader term for this kind of obstruction of output is *sabotage*, derived from the French word, *sabot*, or wooden shoe. Between 1811 and 1816, an inspired group of British followers, the Luddites, rioted in like fashion; lacking both cohesion and political vision, as well as political power, they were brutally suppressed by the government. The question of whether capital replaces labor remains, however, an interesting one to raise, and one which could well be identified, more positively, with Ricardo. For historical reasons, we shall continue to use the term "Luddism," but without prejudice one way or the other.

The cornerstone of Robert Owen's beliefs is that people, in the main, are products of their environment. Unappealing, almost hopeless, in conditions of squalor, they can be improved, lifted up, by better nurture, education, association, and character training. In this faith, Owen echoes William Godwin, the optimistic philosopher against whom Thomas Malthus reacts with such vehemence. Not surprisingly, Malthus is a genetic elitist. Indeed, Charles Darwin credits this worldly philosopher with inspiring him to develop his theory of evolution, based on natural selection that over time tends to improve the race. Many of Darwin's associates and followers, Huxley, Sumner and Spencer in their number, are also genetic elitists, like Garrett Hardin in our times. Not all biologists, however, have been so minded. One such notable is Alfred Russel Wallace, whom we shall study later.

A strong supporter of unions, Owen even tried to form one among his own employees. It being, to repeat, a time of extreme reaction against the ideas and ideals of the French Revolution, English laws dispatched of this union, and all others in the early 19th Century. Although of lesser interest to this reformer, the consumer cooperatives he

founded were much more successful; indeed, his Rochdale copper plan endures to this day, albeit with limited scope. This movement is Owen's one practical legacy.

Impractical reformer, Claude-Henry Saint-Simon, on the other hand, contributes an ideological legacy: that the leisure class should also work. Indeed, his is a religion of work, based on the observation that output won't suffer in the slightest if all *rentiers* disappear over night. (*"Rentiers"* is a term originally categorizing people who live on rents; it has been expanded over time to include individuals living on interest and dividends, too.) This idea has been been turned upside down and used mainly against impoverished welfare mothers, while *rentiers* tend to be admired, honored and revered. Asserting that they "work" in the assumption of risk is not a fully satisfactory justification for the resources they command and enjoy.

Charles Fourier, like Owen, is a designer of communities. In his case, they are called *phalanxes*, and consist of a large general living space (with different levels of privacy), surrounded by farms and industries. All members are expected to work, but for only a few hours a day, and only at what they like best. Centralization and genial competition will yield generous profits, and everything will be happiness and light.

Although *utopia* means literally "no place" (cf. *eutopia*, a "good place"), yet, a place they did find. Puritan settlements in 17th Century New England had both utopian and commercial elements, and this combination proved powerful. "The City of Brotherly Love" in "The Quaker State" was also envisioned as a kind of utopian community, as were some of the other colonies as well. This streak among 19th Century Americans and pioneers was also strong, and colonies like Solvang and Anaheim were both utopian and ethnic. Some utopian colonies still survive. Among their number are Free Acres in New Jersey, Fairhope in Alabama, and Amana in Iowa. Familiar towns like Atascadero and Patterson in California were once utopian colonies, and rural such communities persist among the Amish, the Hutterites, the Shakers, and the Doukhobors. The original State of Deseret under Mormon leadership may also be considered a kind of utopian colony, the largest of all, and it has not only survived but adapted to the commercial world, and grown mightily in the process.

Although utopians were seldom a majority, they were at times numerous – people have been, and always will be, desperate to escape the "Dismal Laws" as adumbrated by Malthus and other pessimists and believed to represent the science of political economy. Our utopians are also important because they leavened the loaf. Some were impractical visionaries, but others were tough and hardworking. Remaining (or becoming) aware of them helps us understand how different the majority of us are today from the 19th Century forebears who spawned such movements in large numbers. Their closest cousin in this century may be the *kibbutzim* of Israel.

It is always important to have some in our population looking up and ahead, rather than plodding along and being careful they don't trip. In the parlance of mathematics so admired by today's academic economists, we can be so busy pursuing the immediate *local maximum* that the *global* one completely escapes our notice.

JOHN STUART MILL

John Stuart Mill (1806-1873) was recognized as one of the most significant philosophers in his day, and this reputation has held up with time. He was also acknowledged, and rightly so, as the greatest economist of the day; this reputation, perhaps because of his radicalism, has often yielded to sly belittlement as time proceeds apace. In a day when alarums sound the smallest of novelties, the sedate and modest prose with which he introduces new thoughts would explain neglect, but not derision.

Inter alia, Mill is a pioneer feminist. An advocate of birth control, he is optimistic about both the social and the economic results of making reproductive technology widely available (see *infra*). Mill accords the credit for his best ideas to Harriet Taylor, whom he loved for years and was finally able to marry, then adopting her daughter. Biographers mostly think he was carried away by love, more generous than accurate. Direct evidence of talent in the Taylor line can, however, be found in daughter Helen's later crusades with Henry George.

In his *Principles of Political Economy* (1848), this master of logic both restates and creates economic ideas. In his borrowing from Smith and Ricardo, he selects well. To their foundation, Mill adds the concept that society may *distribute* (divide up) wealth independently of the laws of production -- most especially that of diminishing marginal returns to labor. Entitlements are arbitrary, and may be reshuffled. This, an attention to history should have made clear to his predecessors: the story of periodic redistributions of wealth is a long a fruitful one, as illustrated by *Leviticus* 25:10 (the Liberty Bell law).

Critics point out that redistribution may affect production by damping and twisting incentives. If you are penalized, at least in part, for saving by taxes, why save as much? If you lose benefits and gain tax bills for working hard, why work so hard? But Mill and later economists like William Vickrey have developed solutions to these problems. Mill proposes taxing inheritances at progressive rates, and taxing future increments in rents.

Superficial commentators also say that Mill thinks a rise in wages will end capital accumulation. They may be misquoting or misunderstanding him. Mill actually says that "Scarcity breeds substitution." High wages direct new capital towards substitutes for labor, while pricey land inspires investment in capital that is labor using and land saving. The idea that there are many ways to skin a cat is one of Mill's greatest, for all that later economists have neglected it.

Mill also predicts that workers will buy out owners in some cases, as indeed they already have, in the recent case of United Airlines (UAL). He does not, however, identify one of the mechanics of the buyout -- having pension funds acquire common stocks.

Many of Mill's predecessors have been gloomy about the course of wages over time -- Malthus thinks that population growth will outrun subsistence; Ludd thinks that new machines will destroy jobs. But Mill is optimistic. He believes both that population growth can and should be limited by the use of birth control (he had no children of his own) and that the increased demand for land will stimulate the substitution of capital for land instead of for labor, so that there are more jobs per acre. Think of a high-rise office building as one example, and then think of others. Aware, as well, of Ricardo's argument that machines may soak up so much capital that too little is left for payrolls ("advancing subsistence"), he replies that, as land prices rise and wage rates fall, investors will choose kinds of capital that substitute for land and create more jobs. Again, "Scarcity breeds substitution.

Mill carries the idea of flexibility in the economy, guided by the price system, further than Smith, further, indeed, than many later economists, even those today, are willing or able to go. The notion of fixed factor proportions dies hard, and is constantly revived. Thus, Mill, whom some

have colored as a socialist, shows a deeper appreciation of market adjustments than many soi-disant libertarians.

KARL MARX

Karl Marx (1818-1883) came of intellectual age in a time of intellectual tumult. This was the epoch of *Les Mis*, and, in 1848, ferment within and without gave birth to both publication of his revolutionary *The Communist Manifesto* and outbreak of revolutions across Europe. The pen was to prove mightier than the sword here, as elsewhere.

Marx's theory of "Dialectical Materialism" owes much to another German, Georg Hegel. Both find antecedent roots in the Greek philosopher, Heraclitus. "Dialectical" describes a dynamic wherein history evolves through the constant struggle and clash of opposites, followed by their synthesis into new forms, which, in turn, inevitably break down into new struggles with new opposites. Heraclitus declares that change is so constant that it is impossible to step into the same river twice; Hegel explains why. "Materialism" asserts the primacy of the economic means of production in this struggle.

By coupling "dialectical" and "materialism", as Fredrich Engels (1820-1895) said, Marx "turn[s] Hegel on his head". The struggle is not one between competing ideas, but one between competing *classes*, classes that spring from current modes of production and exchange. The concept of evolution through struggle has a lot in common with Darwin's *natural selection*, and the two approaches themselves evolved at the same time. Darwinism, however, led to a sort of genetic elitism, while Marxism tended to support a kind of environmental determinism.

Marx does not advocate change by appealing to natural rights. Rather, he announces the discovery, and later adumbration, of natural, and therefore *inevitable*, *laws* of history: the battle of classes in the process of dialectical materialism. By identifying these laws, Marx makes the course of history at first appear deterministic, but it is not quite so. Marx calls on his followers to jump on the bandwagon of history, but also to give it a little push, to "hurry history along." The logic does not quite add up, but the psychology is quite effective, and it is psychology that moves people to act. After all, "The philosophers have only interpreted the world in various ways. The point, however, is to change it."

In any event, all explanations of cause and effect are partly "deterministic". Our old friends Smith, Malthus, and Mill are all deterministic in the sense that they make long-run forecasts based on their understanding of causes and effects. The difference with Marx is in his boldly appelling them *Laws of Motion*, suggesting that they are inevitable, and not just one person's subjective forecast. Within Marx's framework, ideas may help change the social structure, but they also spring from it, so the role of "free will" in affecting historical change is perforce limited. Ricardo and Mill view humankind as hemmed in by natural laws like diminishing returns, but within those natural constraints, they consider people free to choose, both individually and collectively. Marx downplays Nature as a constraint, substituting social structure as the main impediment. Although rejecting any religious concept of a Divine Purpose (no "opiate of the people" for him), he replaces it with an ideology so powerful that, to some observers, Marxism seems to be a kind of religion itself -- albeit secular in bent. Perhaps this is the context in which an uncharacteristically humble Marx once declared, "All I know is that I am not a Marxist." Without being overtly teleological, he does, however, substitute a secular concept of inevitability that has filled the same philosophical or emotional need. Like Calvinism, Marxism sees society swept along on an irresistible current of evolution, led by a small elite whose task, to repeat, is to accelerate historical process.

Marx produced two major economic works: *The Communist Manifesto* and *Das Kapital*. In both, the assistance of Engels was critical. Indeed, the *Manifesto* is considered by scholars to be jointly authored, and only the first of *Kapital's* four volumes was published during Marx's lifetime. Engels not only edited volumes II and III but also provided the financial support that allowed Marx to spend hours researching and writing in the British Museum rather than earning wages sufficient to support his family at even their meager level.

The Marx-Engels *Manifesto* is magnificent writing. Its purposeful and powerful prose propels the reader

along in an urgent and doubt-free present tense. The future is now. United, workers are not powerless -- they are its engine. The most stylistic steam is at the beginning and the end of the document: "A specter is haunting Europe -- the specter of communism...The proletarians have nothing to lose but their chains. They have a world to win. Working men of all countries, unite!" *Das Kapital*, in contradistinction, is both dry in style and belabored in principle. But it rescues Marx from what might otherwise be called "proof by Assertion." Here then, are his theories.

Marx propounds a labor theory of value. First, like Ricardo, he sees value (in today's parlance) from the "cost" or "supply" side only. (Later economists will give a lot of emphasis to Marshall's other blade of the scissors, "demand.") Second, unlike Ricardo, he either ignores land as a factor or fuses it with capital into a single *means of production*, thereby jettisoning classical political economy's "three-factor" economics for something we shall call "neoclassical" or "two-factor" economics.* Third, because Marx also considers capital as exclusively stored-up labor**, labor becomes the source of all value: wealth is exclusively produced by dead labor combining with live labor.

Torturing it to meet objections, Marx's theory of value is not "simple". Rather (and worse), it is "simplistic." Not only does he widen the idea of unearned income to include all returns to capital, but he also denies the need for returns to encourage savings and the need for savings to create capital. Capitalists, in his view, may refuse to invest without a return, but this behavior is perverse and anti-social, and society is justified in forcing them to pony up.

Marx is extremely interested in coercion, distribution and revolution. We shall consider these briefly, and in turn.

Marx's economics forces the conclusion that the incomes enjoyed by both landowners and capital owners are *surplus value* extracted from the workers who alone have truly produced it. In his view, capital is not so much a "thing" as a "relation", giving its owners, the bourgeoisie, commanding power over the people they hire, the proletariat. It is, in sum, the means by which one class exploits another; it is, therefore, inherently exploitative.

Marx disavows religion, but he does not abandon ethics. Goods and services should not be distributed on the basis of the power capital conveys but rather "from each according to his ability, to each according to his need." The sentiment is glorious; the questions of fact are whether individuals work according to ability or according to incentives and whether people have needs or wants (and the degree to which the latter are contrived by advertising).

We have already seen that history proceeds by revolution, the constant struggle and clash of classes, the "opposites" in Marx's mind set. Not just ideas, but also social forms -- entitlements to property, their historical origins, and the laws that support them -- have an economic basis or structure. The most important materialistic changes now necessitating a new social form have been the eviction of peasants from their land (the Enclosure Movement), thereby creating a *proletariat*, and the Industrial Revolution. Social relations (recall, here, the above concept of capital) have become a class struggle between two sharply defined classes: the *bourgeoisie*, who own capital and employ workers, and the *proletariat*, or hired workers.

The bourgeoisie, says *The Communist Manifesto*, has produced goods and adventures in abundance. "It has been the first to show what man's activity can bring about. It has accomplished wonders far surpassing Egyptian pyramids, Roman aqueducts, and Gothic cathedrals; it has conducted expeditions that put to shame all former Exoduses of nations and crusades. " Yet, Marx condemns capitalism not just on ethical grounds but because contradictions within the system create the seeds of its own destruction.

These contradictions are twofold. First, modern industry makes production and exchange highly social and independent, while property remains individualized. This tension can be resolved only and ultimately by socializing property. Second, the bourgeoisie produces its own gravediggers, the landless proletariat. Gathered together in factories, they will unionize, and unions will create socialism

Marx highlights the cyclical nature of economic activity. He predicts that the "rate of profit" repeatedly falls because of under-consumption and the rise of labor-saving capital (rising "organic composition of capital") in response to rising wage rates. This much is good economics. The result, says Marx, is to force wage rates back down, but employers are not helped in their quest for more profit, because they now hire less living labor, and surplus value comes only from living labor. This part is nonsense.

Marx's perspective is that of the Luddites here. He does not countenance Adam Smith's alternative, that capital formation can increase wages. The increased demand for capital should be met by encouraging more savings, by raising the reward (the marginal return) from this activity. But Marx has it work the other way, and everyone is worse off. His reasoning is tortured and unconvincing, flawed, inter alia, by his failure to define "profit" or to distinguish between marginal and average rates of return. Having resorted to "two factor" economics, he forsakes a lot of analytical power by ignoring land rent, which such "classical" economists as Quesney, Smith, Malthus, Ricardo and Mill have given so central a role. It remains for Henry George to revive the distinction between capital and land, and to point out that, while it substitutes for labor, capital can also raise the demand for land, and the subsequent rise in rent cans squeeze both wages and capital returns.

In spite of his glowing tributes to the technological triumphs achieved by capitalism, Marx is the complete pessimist as regards both the system's distribution in the present and its survival in the future. He will not be comforted. Profits will continue to fall, even as technology will continue to advance. Capitalism will experience a series of crises, as noted above. These crises will deepen. The ownership and control of capitalism will grow more and more concentrated. Markets will expand and expand, in an effort to ward off the inevitable, but the day of reckoning will come. The market mechanism is not self-correcting; the capitalist system will collapse. Revolutionaries will strike, and they will inaugurate a new set of circumstances, the dictatorship of the proletariat. In simple terms, Marx calls for a new social order. It has to happen, and it will happen. Just as production has become "social", so too must the ownership of property (capital). The enclosure movement divorced laborers from the land, defining them as mere commodities in the market, lacking the basic rights of humanity. Landless "proles" have no right to be here, except by coming to terms with landowners. Their rights can only be destroyed by a redefinition of ownership and the power it conveys.

What can we say about these explanation and predictions? Well, first off, the Industrial Revolution did not create the landless proletariat. Enclosures came first, beginning with Henry VIII in the 16th Century. Nor did the landless proletariat create the Industrial Revolution. Rome had a similar enclosure movement and a landless proletariat from the 2nd Century (the time of the Punic Wars), and many Third World countries today have latifundios and proletarians; in neither situation was there enough industry to speak of "industrial revolution". Second, profits do fall cyclically, but there seems to be no long-term (secular) trend. Marx's profit prediction is therefore probably wrong, but, as he didn't tightly define "profit", who knows? Of course, there has been technological advance, mighty technological advance, but whom has it benefited most? The key question, and one addressed by Mill, is whether it has benefited landowners or workers. Also most assuredly, we have experienced a series of crises. But did Marx make this forecast, or did later Marxists read it into his obscure prose? I haven't found it in *Das Kapital*. It is also doubtful whether wages peak before crashes. Rather, there is a spike in interest rates. We have also observed a growing concentration of wealth and industry, but the phenomenon appears to be cyclical rather than secular.

Finally, has Capitalism broken down? Will it? Marx does not define "Capitalism" with sufficient clarity for us to know for sure. The first breakdown of governance occurred in relatively undeveloped Russia, in 1917, rather than in a highly industrialized economy like Marx's home country, Germany. Nor were China and Cuba highly advanced economies when they too became "Communist". Countries of the First World today show little sign of economic collapse, although many came close in the 1930s. Russia is moving from "Communist" to "Capitalist." Marx had a difficult, authoritarian personality, and the countries that became Communist have all had authoritarian, not market, pasts. Marx also said that redistributive proposals of the sort advocated by Mill are politically impossible in capitalist societies: the ruling class will not tolerate it. Perhaps in countries like the United States, the ruling class survives by giving labor stock-

option plans and making them mini-capitalists, with a stake in the system. I think we can all agree, with Lord Acton, that power tends to corrupt -- absolute power, absolutely. So one of the biggest questions we should all raise is as follows: if capitalism collapses and is replaced by a dictatorship of the proletariat, which forces take over this power and make the state "wither away?" We don't know. We get no guidance from Marx; he gave no blueprint. As ill as he defined "Capitalism," he devoted so much of his time to it that virtually none remained for a discussion of its successor systems. What the world has known chiefly as "Communism" was the "Leninism" and "Stalinism" forged in Russia and which may be considered with the tincture of time as less a break from the tsarist past as its continuation with a different vocabulary and a different name, but smelling no less rank.

*In the posthumously published Book III of *Das Kapital*, Marx reconsiders this position, but later Marxists did not.

**Ricardo and his predecessor Knut Wicksell more carefully and defensibly support the position that capital is stored-up labor than either Marx or George. See, for example, Wicksell's *Value, Capital and Rent.*

This is mostly off topic.

THE INDUSTRIALIZATION OF AMERICA
THE UNITED STATES, 1877-1919

With Reconstruction yielding to economic depression and labor unrest, the half-century between the Civil War and World War I was both a troubled one for America and one whose very troubles also inspired great reform. In providing corroboration for this rather bold and bald summary statement, we draw heavily on *Standing at Armageddon: The United States, 1988-1919*, by Nell Painter. Professor Painter unites political history and social and economic analysis detailing, from the bottom up, the ideological conflicts that simultaneously influenced and emerged from the political, economic, and often brutal physical conflicts between people of property and those advocating democratic social and monetary reform. I recommend her work highly to anyone seeking intellectual and moral insight and challenge.

During Reconstruction, freedpeople had become more mobile, better able to seek fortunes in other parts of the South and West. They were no longer obliged by immobility to become sharecroppers, leasing land from white planters in exchange for portions of their crops. Participation in Reconstruction governments had supported the growth of Afro-American leaders; this period had also protected space to create autonomous Black institutions like the church, which provided freed people with both an organizational base and a collective vision. Independent schools for people of color grew rapidly, not only educating Afro-American children but also providing a launching pad for Afro-American professionals such as teachers, ministers and lawyers, as well as small businessmen. The end of Reconstruction signaled the decline of both legislation ensuring Afro-American rights and financial and social support of these independent schools. The Supreme Court increasingly used the Fourteenth Amendment to protect corporations rather than individual civil rights (see, for example, Slaughterhouse case, 1873). Its power and that of the Fifteenth Amendment as well were further limited in the Reese and Cruikshank decisions of 1876. By 1896, the Supreme Court ruled in favor if *de jure* segregation in *Plessy v. Ferguson*, thereby offering legal sanction to previous *de facto* segregation. [SW & MG: render these decisions consistent in form? Also, provide precise (paged) references for direct citation?]

Exacerbating these social tensions were the depression of the 1870s and the widespread strikes in the textile industry in Massachusetts and the anthracite coal mines in northeastern Pennsylvanian, and against the railroads in the Northeast and Midwest. State governors, industrialists, and even President Hayes responded with force and violence – the President, for example, sent federal troops into West Virginia to break up the railroad strike, and some of the "Molly Maguires," Irish miners belonging to the Ancient order of Hibernians, were executed. Such unrest made the general population more aware of class division and conflict, and more fearful of workers' organizations -- especially after *Haymarket*.

Indeed, the "open shop" was the workplace most hoped for by industrial elites in this period: one free of unions, in which hiring, firing, and workplace decisions were in the hands of factory and mill owners and their shift bosses. Industrialists used many tactics

to try to maintain the open shop; they included bringing in strike-breakers, hiring Afro-Americans specifically to spark racial hostilities among workers and draw fire away from owners, infiltrating labor organizations with spies, and firing the actual or suspected organizers.

For their own part, most workers were interested in establishing an eight-hour work day, so that they could have adequate time for rest, relaxation, restoration of health, and family. Many were also strong supporters of restricting immigration, particularly the flood of Chinese workers, who seemed more willing to work long hours, in appalling conditions, for low pay.

In Chicago at this time, anarchists led much of the city's labor agitation – to the great consternation of industrialists, local government, and the press. Many Europeans of radical persuasion had moved to the area, and anarcho-communist and socialistic organizations flourished. A general strike was called on May 1, 1886, and three days later, during a labor rally in Haymarket Square, a bomb was thrown. The terrorist has never been identified, but was widely assumed to be an anarchist; assumed not only to condone but actively to encourage violence in the pursuit of political and economic ambition, the associated "ism" moved quickly from obscurity to infamy in the public eye. In the realm of government, executions followed legal proceedings clearly biased against the defendants, and new laws aimed to curtail both strikes and boycotts. In the private sector, many employers established their own form of terrorism, their methods being lockouts, the use of Pinkerton security agents, and agitation against unions. The number of anarchists expanded in response to the publicity, prejudice, and power imbalances, but their ranks remained thin.

Two labor organizations arose or grew to prominence at this time, each with a profoundly different approach to the amelioration of the workers' woeful and seemingly worsening plight. The first was the Knights of Labor; the second, the American Federation of Labor (AFL). Founded by Philadelphia tailors in 1869s and first lead by Uriah S. Stephens, the former shed its initial identity as a secret society in 1881, then growing with celerity and reach unprecedented in American society, attracting tens of thousands of workers in the 1880s, until adherents totaled between 700,000 and 1,000,000. The latter was formally established in 1886, the exact year of Haymarket; it then emerged from the Federation of Organized Trades and Labor Unions. Its growth was to be slower, but prove surer.

The leaders of both organizations were men of distinction. The Knights' Terrence V. Powderly, successor to Stephens, put out his call to unskilled as well as skilled workers, with the messianic vision of replacing wages and employer-employee relationships (and the concomitant conflicts) with cooperative production; strikes he viewed as a diversion from this long-term goal. Notwithstanding this position -- and because he thought he could end it quickly with arbitration, Powderly did lead the southwestern railroad strike in Texas in March of that important 1886; his became the first labor organization to deal on an equal footing with the most powerful elements of capitalism when Jay Gould did indeed agree to arbitration. No shrinking violet, Powderly made quick to predict:

> The historian of the future will record that the revolution inaugurated by the Knights of labor, and carried forward by force of thought and ideas, won more for the cause of human liberty than the revolutions which spilled the blood of humanity's advocates through all the centuries of time.

The AFL's Samuel Gompers, a foreign-born cigar maker and former president of the associated national union, sought reform within, rather than of, the system. An incrementalist, he campaigned for an eight-hour work day and advocated "pure and simple trade unionism," primarily to increase the wages of skilled workers.

Despite their differences, the two organizations and their members were often supportive. And despite the quiet and less perceptible emergence of the AFL and the galloping entrance of the Knights in the 1880s, it is the shadow of Gompers cast long today, while Powderly lives on only in history books – and dusty ones, at that. Labor today is represented not by an American-born utopian cooperative reform movement but by originally Marxist-inspired trade unionism. Why? What caused the demise of the Knights of Labor?

Our first interpretation comes from a contemporary of Powderly by the name of Frederich A. Sorge. According to this Marxist of uncanny perspicacity, although the Knights took the bold steps of organizing the unskilled and breaking "completely with the prejudices against the Negroes," yet, they were not truly progressive because the leadership kept its distance from the eight-hour struggle. Not only did Powderly denounce with chill intransigence the Haymarket anarchists, but he also assumed a sturdy stance against many strikes, failed to support independent political candidates, was unwilling to compromise, and seemed cold to his members. The organization of the Knights, deems Sorge, was excessively bureaucratic and centralized, and they were not a truly class-oriented labor party. Indeed,

> Except for paralyzing the eight-hour movement, the Knights caused the greatest damage through its support and reinvigoration of the petty-bourgeois and small farmer reform humbug regarding the money question and through its intimate alliance with the Populists.

Right before World War I, as prominent a historian as John Commons would edit a multi-volume industrial history of American that unequivocably dismisses the Knights as "a bushwhacking annoyance on the heels of its successor, the American Federation of Labor." In 1918, we get more feedback from another monumental and collaborative economic history, also edited by Commons. Selig Perlman, who contributed the essay on the Knights, suggests that their stance on strikes was divisive, with membership favoring them while leadership did not, so that they were unwillingly "caught in the whirl of pure stike action." Pure, perhaps; unsuccessful, for sure: because a goodly number of their members were unskilled, and therefore more easily replaced by scabs, most of the Knights' strikes were failures. In addition, not only the personality of Powderly – and his

refusal to demand eight-hour days -- but also the inherent (personality-free) difficulties of organizing and disciplining the mixed assemblies that comprised the Knights also contributed to the group's decline. Another problem arose from the existence of trade unions that organized only skilled workers. Dual unionism jeopardized the political and economic effectiveness of workers as a (united) class, in both an ideological "clash between the principle of solidarity of labor and that of trade separatism" and a practical clash between skilled and unskilled workers. As the Knights continued to lose membership for all of the above reasons, and more, the AFL became "more representative of the entire labor movement," and the Knights could no longer sustain their cooperative idealism, much less any short-term practical efficacy, due to "the weaker bargaining power of their membership and the middle-class psychology of their leaders."

Future historians continued to sound the same themes, albeit with different vocabulary and emphasis. Powderly's preference for boycotts over strikes and his distaste for the issue of eight-hour work days proved costly. So did his character: critics variouslydenounced him as "hostile," "intransigent," and "immature," a rigid "windbag," a "poor organizer," even a "traitor." How, however, could anyone gather under one roof "heterogeneous mobs" -- the skilled and the unskilled, those also represented by trade unions and those not -- and make their strategies and goals cohesive and persistent? Admitting not only the unskilled but also women and (after 1883) Afro-Americans improved the ideology, but also undercut the practical strengths of the organization. Efforts to align with reform-oriented agrarian elements were counterproductive as well. Setting his sights on long-term visions of cooperation, Powderly paid too little attention to short-term goals and the important reinforcement and feedback they could provide his members, the skilled of which, at least, could find some of what they sought in competing trade unions. Efforts to organize the "mobs" resulted not in cohesion but in unwieldy and insensitive bureaucracy.

Norman J. Ware, writing in the 1920s, and Philip Foner, in the late 1940s and early 1950s, assume perspectives more smiling sympathetic, even romantic. Ware acknowledges many, if not all, of the above-mentioned causes for failure. He does, however, take issue with the allegation of over-centralization:

> It happens in most societies whatever form of government they have. The American Federation of Labor is certainly in no position to object to the Knights on this account.

In the final analysis, Ware believes, in insisting that people be considered collectively as wage-earners, not fragmented in categories like skilled or unskilled, white or black, male or female, the Knights were:

> teaching something that was not so in the hope that sometime it would be....[They] failed, and in...[their] failure was perhaps a part of the general failure of democracy – or is it humanity?

Writes Mr. Foner about Mr. Stephens:

> Uriah H. Stephens' aim was to unite all workers in a general mass organization regardless of sex, race, creed or color... in stressing the need for unity and solidarity in the ranks of labor, Stephens was obviously far in advance of many labor leaders of the period who spike [sic] (?) and fought only for the interest of their particular craft. Again, in emphasizing the importance of education and discussions of current political and economic issues, he was far ahead of those trade union leaders who urged that only questions of wages, hours, and working conditions concern the membership of labor organizations....Yet Stephens was more a humanitarian than a trade unionist. The organization he wished to build was not a trade union, but a mass fraternal lodge, a working class Masonic order, And his belief that secrecy, education, and cooperation alone would create labor solidarity and solve the workers; problems stumped him as a visionary dominated by utopian ideas.

Whether the perspective is kind or unkind, the conclusion is therefore more or less the same: the Knights, in brief, undid themselves. In a certain sense, I find myself agreeing with Ware, but for different philosophical reasons. I do believe that they failed, in large part, because of the nature of humankind -- unfortunately laced with greed and hypocrisy. As Carlyle is reported to have commented when hearing that Margaret Fuller had pronounced, "I accept the universe," "By God! She'd better." We'd all better.

And yet. And yet, would that we had tried harder. We do not look upwards for a better vision of society, but only at what is in front of our eyes The *National Labor Tribune* asserted in its March 13, 1875 issue what I believe is still true:

> If ever an order turned bad men into good ones [the Knights of Labor] does. If there is a spark of manhood in a man this order will kindle it into a flame of genial warmth for all who toil...Its objects are noble and holy. It makes every man in it purer and better.

The Knights of Labor and the AFL were only two of many reform movements of the time. We have already seen that Powderly's efforts to align the Knights with various progressive agrarian movements is now criticized as counterproductive, however greatly its spirit of inclusivity is admired. Farmer's Alliances and the Grange Movement did share much of the Knights' vision, especially its adherence to cooperative production. They also sought to coordinate their sales of agricultural products as counterweight to the market power of the railroads and merchants shipping them.

1886 was not only the same year of Haymarket Square, but also the year Henry George campaigned to become mayor of New York (We shall study him in depth in the next chapter.) George's candidacy brought to the surface many reform issues of the day. Some came from Farmer's Alliances and the Grange movement and shared Powderly's long-term goal of rendering production cooperative; they also tried to consolidate the sales of agricultural products as countervailing power against merchants and rail roads charging high prices for shipping. Others came from the Women's Christian Temperance Union (WCTU), led by Frances Willard and the nation's largest organization of women in the 1880s. The WCTU argued that low wages and bleak working conditions caused drunkenness and vice as well as poverty and misery. Utopian voices like those of Edward Bellamy, Henry Demarest Lloyd, and Ignatius Donnelly also found a receptive audience in this era of rapid urbanization and industrialization and the concomitant dislocation. Although it lasted for only a year, so did the Anti-Poverty Society, founded in 1887, particularly with the voice of Henry George, whose influence on this group was enormous and whose talks brought thousands to tears with the language of hope. His numerous speeches across the United States were important events for many more thirsting for a better life, especially for the masses toiling both on the farm and in the factory.

Not only industrial workers, farmers, women and reformers but also politicians sought to address market issues in this time of turmoil and transition. 1886 is also the year that President Cleveland called for a revision of protective tariffs; their effect was to raise prices paid for imported goods, thereby supporting or raising the prices of domestic goods like sugar. Two years later, partisan divisions over this barrier to trade gained prominence, as Democrat Grover Cleveland supported their downward revision and Republican Benjamin Harrison called for their being maintained to promote prosperity. Monetary as well as fiscal policy became the subject of debate. The free silver movement drew on the Greenback movement of the 1860s and 1870s, and the Farmer's Alliances' called on an increase the amount of money in circulation, in hopes of raising the prices of their goods and lowering the real cost of their debts.

Named "trusts" by their opponents, industrial corporations of the late-nineteenth century were new in their size, scale, and power – characteristics that not only yielded economies of scale, with cheaper and more efficient production, but also heightened their ability to dominate entire industries and monopolize markets. In "vertically" integrated trusts, corporations gained control of entire manufacturing and distributing processes, owning the raw material sources, the factories, even the means of transportation. In "horizontally" integrated trusts, companies bought out the competition at a single level of production, consolidating the industry into massive single organizations. Both strategies allowed industrial corporations to wield enormous financial and political power, and to edge smaller competitors out of the marketplace. Their opponents claimed they were sufficiently powerful to set low prices for their inputs and high prices for their output.

The Interstate Commerce Commission (ICC) was established in 1887, with the stated purpose of monitoring the rates charged by railroads and correcting those deemed unjust.

But neither the ICC nor the Sherman Anti-Trust Act of 1890 in fact posed any serious threat to the operation of big business like railroads and oil at this time. Titans of business and government like Andrew Carnegie and William McKinley propounded a hierarchical vision of society that somehow also asserted the identity of all interests. They, and the Republican Party in general, argued that mighty corporations, protective tariffs, and hard currency promoted production and prosperity for all Americans. High enough trade barriers to European imports would protect nascent American industries in their home market. The Democrats, on the other had, representing urban industrial workers and white Southern farmers, favored a low tariff, so that consumers could buy products at their lowest possible prices.

Both depression and major labor strikes returned in the 1890s. In 1892, unionized workers struck the Carnegie Steel Company in protest over proposed wage cuts. Members of the AFL's strongest union, the Amalgamated Association of Iron, Steel, and Tin Workers, thus came head to head with one of America's strongest companies. With Andrew Carnegie's support, general manager Henry C. Frick set out to destroy the association, inter alia hiring 300 Pinkerton detectives as strong signal of his resolve. The Homestead Strike, so-named for the location of the plant in Pennsylvania, became forever infamous when several workers died in open and armed battle. The governor called out the state militia, and the plant re-opened, with nonunion workers staying on the job. Six months after its commencement, the strike was officially broken, and unionism in the steel industry remained weak until the Great Depression of the 1930s. In 1894, workers at Chicago's Pullman Palace Car Company also struck to protest wage cuts; they also objected to the firing of representatives of their union, the American Railway Union. ARU leader, Eugene V. Debs, not only supported his members but also called for boycotting all Pullman railroad cars. All railroad traffic out of Chicago came to a halt, and industry leaders called for federal intervention. Attorney General Richard Olney, also a director of the Burlington and Santa Fe railroads, responded to their plea with a court injunction ordering the strikers back to work, and two days later President Cleveland ordered US troops to force them to comply. The government won, transportation was restored, blood was lost, Debs was jailed for defying the order, and precedent for using as injunctions as a tool to fight strikes by making them illegal was firmly established. Eight years later, in 1902, President Roosevelt threat to intervene in the anthracite coal strike in Pennsylvania was strong enough to induce arbitration. An investigative commission then uncovered all manner of evidence of hardship and injustice. Not only did young boys work in extremely dangerous jobs down in the mines, but young girls and their mothers worked in dirty and unsafe jobs in the textile mills nearby. Workers were paid in "scrip" – "money" that could be used only in the company store with the high prices its captive market made possible. In the absence of standardized measurement of coal hauls, worker productivity was unfairly determined, and, in any even, "raises" merited by any increases therein often involved mere decreases in the country store's monopoly prices.

The Progressive Era was a time of conflict and contradiction not only on the front of labor relations and government but for other social reform movements as well. While utopian reformer Edward Bellamy caught the public's eye with his novel, *Looking*

Backward 2000 – 1887, (1888), in which the world had become socialist by the mmillenium, Jane Addams worked practically and quietly to improve the world. Her ideal – and alternative to revolution -- was "industrial democracy," where workers had the greatest voice in determining the terms of industrial labor. When she and Ellen Gates Starr established Hull House in Chicago in 1889, they offered a moral waystation on the urban landscape, beginning, in hopes of also raising critical awareness of labor and industry, a "settlement movement" of community and social reform centers that took root in cities like Boston and New York as well. Coxey's Army also headed east, starting its crusade from Ohio to Washington D.C. on Easter Sunday, 1894, with a band of more than 100 jobless men. The leader of one of several industrial "armies" inspired by the Panic of 1893 to march to our country's capital to protest and personify the plights of the unemployed and poor, Jacob Coxey delivered 500, not the promised 100,000, for a May Day demonstration; they disbanded with dispatch when he was then arrested on the technicality of illegally walking on the Capitol lawn. Meantime, in the agrarian sector, Farmers' Alliances became more seriously involved in politics, and scored some notable victories with the establishment of the People's (or Populist) Party. Among this party's central ideas were that a conspiracy of bankers and railroad executives, many of them Jewlsh, had corrupted politics, and that the railroad companies further gave large landholders preferential rates that priced small farmers out of the market for their crops. Among the party's central achievements was getting "free silver" William Jennings Bryan nominated for president in 1896.

The election was won by William McKinley, and Republicans dominated not only federal but also state politics in all regions but the South. In 1898, a combination of the power of expansionists and capital investments in Cuba, fires kindled by the inhumane treatment of Cuban rebels and fanned into flames by Hearst's "yellow press", and the sinking of the battleship Maine in Havana's harbor overwhelmed McKinley's and the country's general reluctance to take arms, and the US entered the brief Spanish-American War to rid Cuba of Spain's domination. Extending this ambition to another Spanish colony – and crucial stop on trade routes to Asia, we also sent troops to the Philippines. Our annexation of the Philippines (for $20 million) convinced many Americans that involvement in the war was more about economic interests than humanitarian ones. Not only the above mentioned reformers Samuel Gompers, Jane Addams, and William Jennings Bryan but also reform journalist/author Henry Demarest Lloyd and humorist/author Mark Twain were outspoken in their criticism of expansion and imperialism.

McKinley was assassinated in September, 1901, and Vice-President (and "Rough Rider") Theodore Roosevelt then assumed office. With a Corollary to the Monroe Doctrine that allowed for US "policing" of affairs in the western hemisphere, Roosevelt combined expansion with domination over the land and successfully negotiated the construction of the Panama Canal in 1903. Two years later, he won the Nobel Peace Prize.

We must remember that the annexation of the Philippines and the creation of the Canal were not the first instances of expansion and dispossession. Americans who moved westward across the US relied on federal action to remove Native Americans and

Mexican citizens of the US from their land. Not all who spoke out disapproved. In character with the times, others defended expansion, or Manifest Destiny on religious and racial grounds; the vocabulary to justify oppressive domestic policies was similar. The nationalism that accompanied expansion, in brief, was part of a larger ideology.

Nonetheless, reform in the early years of the 20th Century did continue apace. Its source was both government and private citizens; its inspiration, the economics and politics of the day. The labor movement achieved such major advances as creating wage and hour laws to protect workers at least from hyperexploitation, workman's compensation for on-site injuries and work-related disabilities, and inspection procedures for workplaces to improve safety. The political system also became open to as company mergers peaked in 1904, and industrialists increasingly controlled financial institutions as well as whole industries (Cleveland's John D. Rockefeller ran both Standard Oil Company and National City Bank), President Roosevelt promoted limited and cautions reform of those trusts he characterized as "bad." Not anti-trust *per se*, he sought to humanize capitalism without effecting radical change.

On a social front, Roosevelt embodied and symbolized not just activity and virility but also the sense of power associated with vigor. Men and women were all encouraged to exercise, particularly outdoors; naturalists like John Muir garnered attention and respect, and Congress established the Yosemite, Sequoia, and General Grant National Parks in 1890. While other lands were being nationalized and privatlized, then, huge tracts also became open to selective public use.

Both Edward Bellamy and Henry George died at the end of the 19th Century, but their followers continued open political dissent and involvement. The career of George disciple Tom Johnson as a reform-oriented mayor of Cleveland was bold but brief; Robert La Follette's tenure in office spanned a quarter century. First governor of Wisconsin from 1901 to 1906, he then entered the US Senate, where he served until his death in 1925. In both offices, La Follette fought for tax reform and railroad rate control; his program became known as "the Wisconsin Idea." Although many reformers came from the middle class, they sincerely articulated the concerns of the lower class and struggled for protective legislation that would provide for clean and safe working conditions, decent wages, reduced hours, and the right to organize and strike. William Jennings Bryan continued to voice their demands, as well as those of laborers and farmers, even as Frederick Taylor's 1911 book on scientific management symbolized the emphasis on increased production and the dehumanization of industrial employees.

Popular culture offered an avenue for reform agitation through the press in general and the investigative reporting of muckrakers in particular. The invention and spreading use of telephones, gasoline automobiles, airplanes, and electricity made communication possible across the nation. Urbanization increased both consumerism and social contact, especially in saloons, amusement parks, and nickelodeons. As a result, a youth culture began to develop. The automobile made it possible to court or date away from home and

parents; such an environment also made new social roles and relationships possible for young women.

One of their potentially new roles was that of voters. Many were the reformers who argued that the demonstrable moral authority of women should be expressed at the ballot box, and suffrage activists were indeed closely connected to the WCTU. In established roles, women working in the shirtwaist-manufacturing industry in New York City pushed for better wages. Mostly young, Jewish, and immigrant, they were not unionized, but their independent strike was supported by female reformers, the ILGWU, socialists, and the AFL. This heroic group won their battle in February, 1910, but a mere thirteen months later, 145 lost their lives when a fire swept through the Triangle Shirtwaist Company, the locked doors and windows having precluded escape.

People of all colors united in their efforts to expand suffrage not just to women but to all groups denied it. Indeed, when the NAACP was established in 1911, it was an interracial organization led by whites -- when W.E.B. Du Bois became first editor of its organ, *The Crisis*, he was the only prominent Afro-American of the association.

Both physical brutality and restrictive legislation against Afro-Americans continued to rise in this period – the former most notably in the form of lynching, the latter, especially in the South, in the form of Jim Crow laws. Poll taxes and literacy tests for men who wished to vote effectively restricted both suffrage and legal remedies for its denial; they also inspired two reformers of courage: the aforementioned W.E.B. Du Bois and Booker T. Washington.

Modern historians tend to emphasize the opposing views of society and its reform held by these men of color. Differ, they did -- with Washington focusing on vocational education for the unskilled of his race so that they could achieve economic equality, and Du Bois holding broader and bolder immediate ambitions for full political and civil equality as well. But both well understood the connections between race, economics and power, and the use of race as a social and economic weapon.

Not only men but also women of color took prominent roles in condemning racism in its many forms. One such was Ida B. Wells Barnett, who protested the lynching of Afro-American men, decrying the use of trumped up rape charges to incite these and other acts of violence. Herself often the target of harassment and violence, she not only publicized these atrocities by becaming part owner of a newspaper, the *Memphis Free Speech*, but also pioneered the "club movement" amongst Afro-American women. Still experiencing racism and economic discrimination although mostly middle-class, literate and therefore relatively advantaged, these women gathered together to improve education and employment within Afro-American communities and political and social rights without.

As prosperity proceeded towards the 1920s, so did reform efforts, both conservative and radical. "Progressivism" is complicated, and people of differing ideas and social visions some times give themselves the same tag. In many instances, "progressive" middle-class reformers and politicians sought to ensure continued prosperity and stability; their vision

was one of gradual change within the system, with neither major upheaval nor substantial social reorganization. In other cases, "progressives" found injustices so endemic that only a radical overhaul of society would suffice to eradicate them.

Theodore Roosevelt and his successor, William H. Taft, initially shared views on the necessity of moderate reform; by 1912, however, they had split company on this issue. Roosevelt at this time advocated "New Nationalism," a vision of the government's serving the needs of the people rather than those of big business. The presidential race that year became a contest between three soi-disant "progressives:" Taft for the Republican Party, Roosevelt representing its Progressive Party faction, and Woodrow Wilson standing for the united Democrat Party. In the past, Wilson had opposed unions and remained suspicious of widespread democratic participation; as Governor of New Jersey, however, he had also broken with the Democratic machine in endorsing workmen's compensation, direct primary election, substantial regulation of utilities and railroads, and a crackdown on government corruption. In 1912, this Democrat won the presidency, but Republican majorities prevailed in both the House and the Senate.

Many of Wilson's proposed reforms, although "top down," were based on ideas that came from worker and agrarian activism. Their outcomes, however, were rarely as radical, substantive, or threatening to big business as the people had hoped. Indeed, in noteworthy instances, Wilson's administration took dramatic steps in the opposite direction. One such example is when he followed Postmaster General Burleson's suggestion in 1913 that government jobs and workers be segregated; this policy was effected predominantly at the expense not of Anglo-Saxons but of Afro-Americans.

Wilson was also obliged to cope with the increasingly vibrant Socialist Party of the United States. Golden-tongued socialist Eugene V. Debs received six per cent of the vote in 1912; not only had the party's membership doubled between 1909 and that election year, but it had attracted the support of 700,000 voters in 1910 and in the following year, 74 municipalities had elected a socialist mayor or other official. One of New York City's districts also sent Meyer London to Congress.

Other radical organizations included the Industrial Workers of the World (IWW, known as the "Wobblies"). The leaders of this syndicalist labor union concluded that conflicts between workers and employers were fundamental to capitalism, and therefore aimed to overturn the whole system, developing one huge class of workers and eliminating all other classes. Promoting direct economic action rather than traditional political activism, the IWW gained national exposure when it participated in the 1912 textile strike in Lawrence, Massachusetts.

The US continued the involvement with politics and economics outside our borders we had notably begun in the Spanish-American War. In late 1913, Wilson sent troops into Mexico when he felt pressure to protect American interests there. Before the Mexican revolution, US citizens had actively invested in many industries, dominating sectors like railroads, utilities, coal mining, and oil drilling.

Separated by the sea, the United States was not initially distressed by the assassination of the heir to the Austro-Hungarian throne in 1914. We did, however, both fear the destruction of centuries of European culture and civilization and feel economic repercussions from the problems abroad. The effects were first negative: World War I precipitated a banking crisis, which then strained businesses, contributing to already rising unemployment and the cost of food and necessities. Over time, however, Europe's demand for American war materials helped lift the country out of depression.

On May 7, 1915, a German U-boat sank the British liner, *Lusitania*. Having narrowly won re-election the following year, with the Democrat campaign slogan, "He kept us out of war," Wilson continued to resist growing public outcry and to hold positions of moderate pacifism, preparing for defense rather than offense and aggression. Provocation to enter the war escalated, however, when the British intercepted and decoded the Zimmerman telegram, in which German foreign ministers suggested to their ambassador in Mexico that they exploit the tensions between the US and Mexico, and then exploded when Germany sank three American vessels. Wilson asked Congress to declare war on April 2, 1917, and they did. The next January he outlined his Fourteen Points, largely a highly moral program for peace. In points three and four, reducing economic barriers among nations and limiting armaments to those necessary for domestic security, he would echo Henry George. Indisputably idealistic, Wilson may also have been motivated by economics in entering the war: J.P. Morgan & Co., for example, had loaned the Allies more than $2,000,000,000 – in 1917 (or earlier) dollars. [??]

The economic demands of the war effort for the country were even more prodigious. Taxes and loans had to be arranged to finance American involvement, and organizations and bureaucracies to manage domestic affairs. Among the bureaucracies were the War Industries Board and the Fuel, Railroad, and Food Administrations (this last, skillfully run by Herbert Hoover). Congress passed the 18th Amendment in 1918, constitutionally legislating prohibition partly in an effort to ensure conservation of grain. So did economic considerations forcibly intrude into and shape social mores.

Although attacks planned or actual against the US created substantial public support for entering the war, Americans were not united in this stance. Many workers, for instance, worried about both the draft (4 million were eventually brought into service) and the probable higher cost of living [inflation figure here?], while industrialists liked the prospects war entry provided for increasing markets and demands for their products. Pacifist and radicalist antiwar activists remained numerous throughout the war years (women -- Charlotte Perkins Gilman, Leonora O'Reilly, Anna Howard Shaw, Carrie Chapman Catt, and historian Mary Beard in the number -- staged the first protest, well before we entered the conflict, in 1914, in New York City), but were often seen as cowards or traitors. Teddy Roosevelt advocated military strength and preparedness in general, and saw militarism as a good way to promote national unity. He thought US citizens should identify themselves as "American" rather than as members of separate and separating religious or ethnic groups. Supported by other influential politicians, such as Senator Henry Cabot Lodge, this position was far from unique, and it mightily disturbed some progressive social reformers. Yet, as the war wore on, legislation was

added to social custom in repressing antiwar sentiment. The Espionage Act of 1917 prohibited the publication of "disloyal" statements; with determination of content of this term left to the Postmaster General, he was effectively given the authority to censor and control the contents of the mail. Special focus fell on members of the IWW and socialist groups, and, although northern migration offered the prospect of better jobs and escape from discrimination, Afro-Americans were still the target of much violence. On a happier note, women were given the right to vote with the passage of the 19th Amendment in January, 1918.

When the Central Powers were defeated, late in 1918, Americans were jubilant and Wilson's idealistic hopes for future peace and democracy soared. He went to the Paris peace conference without any Republican Senators (even though Republicans had just captured both majority positions in Congress) and with almost an exclusive focus on creating the League of Nations. The Allies had other ambitions: they were largely interested in extracting reparations and stripping the Enemy of both home land and colonies. In this, they were successful. The Germans lost part of Silesia, the Danzig Corridor, Alsace/Lorraine, and their African and Pacific colonies. The Austro-Hungarian Empires were dismembered, as was the Ottoman Empire. Italy received Austrian territory, and Britain and France established spheres of influence over the Middle East. Poland was reborn at the expense of Germany and Russia; Transylvania was taken from Hungary and given to Romania. Students of maps well know just how fluid and variable are national boundaries. Access to markets, raw materials and defense were the primary factors responsible both for the war and the redistribution of land at its aftermath.

Advocating in Europe for creating the League of Nations, Wilson left domestic affairs largely behind, and was himself largely removed from the public's mind. He returned to a society and polity as chaotic at home as abroad, and two serious strokes soon left both his mobility and his thinking significantly impaired. (It is said that Mrs. Wilson was the true "acting" president for the rest of his term.) Violence against both workers continued; violence against Afro-Americans increased – along with a resurgence of the Klu Klus Klan.

Marx, as we know, had predicted, with absolute certainty, that at a certain stage of development workers would unite, revolt and overthrow the existing economic and political powers. In 1919, they did so, in Russia. That "certain stage of development" was supposed to be one of heavy industrialization and its concomitant, a large underclass, the proletariat. The US, in other words, fit the Marxian model for inevitable revolution a lot better than Russia, and when waves of general strikes swept over the East and West Coasts that same year (especially notable were those affecting the Lawrence, Massachusetts, textile mills and the Seattle shipyards), the politicians and the middle class were even more afraid of strikers and workers, protesters and radicals than they had been in previous decades. The Senate ordered an investigation into domestic Bolshevism, and the government promoted domestic fear of radicalism. Included in this fear were apprehension over women's rights and particularly overt racist fears of Jews and eastern European immigrants; racist nationalism also turned against Afro-Americans. Both the protesters and those against whom they protested often turned violent.

The Palmer raids of January, 1920, exemplify this fear of radicals and radicalism. The Justice Department arrested 5,000 people suspected of socialism, with workers and activists as the chief targets. As we have seen earlier, however, within each American group or class, however identified or classified, there were always different voices. While some in government were arresting suspects, others were freeing them. I am thinking in particular of the Georgist Assistant Secretary of Labor, Louis F. Post, who rescinded about seventy percent of the deportation orders during this time.

In many ways, then, our chapter, and the Painter book on which it leans so heavily, end where they began. Americans continued to struggle to reconcile democratic ideals with a society that had a long history and culture premised on hierarchy and intolerance. Some times the government led the reform; some times it co-opted or simply overran reform. Some times, intellectuals and workers were able to come together to articulate coherent agenda for reform – as when Henry George campaigned to become mayor of New York City. Some times, reform ideas even translated into real political change – as when Georgist Tom Johnson became mayor of Cleveland, Ohio. To a direct examination of this man of economic ideas, ethics, and action we therefore now are ready to turn.

HENRY GEORGE

Henry George refuses either to concentrate on efficiency to the neglect of ethics or to focus on economic theory to the exclusion of economic practice. He is both a reformer and a reconciler, and his prose is as passionate as Mill's is dispassionate. His most important writing, *Progress and Poverty: An Inquiry into the Cuase of Industrial Depressions and of Increase of Want with Increase of Wealth... the Remedy*, was published in 1879; it was clearly both inspired by and responding to many of the conflicts and challenges discussed in our previous chapter.

One of today's leading economists, Gary Becker, has said that he has "a irrational passion for dispassionate irrationality." Henry George's passion is not for creating fancy math models but rather for curing poverty. This, combined with a writing style that suited the standards of his day but seems rather flamboyant and emotionally florid today, has tended to divert attention from the clarity of some of his formal analysis and its strong roots in the work of formidable economists from earlier days. *Vox, et praeteria nihil*? No. There is a lot of sense behind these sounds, this voice, and the reader is encouraged to dig deep and find it.

Classical economists Quesnay, Smith, Ricardo and Mill decry the evils of the concentrated ownership and lax use of land, but fail to propound full solutions to these ills. George, on the other hand, stresses labor's need for better access to land, in the absence of which capital controlled by landowners may simply displace labor. He proposes remedying problems in one fell swoop: taxing away land rents – importantly, the annual location value of land, not the value of its improvements -- in their entirety. The revenues will be sufficiently bountiful that productive effort and exchange can then be untaxed. Mill has similar thoughts, and builds much of the stage on which George performs; hesitating before the radicalism, however, he proposes taxing away only future increments in rent, supplementing this revenue with additional taxes on inheritances and high incomes.

At least a partial explanation for Smith's failure to focus on solutions to the land problem lies in his seeing capital formation as a panacea, beneficial to labor in particular as well as to the nation as a whole. Ricardo and George share the contrary view that society is divided by a wedge driven between landowners and workers – in other words, that a class structure exists and is pernicious. Adopting Ricardo's Law of Rent, George applies it to urban land and all resources as well as farmland. While Ricardo says rents must rise as a growing population presses on the means of subsistence, and wants to avoid public policies like the English corn laws that artificially add to land rents, George ascribes rising urban rents less to population pressure and more to population's increasing productivity -- the superior productivity resulting from synergies made possible through market relationships, particularly when they are unimpeded by taxes on exchange.

George also learned much of his basic economics by reading Mill, like whom he clearly distinguishes land from capital, focuses on incentives and the possibility of substitution, and favors land reform and more equal distribution, effected through taxation. As noted

above, George thinks Mill is too timid about raising land taxes; as well, he thinks Mill overlooks the damage progressive income taxes wreak on incentives. Mill is also devoted to small enterprises, especially in farming, while George accepts the inevitability of large-scale production.

In this belief in the importance of economics of scale, and also in the need to come to terms with it by new legislation, George resembles Marx. Both had been journalists, observers trained to insist upon evidence. The two as well believe in unabashedly radical social reform, including making land common property; they both come to this position from an acute awareness of how the Enclosure Movement changed modern society by divorcing labor from its traditional lands, creating a landless proletariat and a class society. But the two differ in many important ways as well. While Marx advocates violent revolution led by a highly organized elite whose tools include conspiracy and guns, George is intensely democratic -- even more so than Mill, with the one supporting "direct democracy" and the other, mere "representative government;" and his set of tools contains the ballot box, the lecture, and democratic "friendly persuasion".

As a theorist, George follows Ricardo and Mill both in clearly distinguishing land from capital and in regarding income from the former as unearned; he refuses to go the Marxian route of lumping the two sources of income together into the category of "surplus value." Although he and Marx both consider capital as stored-up labor, they take that common concept in different directions. Also unlike Marx, George favors retaining and strengthening most elements of the free market system. In further contradistinction, he presents not only a specific blueprint for eutopia, but also a short path to reach it. George's radicalism consists in proposing to socialize the rental value of land, and to do so simply by focusing taxation on it and it alone. The decisions about how to use the land, and the actual users, would then remain private -- "*[I]t is not necessary to confiscate land; it is only necessary to confiscate rent.*" His proposal is therefore non-catastrophic in application, and requires simply a change in the American system of taxation, the institutional structure of which is, of course, already in place.

Like Quesnay and Smith, you see, George favors laissez faire – only more so. Like Ricardo and Mill, he believes that free competition in open markets will compete away most monopoly rents – but not land rents, the main source of unearned income. He therefore calls for the elimination of all taxes on production, exchange, income, sales, payrolls, business, or capital; he proposes replacing them with this single tax on land rent. Whoever makes improvements on or of the land will be rewarded for them. It is the location value of land alone, a value created by society as a whole, that will reward society as a whole in the form of funding government expenditures.

Like Malthus, George stresses that land is limited – but he does so with an affirmative, optimistic spin utterly alien to this predecessor. The dearth of land Malthus identifies as a source of inevitable doom is instead to George an artificial and therefore remediable problem. Brought about by failure of the land market to allocate land to its highest and best use, it can be corrected by taxing land (location) to its full use. Moreover, because

the potential to substitute labor and capital for land is limitless, it creates no meaningful constraint on production once the above-mentioned reforms have been put into place.

George's economics has little of the dismal in it. Instead of harsh trade-offs and deadening dilemmas, he sees heartening possibilities for synthesis and reconciliation. For example, within his framework, private land tenure and free markets can coexist with common rights to land. Taxes can be decreased on labor without increasing them on capital or cutting public services; indeed, by enhancing productivity, land rent taxation finances local public services in a way that attracts, rather than drives away, both population and business. Urban sprawl can be contained, and urban synergy enhanced, without curbing the freedom to choose where to locate homes and businesses. Taxing land rent raises revenue without impairing or distorting incentives to produce, save, or allocate resources to their best use. It actually improves resource allocation: both the "income" and the "wealth effect" of "taxing land into full use" are salutary. Jobs can be created without inflation, deficits, or environmental disruption, and waste in government is reduced in the very process of raising public revenue. In current parlance, the "bad" side of the "Laffer Curve" is not operative here, and the conflicts between "demand-side" and "supply-side" economics are reconciled by raising both supply and demand together, or "leveling upwards."

Above all, for this ethicist-cum-economist, all these increases in economic efficiency actually enhance equity, rather than coming at its expense. They do so for two reasons: because land rents are unearned and because a few people own most of the land and withhold it from the majority.

George can be said to assert not a labor theory of value, but, rather, a labor theory of ownership. "The ideal that land . . . can become subject to such individual ownership as attaches to things that man produces by labor, is as repugnant...as the idea that air or sunlight may be so owned. Indeed,

> [o]ur boasted freedom necessarily involves slavery, so
> long as we recognize private property in land. Until
> that is abolished, Declaration of Independence and
> Acts of Emancipation are in vain. So long as one man
> Can claim the exclusive ownership of the land from which
> Others must live, slavery will exist, and as material progress
> Goes on, must grow and deepen!

Property titles acquired by forced appropriation are a criminal fraud since they have no basis in labor. History – as we saw in parts of the previous chapter – is often the sorry story of land grabs by individuals, tribes, or nations; it has been sad witness to the subversion of our equal and natural rights to land. Only individual labor gives true title to individual wealth.

George argues that curtailing private land monopolization and speculation can reverse the increasing disparity in wealth and its concomitant problems. "[W]hy does industrial

progress result not in the abolition of poverty, but in its increase?" Because land, as a fixed quantity and the primary source of all wealth, is the basis of the "industrial pyramid," and it therefore becomes priced beyond the reach of the masses, and increasingly concentrated in ownership. As well as supplying the government with revenue, taxing the increased value of land will make withholding land from the market prohibitively expensive. Yet more importantly, by reducing its price, this fiscal strategy will open up land for purchase and use by poor workers. Even race relations and voting behaviors are improved as the fierce scrabble for jobs is alleviated and all have a stake in political and economic outcomes.

Both ethically and economically, the "land belongs equally to all [and since] land values arise from the presence of all [it] should be shared among all." The remedy for prevailing economic and social ills and the spur to human creativity is to tax ground rents based on the land's assessed unimproved value, rather than on its selling price. Any improvements on the land or on the wealth and personal possessions earned by labor should also be exempt from taxation (see *supra*).

While land remains private, and land rents untaxed, George predicts recurrent business cycles. His Georgist laws of motion first state that prosperity will lead to overpricing land, which in turn blocks off production and triggers a downturn. Like Marx, he never works out the details well, bequeathing this task to successors. In his theory of "the Rise and Fall of Civilizations," George secondly sees success and prosperity leading to class division, conflict, decline and fall. George contrasts this situation with models either of steady upward progress, as in the work of Smith, or of a benign steady state, as in Mill. Historians Spengler and Toynbee later elaborate the cyclical idea of history, and it is now commonplace, but we should remember that it originates with George.

In essence the optimist, George sees, however, a possible end to Decline and Fall. The "Law of Progress," he wrote, is "Association in Equality" – equality of opportunity. Like Jefferson, he believes that equalizing opportunity results in outcomes that are much more equal as well. Unlike Jefferson – and, to be fair, a century later, he includes Afro-Americans (but not immigrants – his "free" markets involve the movement of goods, not people – "who among us is perfect?") as the beneficiaries of this equality. His reform package is designed to enhance and perpetuate.

While Marx could mainly conspire with revolutionaries, George could -- and, unlike other Worldly Philosophers, did -- run for mayor of New York City, and almost get elected in 1886. His constituency, especially among Irish-Americans and the labor movement, held the balance of power in New York, which in turn held the balance of power in national elections when George was politically active (from 1886 to 1897). Winning not being a matter of all or nothing, as regards the influence, if not the office, his campaign would shape the issues for years to come. Thus was George a clear and present danger to the establishment during the formative period of Neo-Classical Economics, when the other big threat, Marx, was being ignored. Indeed, George and his followers led in the adoption of the initiative, referendum and recall system; the secret

ballot; direct election of US Senators; and selection of presidential candidates through open primaries.

As a practical matter, Georgism means making heavier use of the property tax to finance public services, and modifying the tax base to exempt buildings. To a surprising degree, these changes did occur in the United States for roughly thirty years after his death, say from 1897 to 1930. Indeed, by 1920, property taxes generated 90% of local revenues, and even 50% of state revenues. George opposes income taxes, but considers them less bad than the excise taxes that financed so much of federal expenditures when he wrote. When income taxation did come, Georgist influence helped focus it on property income. Allied with Populists, the Georgists in Congress kept the 1894 personal income tax from exempting property income, as it otherwise would have done. The US Supreme Court then declared it unconstitutional to include property, but Americans were spared what would have been simply a payroll tax. By the time the 16th Amendment was first evoked, in 1916, Georgist Congressmen (notably, Warren Worth Bailey) were able to frame the legislation so as to exempt most wage income. Meantime, Congress had also passed a corporate income tax (in 1909) that fell 100% on property income.

Georgist influence was also present in the Conservation Movement, which created the National Park System and city parks throughout the country. Urban mass transit systems with low fares were another popular Georgist cause. Urbanization called for heavy cit spending on public health and safety, financed from property taxes. Public utilities and rails were subjected to the common carrier principle, outlawing discrimination against small users. Restriction of monopoly, more democratic political machinery, universal public education, utility rate regulation, and improvement of labor laws were all accelerated by Georgist influence.

Like the utopian economist/reformers we have studied earlier, George believes that the actions of humankind can be radically different, and better. As he puts it,

> Our aim, and it is the same everywhere, is not merely to banish animosities, to still prejudice, to unite the nations, it is to abolish poverty; it is to take away forever that unnatural thing, undeserved poverty. And that, too, not by protecting men, not by coddling men, not by condescendingly attempting to do something for any class, but by the simple means of assuring to all men equal rights, by the simple means of opening to all men those opportunities for the employment of their powers that the Creator of this world has given to them.

Henry George, you see, while unchurched and ecumenical, was a religious man, with a strong teleological streak. Although Marxism became, at least in some functional senses, a sort of religion, Marx himself was a militant atheist whose bent was more Darwinian. He was a transplant, a recluse, and a revolutionary. George was an indignenous product and part of his society and culture – a can-do American. To another quintessentially American matter, the frontier, we shall now turn.

JOHN BATES CLARK
(1847 – 1938)

Around and about the time that Progress and Poverty was selling faster and better than hotcakes in the United States and abroad, Neoclassical Economics was beginning to hold sway in our halls of ivy. While the former inspired people with and without college degrees to examine matters broadly and dynamically economic and ethical, the latter focused increasingly on static conditions of efficiency and competition's theoretical power to achieve it. "What's in a name?" In this case, a great deal. When "Political Economy" yielded to "[Neoclassical] Economics", the consequences for the Land Question have been profound, and largely negative. The chief architect of this shift was the American economist, John Bates Clark.

"There's no such thing as a free lunch" might be the one quotation economists would choose to epitomize their field, were they so foolishly limited to one. George Stigler preferred a variant: "Nothing is simultaneously free and interesting." We need now extend ourselves and contemplate the possibility that "Nothing is pure, not even – especially even – 'scientific' research." As the Torah observed, "We see things not as they are, but as we are;" in the vernacular, "Where you stand depends upon where you sit."

To dispel doubts that we are indeed a product of our times, consider the following, from The Household Physician, published just twelve years before Progress and Poverty. In a chapter on "Female Diseases" (which includes several topics now considered signs of female health), under a section entitled "Hysterics," we read:

> The name of this complaint is from a Greek word, signifying the womb. It took this name from the belief that this organ is the seat of the irritation which produces the hysterical disturbance.
>
> This belief is correct, if we include with the womb, the ovaries and the other sexual organs. The sexual system is doubtless the center of the reflex nervous derangement, called hysteria…
>
> **The Hygienic and Moral Treatment** are of great consequence. the complaint is very much under the control of the will. Whatever tones the moral nature, and strengthens the will, tends to subject this disorder to the control of the patient. Plain wholesome diet, exercise, bathing, and the enforcing, as far as possible, of a rugged, self-reliant habit, generally go far towards breaking its force.

Pregnancy is also listed in this chapter on female disease.

> When the time of her lying-in arrives, let every woman meet it with calmness and undoubting confidence... *one pang at a time...*
>
> **Diet of the Mother. --** For the first few days after confinement, the most appropriate diet for the mother is gruel, cocoa, rice-water, crust coffee, or some similar liquid nourishment...
>
> **The Perpendicular Position. –** During the first month, let the woman avoid being often or long on her feet.

Enough! Too much? At least breastfeeding was endorsed; "scientific" formulae and "scientific" feeding schedules -- it's never too soon to get workers ready for factory discipline -- were received wisdom when Dr. Spock was in medical school. But it should be, and therefore is, noted that women rarely participate in drug studies because of what is regarded as the inherent instability of their systems. Where we stand depends upon where we sit, both as individuals and as members of a culture.

Where J.B. Clark sat, for the bulk of his career as preeminent American economist, was Columbia University, in the Age of Railroads and the Secularization of Universities. Columbia's president, Seth Low, personally recruited Clark in 1895, outbidding the University of Chicago, Johns Hopkins and Stanford in the process. Low was about to launch a bid for Mayor of New York, in a political run, *inter alia,* against Henry George, who had for many years also been in a disputational run against E.R.A. Seligman, Chairman of Columbia's Economics Department and Clark's ally in a famous debate against George in Saratoga. Following Low at Columbia's helm was Nicholas Murray Butler, both one of the many enemies of George and one of the many friends of Wall Street and Big Business. Universities at this time were replacing clergymen with businessmen on their boards – businessmen who were also major fundraisers and directors of major corporations. J.P. Morgan and Wall Street helped make Columbia the wealthiest academic institution in America at this time, even as Chicago was founded with Rockefeller money, Johns Hopkins with B&O and Stanford with Southern Pacific railroad riches. Cornelius Vanderbilt, chairman of the board of directors of the New York Central & Hudson River and Michigan Central railroads and president of the Canada Southern Railway, was also a trustee of Columbia from 1891 to 1899. The relationship of railroads to universities was profound (Low's obituary of Vanderbilt, in the "Columbia University Quarterly," is still referenced today;) their relationship to land has been much deeper than just crossing it.

Professors are sheltered in some measure today from pressures to "research" popular subjects and avoid topics powers may view as "inflammatory" -- "in some measure" rather than "completely" because even after the award of tenure, salaries, offices, course loads, research and secretarial support tend to follow "merit." The scramble to acquire tenure (without which one's full-time association with any single academic institution is

limited to seven years) means that one's most productive, original years may be directed to subject matter that doesn't threaten editors of the received journals and other publishers.

Tenure didn't exist in Clark's day, a day when courts still upheld the principles that university boards of trustees were self-perpetuating and unaccountable, as established by *Dartmouth College v. Woodward* (1819). While Georgists Allen Eaton and Scott Nearing were fired from the University of Oregon and the Wharton School at the University of Pennsylvania at this time; at Columbia, the ranks of the Economics Department under anti-Georgist Seligman increased from two to some forty or fifty. "Publish or perish," today's university mantra, may once have been "placate or perish" [The Corruption of Economics, p.51]. Termination of one can subdue many when the word spreads fast.

Please be ever mindful of this setting when evaluating the contributions of Clark to the field of Economics. The man was brilliant, and his power endures to this day. The American Economics Association (AEA), which he founded and of which he was president, remains the profession's preeminent organization. And the John Bates Clark Award, one of the profession's most distinguished prizes, is still awarded to economists under the age of forty (when they generally do their most creative work). . We are not suggesting that Clark willfully set out to protect powerful landowners from losing some of that power in support of the public weal. No. The effect of force is even greater when it is subconscious.

Clark's analysis is particularly brilliant and sharp-edged when he focuses on efficiency and distribution. To do so, like all good theorists, he *simplifies*, he creates a model, he *abstracts* from the "real world" to isolate the effect of certain key variables. The lasting legacy is to collapse the "Three Factor Economics" we have heretofore been studying into "Two Factor Economics." The lost factor is *land.* It has been conflated with *capital.* And here is how it happened.

Because, to make his efficiency and distribution points, Clark's analysis is static, the quantity of capital is fixed, just like land. Its costs of production therefore become irrelevant, just as if, as for land, they were zero. Clark's capital is moreover immortal, just like land. There are no dynamics, except for the turnover of capital, which occurs so smoothly, so "glitchlessly," and without a measurable period, that it is hardly "dynamic." There is no capital formation: just like land, it all comes from the past, and is automatically retained for the future. With these simplifying assumptions, designed, we repeat, to hone our analysis of distribution and efficiency, the value of capital is solely determined by demand, yet again just like land. Just as in the evaluation of land, in today's parlance, the price of capital equals the discounted sum of its stream of estimated benefits into the foreseeable future (and the way discounting reduces distant benefits, you don't need to see too far).

Why, then, not collapse the two categories of land and capital into one – capital, an asset whose productivity exceeds one period of production? Why not, indeed, when land is

important only in farming, urban land values are negligible, land is becoming less and less important even in farming, and farming is becoming less and less important as the economy becomes ever more industrialized, as economists like Ely believed and asserted? Why not, when the value of land is largely man-made, by cuts and fills, by draining swamps, fertilizing and irrigating the soil? Private and public works (it doesn't matter which) are what enhance land values. Nature is uniform and sterile until tenured and developed by man. Land rents and values are trivial.

In Clark's point of view, nothing has value until it has become *property*. When one buys land, the funds used are capital, and this capital "vests itself" in land, becoming land itself. Land and capital are the same because "pure capital" is abstract value, and the fund of it is permanent. With perspective and language worthy of a mystic, Clark talks about the "transmigration" and "transmutation" of this value into various "receptacles," the details of which matter not in a competitive economy in equilibrium. Land, then, "is made to contain" the capital of whoever buys it. (In more modern language, if markets work well, a superior asset has been purchased for a superior price, so average costs tend to equalize across production of the same product, as well as to equal product price.)

If a production function is then characterized as one where output increases by x if all inputs increase by x (in other words, is "linear"), then paying to each input its marginal product exhausts output. This outcome seems tidy, efficient, and just. From his seminal work on the concepts of "marginal productivity" and the "Marginal Productivity Theory of Distribution," Clark's ethical conclusions about distribution are quite powerful. Efforts to redistribute wealth and income are futile and counterproductive, just as Malthus has said, but for different reasons. Clark, as we have seen, rejects Malthus' distinction between land and capital. The new emphasis is on "Pareto's Law" – that actual distributions are the same in all nations, regardless of public policies. In any case, interpersonal comparisons of well-being are impossible, so there is no way to justify egalitarian redistribution on the grounds of diminishing marginal utility of consumer goods. As one of the leading figures of the "Marginalist Revolution," Clark also developed the theory of "marginal utility" on the demand side of each equation; in this case, however, he is not accorded original pride of place. Borrowing from Edgeworth and Pareto, he suggests it is, however, possible to say that those raised in wealth need more than the poor, because of their greater learned capacity to enjoy the good things of life, and that their offspring inherit this heightened capacity. Hence, although Malthus and Clark both oppose "leveling" policies, they do so for different reasons: to Malthus, efforts to level (equalize) just encourage workers to spawn more children, doomed to starvation wages because of diminishing returns to labor applied to fixed land; to Clark, where land, a form of capital, is ample and expandable, efforts to alter distribution of pieces of the "pie" only reduce its overall size, by damaging incentives.

Statements like this are sounded repeatedly today. The presumption is on of austerity. "There's no such thing as a free lunch." Every gain implies a loss, all choices in life are trade-off's, many harsh or "dismal" as in Malthus; they involve not just his food versus sex but also more modern jobs versus the environment, inflation versus unemployment,

and equity versus efficiency. This attitude, as we have seen and shall keep on seeing, keeps rising to the top, and losing elections for those who peddle it.

Clark himself is actually less austere on this matter than his successors in the modern "Chicago School." For example, he ventured into dynamics long enough to say that new capital and technology use labor and both save land and bring new land continuously into the market (recall: it has no value until it is brought into production, as property and the embodiment of capital). Evoking the optimism of Adam Smith, Clark sees no scarcity of land and no decline in the demand for labor. Land grows hand in hand with capital. What do we make of the fact that his career spanned the height of the conservation movement led by Presidents Theodore Roosevelt, William Taft and Woodrow Wilson?

With land indefinitely reproducible (recall, Clark asserts that most of its value comes from human improvements) and with people getting what they give, Clark likes the world pretty much as it is; he devoted his career to keeping it that way. His only reform issue is breaking up monopolies: they interfered with free markets, in which he places his faith. In contrast, we remember Mill's fear, the fact he asserts, that land tenure is based on historical force and fraud, with accordingly little ethical justification. His faith is in the coupled powers of persuasion and representative government to effect gradual correction. Marx agrees with the ugly origin of property in land, but extends it to all private property, which he then condemns, all and all. Owners will never accept any leveling by any method, says Marx. He has no faith in persuasion, because those who own property also dominate education, religion, politics and the media, and will always brainwash and dominate voters. Revolution, revolution led by unions and a self-educated elite, is the only viable path to reform.

And yet, and yet, there are striking similarities between Marx and Clark. The enemy against whom John Clark wielded his pen was not Karl Marx, but Henry George. In classical, three-factor political economy, writes Mason Gaffney:

> major writers in England were able to portray the dominant class of rent-takers as idlers and superfluous drones. One surmises they got by with this because the idlers were proud of it. In their value-system, labor was not respected; conspicuous leisure was. Saving was regarded contemptuously as stinginess: conspicuous consumption was the mark of a gentleman and aristocrat.
>
> In the later 19th century, however, especially in America, values were changing... To George, the landowner *per se* is nonfunctional (unproductive)... Worse..., he or she often makes the land itself lay [*sic*] about, too: then he or she is *dys*functional or counterproductive, a double-dipper. Worse yet, landowners become triple-dippers when they use their discretionary income and wealth to dominate politics and drain away yet more treasure through subsidies, public works and services, protections from competition,

> cheap credit, and so on. Often they are not just passive drones, but active predators. [46]

Gaffney calls Neo-Classical, Two-Factor Economics "the inevitable counterattack." [*Ibid.*]

At least twenty-four of the publications in Clark's bibliography comprise this counterattack; on word fronts both printed and oral, it was an important part of Clark's career until 1914. In the preface to his masterwork, Distribution of Wealth [1899], Clark acknowledges George as his inspiration, this time positively: he says he was moved to generalize the theory of marginal productivity because of " the claim advanced by Mr. Henry George" that labor is paid its product on land at the margin. [p. viii] We have already mentioned the Saratoga debate (in 1890); here we shall simply add that Clark's disciple Frank A. Fetter, if anything "more Clarkian than Clark," [Gaffney, 49], sees as the

> probable source from which immediate stimulation came to Clark [for 1888's Capital and its Earnings] was the contemporary single tax discussion...Events were just at that time crowding each other fast in the single tax propaganda. Progress and Poverty...had a larger sale than any other book ever written by an American...[while Clark's book] wears the mien of pure theory...we can hardly fail to see on almost every page the reflections of the contemporary single-tax discussion. [48-49]

It was in Saratoga, in his debate against George, that Clark introduced his theory of "pure capital" as abstract value capable of migrating and transmuting and vesting in land. This echoes Marx remarkably well (hence we remark):

> The value of commodities...in the circulation...of capital, suddenly presents itself as an independent substance...in which money and commodities are mere forms it assumes and casts off in turn....Land as capital is no more eternal than any other capital. [53-4]

Clark addresses George, not Marx, by name; it is George, not Marx, in the indices to his various works. It is George, not Marx, who insists that land is a distinctive factor of production and that Economics must be three- not two- factor analysis. George, not Marx, was the pressing threat to vested interests in Clark's America.

In the *Quarterly Journal of Economics, Vol. 5, 1890-91*, Clark states a more "cerebral" reason to conflate land with capital:

> The law of rent has become an obstacle to scientific progress:

> it has retarded the attainment of a true theory of distribution. Yet it is itself capable of affording such a theory. The principle that has been made to govern the income derived from land actually governs those derived from capital and from labor. Interest as a whole is rent; and even wages as a whole are so.
>
> Both of these incomes are "differential gains", and are Gauged in amount by the Ricardian formula.

Clark continues to justify his analysis of a "static" model, one in equilibrium. "Pure profit" is an another kind of "income," a "distinctively dynamic" one that exists only in a state of disequilibrium occasioned by changes to which society has yet fully to adjust. Eliminate change, and

> [t]he remaining product of social industry will then resolve itself into wages and interest; and both of these are rent, or differential product due to permanent agents... The true method of attaining a law of distribution is not, therefore, first to eliminate from the earnings of society the element of ground rent, and then to try to find principles that will account for the remaining elements: it is to eliminate what is not rent, -- namely, pure profit, -- by reducing society to a static condition, and then, by a use of the rent law, to account for all that remains.
>
> ...the earnings of land are a sort of mock rent. They are equal to a differential product, but are not the genuine thing; while the earnings of the entire fund of social capital, as embodied in land and in all other productive instruments are a true differential product.

This line of reasoning has become embodied in today's parlance of "consumer" and "producer surplus."

As we shall seen, another famous economic dictum [from John Maynard Keynes] rings, "In the long run, we are all dead." But our children's children to the nth power are not. And, in the long run, land, unimproved land given by Nature, is fixed, is radically different from capital, has a value determined more by social than individual initiative. Land and capital are not mutually convertible, land values are a substantial part of urban values, landowners concentrate wealth and political power, capital does have costs of production [see later chapters, by Gaffney]

Clark's economic system is solely one of relations of coexistence, without relations of sequence. The economy is at rest, in a benign equilibrium. Booms and busts, whether

due to oppressive tariffs or financial policies, stock market bubbles that burst, or speculation in land, have no place in this model. There are no Laws of Motion – no history, no forecasts except for continual improvement.

The model has its uses, but it also has its misuses.

Included in the latter are its policy implications, especially as pushed by Clark's Columbia colleague and department chair, E.R.A. Seligman. Since land is just a form of capital, it – and all other forms of capital – should be taxed at the same rate. Differential rates will distort allocation by distorting incentives.

In the last decade of Clark's life, the World wrestled with the Great Depression. Although Clark's world of theory was static, abstracting from change and disruption to illuminate key principles, he had written that capital formation would effect an indefinite expansion of the land supply, to the benefit of labor. Capital formation was not propelling economies forward in the late 1920s and '30s. Many Worldly Philosophers had already warned that the marginal rate of return on capital might fall so low that investors would cease to invest. Ironically, mostly radicals and reformers voiced this concern. Ironically? Perhaps not. Low interest rates raise the value of existing assets, benefiting the owners of land. The owners of land have concentrated their power not only in land wealth but also in political force. It is not enough to study the allocation of resources in a competitive economy in equilibrium. Markets require personal property (the decline of whales may be a sign not of market failure but of the failure to have a market), and personal property requires law. Laws are made by governments. Governments are concentrations of power made by concentrations of power.

This power continues to endorse the theft of land. While George fretted that land is limited and pressing its limits may displace labor with capital, Clark envisioned pushing back frontiers into an infinite reservoir of raw land, creating ever-expanding opportunities to invest capital, produce more goods, create more jobs. This expansion has included military actions to displace, kill off, or dominate previous inhabitants. Whatever caused the Great Depression, there is no doubt that World War II, with its massive increase in Aggregate Demand, helped end it. Today's "Keynesian hawks" have favored high military spending in part to reduce unemployment. One of their number, Lawrence Klein, even was awarded a Nobel prize in economics – from the same group that awards the peace prize…

Political Economy has become *Neo-Classical Economics*; *Three-Factor Economics* has replaced *Two-Factor Economics*. After 1936, when Keynes introduced Macroeconomics to help understand the Great Depression, static Neo-Classical Economics faced a crisis. It survived by more compartmentalization -- not just separating static (and comparative statics) analysis from dynamics but also separating economics into two distinct subdisciplines: microeconomics and macroeconomics. With the tincture of time, Keynes General Theory of Unemployment was debunked by schools like Chicago as a "very particular theory of unemployment, ridiculously and critically dependent on the assumption of "sticky wages." Macroeconomics, to many of today's economists, like

Milton Friedman's son, David, is "a study of tombstones (like Keynes') and calls for future research."

Many of us remain prisons of this peculiar prism that denies the economic importance of land and thereby increases its political and social significance. This book is written in tribute to two more quotations, first, and again, from Keynes, and second from Edward George Bulwer-Lytton (!), quoting Richelieu:

> Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back.

> Beneath the rule of men entirely great
> The pen is mightier than the sword.

Ideas have power, great power. They can overturn and recreate economic and political power; they cannot overturn economic laws. By reasserting the primacy of the Land Question in economics and history, we wish to end the slavery of ignorance and power. There is another frontier out there in the realm ethics. The principle that the Earth's resources should belong to all of us will eventually seem as basic as the principles that all adults should be able to vote and that all people have the right to the product of their labor and no right to the product or life of another. Disenfranchisement from nature's riches, like that involving voting, is just another form of slavery and, like slavery should be abolished, relegated to the pages of history.

FRANCIS YSIDO EDGEWORTH
(1845 – 1926)

We have seen that in the comfortable (for some) times of Victorian England, the inquiry of worldly philosophers changed from cosmic questions of growth and revolution an the meaning of history to a more professorial concern with formal tidiness and refinement of theory. Perhaps no one better exemplifies this shift that Francis Ysido Edgeworth.

In 1881, just two years before Marx's death, Edgeworth published a book small in size but massive in ultimate implications. *Mathematical Psychics* began to translate the verbal insights of Political Economy into the precise and formidable language of mathematics. With this tool, as with any formidable weapon, wisdom has often yielded to mere cleverness; with this tool, as with any formal and specialized vocabulary, barriers of entry began to shield its users from the common sense of the common world. *Political Economy* began to yield to *Economics*, and the economists most heard were those who inhabited ivory towers. The ivory tower in Edgeworth's case was Oxford.

Math requires simplifying assumptions, and the assumptions key to Edgeworth's theory are two. First, everyone is a calculating sort of pleasure machine. Second, it is not possible scientifically to compare one person's pleasure to another.

The implications of the first assumption are that each individual cannily calculates how to be most happy, but is constrained in this pursuit by the hard facts that his or her income is limited and nothing is simultaneously interesting and free. These constraints are the least binding when competition is perfect. Competition being demonstrably imperfect, the assumption leads inexorably towards efforts to make it less flawed. Unions, for example, are pesky interferers with perfect competition, but one need not worry excessively about them, because time will do the job of eliminating them without undue academic effort. Indeed, even Marx at this time was observing workers getting less unsatisfied with their lot, eager more to join the bourgeoisie than to unite to overthrow or obstruct it.

The second assumption -- basically an assertion that people are very different, one from another – combines with the first to focus theoretical attention on the virtues of competition and practical attention on policies to reduce any imperfections. If trade is voluntary, and prices reflect, or can be made to reflect, costs, then the more exchange the merrier. At least one party to the transaction benefits, and the other cannot be hurt. There are "gains from trade" in the domestic as well as the international arena.

But what about the matter of redistributing income that earlier economics found so compelling? Another implication of the two assumptions is that government policies to reduce inequalities in income may be not only costly in terms of incentive but also inappropriate in terms of maximizing total pleasure in the community – the sum of each individual "utility" or happiness. In today's English, some people may be wealthier, able

to consume more, because they derive such delight from material possessions that they work hard to get them. Others may be less wealthy, even poor, because they value their leisure, their nonpecuniary returns, a lot more than the goods they could buy with more money and more work to get it. Parents fortunate enough to have estates must face this problem when they decide how to will their belongings in order to be fair to very different offspring. Should the heir who is poor receive more financial assets from the estate than the heir who has earned his or her own fortune? Maybe. But what if the poor sibling could have been rich, but has chosen instead to have more free time and an easier job renumerated more in quality of life than in money? What if the rich sibling has chosen to suffer, stiff upper lipped, in a tough career because this sibling gets enormous pleasure from the consequent purchasing power? Should we subsidize the one and punish the other for essential differences in taste?

And how can we glean their relative abilities as pleasure machines? Within a family, siblings tend to start the race at the same starting gate, at the sound of the same gun. If they could have entered the same vocations but have chosen to take different paths, we can gather, with some degree of certitude, that their pleasure machines do not have the same engines.

From these sorts of considerations comes a proposition now called "Pareto Optimality," although it originated with Edgeworth (whom Vilfredo Pareto credited when he created the powerful tool of "indifference curves"). Pareto Optimality is achieved for a society when no one individual can be made better off without making another worse off. Because "interpersonal comparisons" of well-being are unscientific and therefore illegitimate, programs to redistribute income may reduce society's total well-being: the losers may value what they lost more than the winners value what they gain.

This kind of thinking provides a certain kind of comfort to the social observer who endorses it. There is no scientific foundation for meddling with the *status quo*, so let's take the income distribution as given and just work to reduce imperfections in the market from this starting point. The very world "Optimality" guides one in this direction. The imperfections in competition generated by inequality in starting points, in power, in education, in wealth may simply be a consequence of the sorts of differences in pleasure machines limned immediately *supra*. And in these cases, government policies to reduce inequalities may also reduce total pleasure.

It is, of course, a leap of faith, not science, to say that the existing distribution of wealth (and with it, power) should not be altered because we cannot see into the mind, the heart, the soul, the inner workings of all the pleasure machines out there in a community. Indeed, Edgeworth has some decidedly unscientific prejudices (assumptions?) to bolster the virtues of the *status quo*. Men, as a whole, in his worldview, are better at converting material consumption to pleasure than women. And that "aristocracy of skill and talent" are also more skilled in this conversion than the unwashed masses in city alleys and country lanes. Perhaps the mere fact of their greater wealth proves this difference in taste; the causal connection would be more credible were it not so easy to observe

inheritance across generations coupled with gene pools that through out more surprises than red hair and freckles. The acorn can fall very far from the tree.

A century after Edgeworth, with math transcendent in academic economics, professors have applied their educated intelligence to modeling households and individuals as if they were quite similar to firms. The difference in the product produced – happiness instead of widgets – is *de minimus* in this view. Some of Gary Becker's work demonstrates, mathematically, that if the production coefficients for human happiness can be altered by education and experience, it becomes relatively cheaper and cheaper, for example, to enjoy classical music. Hence, the empirical observation that people listen to such music in extremes – every little, or quite a lot. The reader should think hard about this demonstration. If "life" can make one a more effective pleasure machine, particularly backed by wealth, then the sanctity of the *status quo* begins to look a little shaky. Trouble is, if you make the race fair, someone will win it, and that someone's children will begin the next generation's race ahead of the rest. But perpetually equalizing the start is like making the race fair and then calling it off. {An Uneasy Case for a Progressive Income Tax – I'll get the precise reference if this stays in.)

What, the reader may (perhaps should) be asking, is the import of all the above to the Land Question? What, indeed? Much more, as it happens, than just developing important skills as an economist. Most, it happens, in learning how to examine carefully, critically, the assumptions from which all the conclusions so tightly but perhaps speciously follow.

First of all, Edgeworth's insight that economics deals with quantities and therefore can be well dealt with by mathematics by itself affects the treatment of land in economics. This powerful move to the abstraction and simplification necessitated by mathematics has made it easier to conflate capital and land. Keeping the distinctions going is messy to the economist. It's hard to model, we need those first derivatives.

Second, Edgeworth recognizes that his competitive outcomes require law. Markets don't work well without properly defined and enforced property rights. We have seen this truth in the breach – in Russia immediately post Communism, in Iraq today. But another delightful development in modern economics doesn't take "law" as something forever outside the model. In the short run, yes. But in the long run, laws get written, and more importantly, laws get enforced due to forces economics is well suited to analyze. Politicians don't get elected by their verbiage. They get elected by votes. Concentrated groups rally to get out the vote. They are easier and less expensive to organize, and the benefit they derive from voting vastly exceeds the cost. It remains a marvel that the "little guy" in the system shows up to vote at all. There's a cost to being informed and getting to the polls and waiting in line there, and what's the benefit? The probability that this one vote changes the election. That probability is very close to zero.

What is one of the most concentrated, vested, interest groups in the country? Landowners. Was Edgeworth a landowner? Yes, indeed. Not only did he teach at Oxford, a great absentee landlord, but he inherited Edgeworthtown, and ran it in like

fashion. Edgeworth's family had been part of the "Protestant Ascendancy" in Ireland for 300 years, their profession chiefly landlords.

Henry George, as Mason Gaffney notes, "had risen from obscurity by attacking absentee landlords generically, and Irish landlords specifically... [Indeed, h]is 1881 tract on *The Irish Land Question (L or l????)* (later retitled *The L(l?)and Question* is what had sparked initial interest in the more heavyweight *Progress and Poverty*. George's wife was Irish, one of his bosses was Irish, he traveled and reported from there. He also announced, "It is hard not to feel some contempt for a people so oppressed (as the Irish) who have only occasionally murdered a landlord." (105) Is it any surprise that Edgeworth, after the speeches but in the very same year as George's land tract, would publish a book of marvelous mathematics, one marvel of which was abstracting away from land and directing attention away from income and wealth distribution and toward efficiency holding these distributions fixed? Is it any surprise that Edgeworth would favor "the privilege of an above brute, of civilized above savage, of birth, of talent, and of the male sex"? Marx might have cited him (had Marx lived that long) as a textbook example of a person whose ideas are determined by his own material circumstances.

The reader is probably protesting that this is psychoanalysis from a far, psychobabble, really, and very superficial. Maybe. But what mathematics really reinforces is consistency, and some of Edgeworth's inconsistencies are most revealing. In vindicating unequal distributions of wealth, Edgeworth himself makes interpersonal comparisons, claiming, as we have seen, that men and the rich are more sensitive to pleasure than women and the poor. But if we cannot justify redistributing wealth, neither can we justify keeping it the same. We can justify nothing. Edgeworth's strategy is simply to put the burden of proof on those favoring change, and then make proof impossible. Given that impossibility, let's focus on what *is* scientific: that competition is the best environment for "win-win trades." Let's not hold back progress on this front – improving competition – with iffy proposals about income and wealth distributions. The main obstacles to free markets are labor unions and limits on the full power of private owners to administer and dispose of their property. The first will self-destruct, the second is advanced by giving owners full power to manage and dispose of their assets, removing any residual social obligations. No clean slates like the Biblical Year of the Jubilee or the Russian distribution of corporate stock vouchers to all citizens equally (???) for Edgeworth. Rather, the pace of privatization should be picked up. Edgeworth advocates the privatization of all resources currently held in common, untenured, or held by government agencies. The next step, in his opinion, is to remove most or all regulations, price controls, subsidies, and the like. In these beliefs, Edgeworth "bucks" the mainstream trends of social thought in his day and most of those clear up to the Reagan Revolution in the 1980s and the George W. Bush administration of the 21st Century.

Aren't monopolies also an imperfection in the market? Why, then, is Edgeworth so tolerant of property-based monopolies? And how can he assert both that Georgist land taxation creates the incentive for premature building ("force[s] the market" – Gaffney, 104) and that it also slows down building by eating into profits? The latter belief is

particularly telling, because a tax on buildings directly surely discourages their development, and rent taxation could replace or reduce this burden.

Edgeworth is not the only brilliant individual to suffer from "compartment-mindedness." We have already seen that Malthus could simultaneously hold the beliefs that demand will be insufficient to buy all the goods produced and that land scarcity will prevent supply from meeting the demand of all those who are born. Who among us is perfect?

It's just that Edgeworth's influence on today's economics is one of many forces that has buried the Land Question and that, in so burying it, he served himself. Quite unlike the overbearing and university-less Marx, the personally shy Edgeworth occupied a position of quiet power at Oxford, and he used it to reward friends and punish foes from behind closed doors. Among those foes may have been J.A. Hobson, whose high opinion of Henry George was both written and read, and J.E. Cairnes, who supported rent control in Ireland, publishing several articles on the subject and asserting that such a position was fully consistent with classical rent theory. . Both men favored redistributing wealth; both he accused of being weak in mathematics.

This writer, it is confessed, is extremely fond of mathematics, which she used to study for fun, and as "aerobics of the brain." She has little respect for people who reject mathematics without being able to do it themselves. Mathematic modeling is extremely important for econometrics, computer analyses of our world. Logic helps us reason tightly. Mill, for example, is a master of logic. He reasons through the careful definition and use of words and, as we have seen, is a much more important and original thinker than his sedate prose would suggest. Edgeworth is a mathematician, reasoning through abstract symbols and the rules of calculus. Mills' tools can tell us that a tax on cigarettes will reduce consumption. Only the tools for which Edgeworth laid the ground can tell us how much – how much consumption will decline and how much revenue will be raised from such a policy instrument. These answers require number crunching. Only numbers will help us estimate the elasticities of supply and demand. Math deals with quantities, and this is quantitative analysis.

That tribute paid, we must also reflect on the negative. It is Edgeworth in England who started the movement, whether conscious or not, to shift three-factor economics to two-factor economics. It is in America, however, that economists like J.B. Clark fully carried out the deed.

Possible Additions to this chapter – editor's note:
1)E-prof of pol ec at oxford, first editor (1891-1926) of the *Economist* 2) Mason 45 It was Mill who popularized the idea of raising taxes on landowners only after first compensating them, thus buying the right to tax them. It was a selective scruple: neither Mill nor anyone, to my knowledge, ever proposed compensating workers, consumers, or the owners of capital before taxing them.3)Walras and GE Theory – simplify to understand, not stop

ok, M.S.

RICHARD T. ELY
(1854 – 1943)

As Germany's "Iron Chancellor," Otto von Bismarck (1815 – 1898) was the reigning statesman of Europe in the latter part of the 19th Century. His sophisticated network of alliances and alignments on the continent, his creation of colonies far reaches away, and his support of the German state in its contretemps with the Catholic Church (the *Kulturkampf)* were all elements in his historical, political, intellectual, and economic importance and power. Bismarck's feud with Rome especially endeared him to many of the age's intellectuals, most of whom were not only non- but also anti-Catholic. Particularly sympathetic were nativist Americans who were appalled and frightened by the swell of immigrant Catholics, especially those rebellious, politicized, unionized, and Irish in their number.

In economics, Bismarck was a Managerial Socialist, embracing both *dirigisme* and paternalism. In pursuit of the first, he supported direct state involvement in industry; for the second, he believed in regulating work conditions like hours and wages and providing specific goods and services for the poor, especially when their poverty was due to unemployment, illness, or old age. Government agencies, according to this group of socialists, should actively administer publicly owned resources and businesses (city water supply systems are good examples), as well as regulating the use of private property (the values of which can be raised by such social investments as those public water systems). In sharp contradistinction, Distributive Socialists believe that most of the effects of the free market are salutary; property should be controlled and managed privately, and the government should simply tax it, using the revenue for common public functions, including services to people and the redistribution of income towards the poor, who should spend it however they choose.

Into the intellectual and cultural environment described above came Richard Ely. Like many of his contemporaries, this American was educated in Bismarck's Germany. There learning to embrace Managerial Socialism of the chancellor's bent, Ely broke rank with such of his predecessor economists as Ricardo, Mill, and George, who favored policies more in line with the Distributive Socialists. He also earned a reputation as a progressive -- and this reputation was to prove much sturdier than Ely's adherence to the principles on which it had once been based.

Two university presidents and a wealthy industrialist-turned Congressman helped launch Ely's American career in these times. The presidents were Daniel Coit Gilman, of Johns Hopkins, and eponym Ezra, of Cornell; the businessman-cum-politician was Abram Hewitt. Gilman founded the first Ph.D. program for economists in the US. From 1880 to 1930, the formative years of Neoclassical Economics, his graduates dominated the discipline, and Ely was his first hire. With Gilman's and Cornell's support, Ely become a powerful academic and popular teacher, not just at Johns Hopkins but later at Wisconsin for thirty-three years and at Northwestern for eight. For his part, stating that "[t}the problem is to make men who are equal in liberty content with inequality in property,"

Not one to bite the hand that had been feeding him, Ely, in brief, joined J.B.Clark in reshaping economics in a direction that discredited George. The title of his specialty, "Land Economics," was to prove as misleading as his original designation as "socialist." Ely, you see, aimed to show that land is NOT distinctive, but is just like capital, quite like labor. The purpose of his work in land economics was to show that the market works very well. The main problem is not the market in land, but the taxes on land. Sales and payroll taxes should replace them as the main source of revenue for government. No bomb-throwing "anarchist" was Ely – in his day, that phrase was redundancy. The government and taxes were all right – so long as the taxes were not on land.

John A. Hobson

(1858 - 1940)

Victorian England was a time and a place of material progress and the related intellectual optimism. It was, accordingly as well, a time and place for economists in the main to focus their attention not on the nature of systems as a whole but rather on how individuals in groups and signally made decisions based on those systems, accepting those systems, given those systems. In the main, but not *in toto.* On the fringe or in what Heilbroner calls "the underworld", were students, still, of the sweep of history, its convulsions and turmoils, its injustices and instabilities. And in their number was John A. Hobson.

It was Imperialism that caught his eye, and saddened his heart. An "ism" as old as humankind -- and our relentless and often tribal grasp for land and other of Nature's bounty, it exploded in force around 1870. Europe "discovered" southern and eastern worlds in the very Victorian times when "white" stood for "purity" and "goodness" and "black" for "depravity" and "sin". These distinctions lent lamentable credence to such "us v. them" posturing as the Kaiser's confident belief that God was on Germany's side and Victor Hugo's ringing declaration that "France is needed by humanity" [Heilbruner, p. 190], giving pseudo-intellectual support to Europe's various land grabs around the globe. As the respected economists and the empowered politicians respectively studied equilibria with ever more refinement and trumpeted the superiority of their various national groups with ever more sustained voluntary, Hobson despaired that insatiable needs of the market economy led inevitably to imperialism and, ultimately, war. In this prediction, for his times, he was sadly correct: the grabbing of foreign lands that surged in the late 19th Century did, indeed, climax in war -- the convulsions of World War I, 1914-1918.

Hobson's first book, *The Physiology of Industry*, co-authored by A.F. Mummery, suggested that national economic prosperity was limited not so critically by land, as Malthus had decreed, but rather by savings. The focus becomes the distribution of income, and the discovery is that it is wanting not just ethically but economically as well. With growth and prosperity, the rich get so rich that they cease to find any spending uses for their wealth, saving a substantial fraction of their incomes as a consequence. This saving will not make it into domestic investment and additional employment, as Smith had happily assumed, because there is no incentive to produce more when both the poor are too poor and the rich are too rich to buy/consume any of this extra output.

While Mummery helped educate Hobson in a bookish way on the problems of income distribution and overall consumption, Cecil Rhodes and Africa pointed him in real life fashion towards a "solution". An aggressive Anglo railroad and empire builder in South Africa, Rhodes rationalized The Empire as a safety valve or vent for population pressure and surplus English labor (the US analogue was "Go[ing] West, young man," to the American frontier for Horace Greeley). Although most of his journeys were internal, Hobson traveled to Capetown and Johannesburg and met with Rhodes shortly before the Boer War (1999-1902). Returning to England, he wrote about this war and jingoism in

Hewitt paid the initial bills for the American Economic Association, which Ely help found in 1885.

Illustrating the breadth of the "no free lunch" dictum, however, was Ely's inheriting, at considerable expense to himself and to economics and history, a feud and a fury as the price for all this assistance and largesse. The feud was with Henry George, the fury with his ideas and their supporters. Gilman and Cornell had early scores to settle with George, and Hewitt so loathed the man and his positions that he became "a candidate for Mayor for only one purpose. I regard the election of Henry George as Mayor of New York as the greatest possible calamity." He won the election, thereby ceasing Congressional service continuous, less one term, since 1874.

Meantime, although credited with starting the AEA, being one of the most influential teachers of his day, and popularizing the study of economics, Ely came to be persecuted and threatened with losing his job at Wisconsin in 1894 for his allegedly socialist positions. He did not lose his job, he did lose his socialism, he did not lose its protective cover. In many ways, with time, Ely had, as we shall see, become a supporter of unbridled robber-baron capitalism. His former allegiances have kept many convention-bound economists from recognizing this seismic shift.

Even the prelude to World War I, but especially the war itself, tarnished the attractiveness of German culture in the Unites States, and Ely fell back and regrouped. In 1920, he founded a new discipline he called "Land Economics," and sought and received funding from major land-grant railroad corporations for an associated institute and journal.

The major theses Ely's Land Economics advanced are these:

a. land, as Clark asserted, is basically the same as other factors of production, especially capital;
b. it has little value, and, as Walker observed, that little is falling towards zero;
c. its market is efficient;
d. its distribution is . . . ???
e. tenancy is such a good arrangement that one-third or more of all farm and other business land should be worked in this form;
f. taxes on land should be lowered, and they must not be raised without compensating landowners in advance for the presumed loss of value;
g. taxes on sales and payrolls, on the other hand, should be increased ;
h. "land speculation" (in the sense of withholding land from the market) is socially beneficial: much like fine wine and timber, the land is "ripening" into a higher use during this time;
i. the costs (interest and property taxes, in the main) of buying and then holding land are "ripening costs," socially useful and deserving of reward;
j. taxes on ripening land are inappropriate because they tend to "force the market" (cf. Edgeworth), causing premature development; and
k. high land prices are desirable because they promote capital formation.

general and began to synthesize these observations with the theory he and Mummery had developed some time earlier.

The result was the publication of *Imperialism* in 1902. Continuing both analysis and prognostication, Hobson modifies Rhodes' "vent" to be one for surplus savings rather than surplus labor. Imperialism has become, he decided, an economic necessity for developing nations. By providing both new outlets and new consumers for all those savings of the rich, it provides a solution to the underconsumption that would otherwise limit or destroy their growth.

For this work, Hobson was quickly cast out of English academia, with Edgeworth leading the charge. Those in the fold at "Oxbridge" were preoccupied in the present with what would come to be called "Microeconomics", full of mathematics and abstraction and equilibrium conditions, and more sanquine or neglectful in general about the future. It would take thirty years, the Great Depression, and John Maynard Keynes to make the idea of underconsumption acceptable at Cambridge. Although Malthus had already seen worsening conditions ahead, albeit stressing the limitations of land combined with the fecundity of humankind, Mill had been on a completely different page: for him, "scarcity breeds substitution," a growing population sets the stage for new investment opportunities to substitute capital for land and create new jobs for labor and Marx had already identified problems with overall consumption. Marxists quickly embraced Hobson to give their "ism" a boost and Lenin published his own versions of *Imperialism*, with the added and ominous tones of inevitability. The Soviet paranoia, 1918-90, was indeed based on this dogma: if Imperialism was inevitable, it was incurable – except by the conquest of capitalism by the communist USSR.

Nonetheless, the theories were suspect not only because they challenged academic writ. They also have weaknesses internally. The necessity of Imperialism and the consequence of War was already denied by empirics: Europeans had often moved their capital to many lands without conquest – one prominent example being all the investment they undertook in North America, even after the American Revolution, even after the repudiation of many US debts with the crash of 1837. And the colonies were incidental to the outbreak and raging of World War I, centered in Europe.

Moreover, in the main, colonies appeared to cost more than they benefited. Why, then, did nations really want them? Because they paid off handsomely for a few, and these few were able to manipulate and lead along the many, exploiting honorable but misguided instincts of patriotism and national defense. And perhaps because of Cultural Imperialism as well.

Perhaps, but perhaps not. "Democracy," "free trade," "liberalization," "economic development," "green revolutions" . . . these may be no more than new code words for the old desire either to acquire, hold, or recapture private property – as in Cuba and Viet Nam; or to privatize and acquire public property – as in Russia.

Another motive is the desire by both nations and firms to control (or own) its own supply of raw materials. The concept is one of vertical integration, where it is better to

incorporate earlier stages of production or ownership of inputs than to rely on free markets in raw materials for their supply. Harkening back to the days of Mercantilism, here is something that really *does* lead to warfare, in the most direct and obvious of ways.

Among the few who decidedly benefit, then, from different and differently labeled forms of colonization are multinational corporations, some of which are now growing more powerful than many nations. This phenomenon is not new: it occurred both in general with the Renaissance in the 15th and 16th Centuries and in particular with the East India Company in the 18th. One might say that the shift has been away from raw materials to outsourcing, in recognition of the growing competition of Third World labor with US labor. But one would then reflect on the rising pressure to intervene militarily in response to current tensions in the Mideast, environmental concerns and the rising price of oil and perhaps think again.

In what senses, if any, have the colonies themselves benefited from Europe's "investments?" The effect of Britain's export of its system of law seems on the whole salutary. Economically, it should be noted – and therefore is – that Manila, Latin America, and Saigon are examples of how transported development can fail; while Japan, Taiwan, S. Korea, Singapore, Sydney, and Johannesburg indicate the possible success of indigenous economic development.

ALFRED MARSHALL
(1842 – 1924)

The economists of Victorian times, as we are beginning to see, were a varied lot. Some were "academic" in the many and varied senses of that good term; others were not. Some were focused and precise, with a rigor implicitly if not explicitly mathematical; others were not. The problems that interested some were those of individual decision-making in the context of determined culture and law, while others studied, and predicted, change, even paroxysms in those givens. In each case, Marshall was part of the "some," and none of the "other."

It is especially to Marshall that today's economists, academic and otherwise, owe the concepts that every micro problem must be analyzed with both *blades of the scissors*, *supply* and *demand*; that individual choice on both sides is relevant and rational; that the *firm* is an appropriate unit of analysis, and that the *short* and *long run* are insightful distinctions. With Marshall, the broad sweep (often associated with a certain sloppiness) of *political economy* narrows and refines into the narrower subject of *economics*, and particularly that subcategory of economics called *microeconomics*. We shall proceed to analyze these concepts, commenting throughout on both their continuing value and their continuing and largely lamentable consequences for our Land Question.

Edwardian England generally includes both the reign of King Edward VII, 1901-10, and the first years of the regnum of King George V, 1910-14; Marshall, again generally, reflects the temper of these times when old guarders conducted a long strategic retreat in the face of aggressive radical offenses. As one of Cambridge's most distinguished professors from 1885 to 1908, he insisted that prices are determined not only by cost-side values but by those on the demand side as well, in proportions quite dependent on time. In methodology, this "Great Compromiser" straddled the fence between classical political economy and neoclassical economics, smoothing the transition between the two. By nature and in his policy recommendations, Marshall was both conservative and compassionate, bending and understanding, an adherent of *noblesse oblige*. His conservatism one could call "passive," as distinct from "aggressive" or "predatory," for its roots lay in not wanting to disturb existing institutions very much rather than, say, wanting to seize public lands for private profit. And in his compassion, he was more "liberal" than many of today's "liberal Republicans," identifying the elimination of poverty as a major goal of economic policy. Ultra-Liberal Democrat LBJ could indeed have found the roots for 1965's "War on Poverty" in Marshall's *Principles of Economics*, the first edition of which was published eighty-five years earlier.

In continuing to analyze three factors of production, land as well as labor and capital, Marshall is a Classical Economist, quite different from such somewhat militant and overtly Neoclassical Economists like Americans Alvin Johnson, Frank Fetter, and Frank Knight, whose studies conform to the two-factor analysis of J.B. Clark. However, in changing the basic production unit of study from a parcel of land to a firm, his analysis leads to consequences much the same. The previous manner of going, "productivity

analysis," is wont to hold a unit of land constant and study the productivity of variable additions of labor and capital. With Marshall (see Appendix), "cost" curves tend to replace "productivity" curves. Behind the latter, any of the factors may be held fixed, with their proper choice dependent on "time." In the shortest of "runs" -- "now," everything except, perhaps, the choice to sell or not to sell is fixed for the firm; in the longest of runs, all is variable, including the existence of the firm itself. The analysis is brilliant (and very important, inter alia, in the matter of tax incidence –"writing the check" is quite different from truly paying the bill in the economic sense; see, again, Appendix). Further, Marshall's apparatus supports the important distinctions between average and marginal costs and utilities, with most outcomes determined "on the margin." ("To be or not to be" in continued existence as a firm will be a matter of how average costs compare to prices.) The difficulty is that, in the hands of the less skilled – and most of us are less skilled than Marshall, the focus on individual firms (albeit aggregated into markets) and the variability of all factors to those individual firms in the long run can blur the important distinctions among land, labor and capital and make us forget the inherent fixity of land, absent invasion and space exploration, to the larger units of a city, a nation, a planet. We might think, many of us have thought, that, whereas "firms" may add land to their production mix, much as they add labor or capital, and whereas economies are just collections of firms, ergo (by strong implication) economies, nations, and the whole world may add land at will. They, it, cannot.

You see, for all that Marshall introduces important distinctions of time frames to analysis, his work is also importantly, ironically, *ahistorical.* There is a *static* element to his theory, much like Clark's, and in this sense it is neoclassical, if three-factored. Not for Marshall, the study of broad stretches of history, or even booms and busts, even though, in his long lifetime, England experienced political revolution as labor earned the vote and learned how to use it, Ireland boiled over repeatedly, achieving Home Rule under Michael Collins, the crash of 1893 devastated lives, Germany challenged the British navy, with a consequent and expensive naval race, World War I erupted, concluded and reconfigured nations, and the Russian Revolution rewrote history and a variety of 'isms. He is silent on secular "Laws of Motion;" like Clark, he leaves the profession unprepared for the Crash of 1929, five years after his death (although he does help train one of the economists who would help us grapple with the macro issues of cycles of unemployment). In brief, although Marshall lived in exciting, dynamic times, he viewed them in tranquility, with equanimity, as befits his general manner of going, personally.

Marshall's focus is equilibrium, not disruption. With his motto, "*Natura not facit saltum,*" the curves he draws are continuous and today's analysis would probably decree that any slight perturbation of his equilibrium would alter it only temporarily. Stability is the order of both his emotional and his mental day.

When Ricardo analyzes rent, as we have already seen, he takes the price of "corn" as given – graphically, a flat curve, if price is on the vertical axis and quantity on the horizontal, as has become conventional. With this set-up, the cost of production on the margin comes to equal fixed price, and the graph is quite useful to show that, as inferior land comes into production, the earlier and superior plots are rewarded with rent.

Economists now examine how this rent gets capitalized into the prices superior units command as they change hands, so that the tendency is for average costs to rise to price and profits to fall to zero when markets are competitive; rent in this sense disappears for the firm; but it remains for the nation – unlike the insight into this persistence.

Instead of focusing on productivity, fixing prices to enhance this focus, Marshall bears his keen gaze down on equilibrium prices and how they are set by the interaction of Supply and Demand. Supply continues to be a marginal matter (not "trivial," as in common parlance but rather an extremely important matter of "extra"'s, as in the economist's careful lexicon), and now Demand becomes one as well, as consumers/buyers calculate margjnal utility (the extra happiness gained from acquiring an extra unit) and compare it to the extra cost (the price, in competitive markets).

Instead of continuing with these clumsy parentheticals, the writer will here pause and comment directly on how unfortunate it is indeed that some of the most important technical terms in economics are also words used outside the discipline with very different meanings, if their own form of discipline. The resultant confusion is one reason that economics, really only "structured common sense" unless in graduate school, where it becomes "common sense often structured to a nonsensical degree", can become so speciously difficult to some. Just consider the following: *utility*, *marginal*, and *rational*. *Utility*, to economists, has nothing directly to do with *utilitarian*. Goods have utility if they give pleasure, and may be quite distant from what others would call "practical". *Utility* means happiness, and perhaps the profession would be better off if it had adopted Pigou's suggested *omphalimity*. *Marginal*, as above noted, means "extra," not "on the fringe" or "barely acceptable." And *rational* describes the calculating activities of *homo economicus* in trying to maximize xer happiness by doing something only if the extra benefit it generates is worth at least as much as its extra cost. In this cost, out-of-pocket monetary price may be less important than *opportunity cost*, what could not be chosen because this activity or item was selected in its stead. Also note that *quantity demanded* refers to the amount consumers will buy at any price (holding other relevant factors constant), while *Demand* refers to the whole schedule of prices and quantities. When Demand becomes a function of marginal utility (and income and substitutes and complements), it then becomes a curve with a negative slope: *ceteris paribus*, the higher the price, the lower the quantity demanded. (Note: a *shift in Demand* means movement in this curve (perhaps in response to a change in income), while a *change in quantity demanded* means movement along this curve (definitely in a response to a change in price. The same distinctions hold for *quantity supplied* and *Supply*.) Equilibrium prices and quantities are found where Supply and Demand intersect. At any price below equilibrium price, more is demanded than is forthcoming, and competitive forces will work up the price; at any price above equilibrium, more is supplied than will be purchased, and suppliers will compete among themselves to bid the price down. At any quantity below equilibrium, the last unit is worth more than it costs, and, responding to the profit motive, suppliers will start to provide more; at any quantity above equilibrium, the last unit is not worth its cost to consumers, they won't buy it at that cost, and suppliers will respond by cutting back. (See Appendix.)

A new source of rent has now been identified. Called *consumer surplus*, it is the area under the demand curve and above the price line, to the left of equilibrium. All units are bought at equilibrium price, but each earlier unit is worth more to consumers, and they would accordingly have been willing to pay higher prices for the earlier units. Consumer surplus equals total utility measured in money terms minus total cost in the same terms. Readers adept in calculus can derive the formula for consumer surplus by noting first that, by reflecting marginal utility, the demand curve is the derivative of a total utility function, and second that price multiplied by quantity equals the total cost to those who purchase the product.

The slopes of both demand and supply curves change, Marshall observes, with time. In the *short run*, very little is variable, much is fixed. Any expansion (or contraction) will then occur more awkwardly than it can in the longer haul, so the response to price changes will be less substantial than over time. At its extreme, one instant in time and with perishable goods, the supply is fixed, so the curve is vertical. No change in price can increase (or decrease) supply, and all "income" is "rent" or, as Marshall says, *quasi-rent* -- rent that exists in this short run, when some factors are fixed that can be varied over time. (When goods can be stored, this fact can re-introduce responsiveness to price (*price elasticity*)). A vertical demand curve would represent *need* for a product, but most of what we think we *need*, including food, we actually *want*, and less at a relatively higher price. Consider, here, all the purchases of calorie-free, caffeine-free, sodium-free colas, where what is purchased is liquid and taste, not nourishment.) With more ample time, the quantity response to higher prices is itself higher: more inputs are variable and consumers are more able to change their packages of purchases. The sense is summed up in the old saw, "There are many ways to skin a cat' – especially given time.[1]

In Marshall's world, adjustments are incremental in economics, as in nature. There are no discrete changes, no mutations, no quanta, no explosions, no crises, no chasms to cross nor cliffs to scale -- just fine, continuous change, as in calculus, Newtonian physics, or Darwinian evolution. Discrete calculus, quantum physics, and the discovery of gaps and leaps in evolution have come along to challenge continuity in their various fields. Nature does, in brief, leap. Some might say that when Marshall divided time into two distinct parts, short and long runs, the challenge to his work was immediate, and self-imposed. Such critics need to understand that all theory abstracts from and therefore simplifies "reality." The question is whether Marshall's heuristic devices capture more than they lose. In able hands, they do, well illustrating the central point that flexibility is a function of time and so, therefore, are quasi-rents.

One result of "Nature makes no leaps" is to keep economic analysis and its conclusions safely inside the psychological "comfort zone," a place attractive to many. It does, however, repel others, and for two good reasons: it eliminates the drama, excitement, and

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[1] If goods are defined narrowly enough so that substitution is infinite, supply or demand could be horizontal. A horizontal demand curve would, of course, eliminate consumer rent or surplus, but not producer rent, while a horizontal supply curve would eliminate the rent but not the consumer surplus.. (One analysis of the vast size of the snack offerings at movie theatres with their captive customers is that they represent *all-or-nothing demand curves* that scoop out all of the consumer surplus by offering no incremental choice.)

challenge of major crises and shocks, and it nurtures skepticism about possibilities for grand reconciliations like those described earlier by George and later by Keynes and Laffer.

As we have excused the lapses and celebrated the discoveries of earlier economists, however, so shall we do with Marshall. Handy with math, he also knew better than to assume his readers were adept as well, and he wrote for these readers. His emphasis on the margins of both utility and cost, his insistence on using both blades of the scissors for any cutting analysis, his observation that with time comes flexibility for both consumers and producers, and his shift in focus from productivity curves to cost curves (the latter, of course, underlay by productivity considerations) were, and remain, brilliant.. Many are the lesser thinkers who see far because they sit on Marshall's shoulders, and their macroeconomic insights are all the brighter for his microeconomic foundations.

And yet, and yet . . . when one focuses on the representative firm, for which all inputs to production can be increased if time itself increases, the hazard is in forgetting that one key input, land, cannot be infinitely expanded, even for a nation, even for an imperialistic nation. Land, then, tends to be treated like capital, a durable good, a product of savings and investment. True it is, that land represents a cost to each firm, but true it also is that land is ultimately a gift of Nature, with no cost of creation to humankind as a whole. Not all micro insights aggregate in a straightforward manner into macro realities. Marshall's Three-Factor Economics therefore tends to slip into Two-Factor Economics, Classical Economics into Neo-Classical Economics. Tends to, and did.

THORSTEIN VEBLEN
(1857 - 1929)

Perspective implies a certain distance, does it not? And although our next economist, Thorstein Veblen, was impeccably educated at Carleton College for his B.A. and at Yale University for his Ph.D. (in philosophy?), this distance from the Establishment he certainly managed to possess, maintain, even consciously cultivate. As Robert Heilbroner writes, "Other economists – and this includes both Adam Smith and Karl Marx – were not only in their society, but they were *of* it...Not Thorstein Veblen" (p. 219). In this sentiment, Heilbroner echoes one of Veblen's greatest students, Wesley Clair Mitchell, who called his teacher "that visitor from another world...No other such emancipator of the mind from the subtle tyranny of circumstance has been known in social science, and no other such enlarger of the realm of inquiry." (pp. 246-7)

The wherefores of Veblen's "alienation" – his . . . peculiar . . . personal hygiene, his taste for the ladies and distaste for the day's standards of propriety as regards interacting with them – these are far less important for our purposes than the consequences of his distance. Instead of accepting the assumptions of economists before him, and then refining the derivations therefrom, Veblen questioned these starting points, again and again and again. Instead of beginning, as Heibroner concisely puts it, with the "economic play", he examined the "players", in an approach "almost anthropological" (p. 221).

Living in the time of the mighty Robber Barons, employed by a university – Chicago -- funded by perhaps their greatest eminence, he was still able to excoriate their behavior, place it in context, writing even more compellingly because of an ability to tweak perspective provided by his remarkable, and sarcastic, sense of humor. Add to this package a brilliant writing style, and you have an original, powerful, insightful and influential thinker, one of the first truly American economist – as compared to one living and writing in America but with European vision and in European terms.

Veblen's most influential writing appeared in 1899, with *The Theory of the Leisure Class*. Most notably, in this volume, he introduced the concept of "conspicuous consumption," that consumers actually buy something because of its high price. At first gasp, this notion threatens our beloved tool, the downward-sloping demand curve. Don't quantities demanded decline as prices rise? Today's Chicago economists can reconcile the two views, and do so thusly: buying at a high price is a sign of commanding purchasing power, itself highly desirable. But there are as many ways to achieve prestige as to skin a cat). As the relative price of Mercedes rise, snobs will buy yachts or Porsches instead. Although a *high* price, in other words, may be "good," a *rising* price puts in play the powers of substitution.

But when many of our consumer "needs" are, in reality, just "competitive, pecuniary, emulation," so that most consuming is dominated by the drive to gain or maintain relative social standing, rather than the individualized "felicific calculus' of Edgeworth, then what we have in these self-validating efforts to keep up with the Joneses is an endless,

fruitless spiral of waste. In today's terms, our utility depends not just on what we consume, but on how that consumption compares to what others are doing. Consumption then becomes another kind of disequilibrating "positive feedback," one that can make life an endless rat race. Taking the form of acquisition – the biggest balance sheet, the vastest land, the most power, it can make any population, however small, run up against Malthusian sorts of limits – a point stressed by "green" parties today, but neglected by Veblen himself. The discoverer/labeler of this phenomenon, however, refused entry into this sort of competition. If anything, he competed to be the most penurious in all creature comforts except those provided by an almost constant parade of women through his life.

In questioning the concept of "consumer sovereignty," Veblen attacks the only value venerated by both neoclassical economists and "underconsumptionists" like Hobson and Marx. He parts additional company with Marx by providing a theory of social stability and cohesion in marked contradistinction from the German's theory that the proletariat and the capitalists are irretrievably, and violently, at odds.

This even deeper inquiry, why the exploited tolerate a leisure class riding on their backs, has many modern equivalents. Why do we even consider voting billionaires into office, their fortunes made by inheritance, hard work or marrying "up," but arguably maintained or amplified by government action? Why do we respond favorably to political ads, when we know politicians have to sell themselves to pay for the airtime? Why do we vote to disenfranchise ourselves, as in California's Proposition 218, in 1996? Why do we let Congress through the IRS give loopholes to property income, raising taxes on payroll?

Why, indeed. Veblen has a theory, and it's a strong departure from anything Marxist. While Marx introduces the destabilizing, nay revolutionizing, antipathy of the proletariet for the capitalists, Veblen produces a model of social stability. Workers, to Veblen, submit to the *rentier*, who exploits them, out of grudging admiration. They despise work, and must be paid wages more for the indignity of labor than for its irksomeness. They want not to overthrow but to join the ranks of the leisure class.

As we are poised to elect two of the four millionaire white males to lead the country, Veblen's theory is hard to resist. But how has this remarkable cohesion of attitude come to prevail? Here this "man from Mars" adopts the perspective of the anthropologist. Veblen rejects the *homo* economicus of the neoclassical economists as an imaginary construct of theoreticians blinded by mathematics. Observing real behavior as swayed by more primitive, atavistic emotions as well as by envy, he stresses that humankind is social, custom-bound, and less than rational – little if at all like the coldly robotic and calculating "pleasure-maximizing machines" of Edgeworth. Veblen discusses subjects like tradition, ceremony, symbolism, hypocrisy, advertising, cosmetics, customs, emulation, team spirit, family clans, military bands, social standing, folkways and mores, fads and fashions, group values, image, "vicarious leisure," cults, credibility, fraud, ethnic loyalty, ornamentation...the stuff of real life. As a member of academia who understood what the Clarks and Edgeworths and Marshalls were saying, Veblen could not be easily dismissed as simply someone who just didn't get it. He got it, all right; he just didn't buy it. There's a world of difference.

When Veblen uses this perspective to study "primitive" societies without a leisure class, he finds work to be admirable in their eyes. Not only does it stave off starvation, it provides pride in craftsmanship, in a job well done. But the attitude changes in pre-industrial societies with leisure classes. "Leisure," we note here, is as misleading a term for most of us as "rational" and "utility." For members of the leisure class are emphatically not doing the old-time equivalent of watching "Oprah" while munching on bonbons. Rather, they are energetically, almost exhaustively, involved in what today we might call "rent seeking," and what Heilbroner deems "the winning of wealth by force," a behavior "predatory," not "productive." Conspicuous consumption, or, perhaps more properly, conspicuous *waste* in this model is a good (relatively efficient?) way of announcing to society that they are successful predators, and society applauds this achievement as a the modern equivalent of the personal strength so prized in battle before laws replaced swords as the most common form of adjudicating differences. Veblen, himself of Viking stock, despises modern-day predators and sees the awe and respect they are accorded as a dangerous, distasteful but widespread sort of atavism.

In Veblen's day, robber barons like Gould, Vanderbilt and Rockefeller (the funding founder of the University of Chicago, his employer when he published both his major works) were busy creating not production but claims to production. Veblen's 1904 *The Theory of Business Enterprise* excoriates businessmen for being interested only in grabbing profits, not in producing goods. In a high-finance version of the later Schumpeter, he finds that in pursuit of this ambition, they willfully disrupt production to take advantage of the consequent variability of stock value. Among the counterproductive aspects of business leadership, Veblen includes their roles in monopolies, cartels, bureaucracy, false advertising and other exploitations of credulity, unearned income, and absentee ownership.

Beginning not with Ricardo's or Marx's competing interests but rather with the *machine*, Veblen may find human nature decidedly neither rational nor robotic but asserts that production is indeed, well, mechanical. Engineering, science and mechanics are the fields he predicts the machine will elevate in value -- and with them, their practitioners. There should eventually be no place for predators, warlords, traditionalists and ritualists. Indeed, engineers are the leading workmen of modern society, imbued with an instinct of workmanship, oriented towards producing goods.

A corporation, to Clark, is just another "economic agent" or "firm," following the same rules as Adam Smith's atomistic proprietors, protected by the 5th and 14th Amendments, properly enjoying both the rights of actual persons and immunities beyond their reach. Nonsense! says Veblen. A corporation, actually, is a combination of properties working in concert, unavoidably amassing great market power. Businessmen are, at base, predators. Their corporations can, and do, stiff creditors and pensioners by declaring bankruptcy, while they remain vastly wealthy. Corporate officers are nearly immune from legal responsibility for the action of the companies they control. The corporation is a new and menacing form of property, one that does not fit nicely into free market theories. The world has changed, and so should the theory.

For many years, *institutionalists,* many of them followers of Veblen, did as he commanded and modified theory to encompass such uncomfortable facts. A century later, however, with transnational corporations bidding to rule the world, more and more economists, following neoclassical rules, are shutting their eyes to the matter. Veblen may have made a more enduring mark in the explanations he essayed in crashes and depressions. The student we have quoted earlier, Wesley Mitchell, pioneered the intensive statistical study of business cycles, founding the National Bureau of Economic Research. Mitchell, among others, considered Veblen the father of cyclical research. Keynes was later to insert an echo of Veblen's views of humankind, "animal" rather than "rational" spirits of investors into his analysis of stock market booms and busts.

The days of the corporation may not be numbered, in Veblen's eyes, but those of the predatory capitalists are. Unlike Marx, he does not source their destruction in the powers of proletarians, but rather in those of production-oriented engineers and technicians who understand machinery. The key force in Veblen's world, he thinks, is the combination of science and technology, which will be harnessed by engineers, not predators. The descendents of yesterday's buccaneers will, in his view, become mere "ornamental functionaries," like the do-nothing kings (*rois faisneants*) whom Saint- Simon denigrates for their lack of the true productivity he reveres and who finally lost power to their ministers and mistresses. Apotheosizing engineers, as uncritical of them as he is critical of almost everyone else, as we've seen above, Veblen, for all his phlegm in other matters, ends with the sunny prediction what engineers will finally beat out the captains of industry, the financiers and the lawyers, leading to an economy of abundance. No dismal scientist, Veblen – at least in this regard.

Lots of Veblen's future is now past, so far denying engineers the leadership he would accord them – unless we consider the term to encompass government bureaucrats. In public works, it is true, civil engineers have great authority, including the power to get away with huge cost overruns. In an evolution exposed by the institutionalists mentioned *supra*, corporate managers and accountants have played the role of his engineers, dominating both the customers and the nominal owners, the shareholders. And today's computer programmers seem on their way to joining this power elite.

Reserving his admiration for the engineers of today and the craftsmen of yore, Veblen does not spare his academic peers from mockery (so much for that central assumption of modern economics, the pursuit of self-interest, at least applied to this academic; so much for pay and promotion). Considering the universities in which profs prosper to have devolved into promoters of public relations and football (but do note that the president of the University of Chicago declared that a university has either a good president or a good football team and then abolished the latter), he talked about subtitling a book on higher learning "A Study in Total Depravity." The field of economics he deemed at best ornamental and hidebound (a view later shared by President Truman); at worst, venal and hypocritical, rationalizing leeching and preying by confusing them with workmanship and saving (a view later shared by Labor Secretary and Veblen disciple Ray Marshall).

Regnant when he wrote, Clark, Edgeworth, [Alfred] Marshall and Ely were recipients of most of his barbs.

Two of these Neoclassicists, Ely and Clark, were visible churchmen. Veblen likens the faults of academic economics to those of organized religion, thus alienating the clergy and pleasing the anti-clericals. In these views, he follows the tradition of Adam Smith, who wrote equally scathing criticisms of the state-supported churches of Europe in 1776, but did so without incurring commensurate wrath. Atheism, Agnosticism, Deism and Unitarianism are probably weaker today than they were two centuries ago. No modern US president would reveal the agnosticism of Washington, Jefferson, Franklin and others of the founding fathers. In 1884, the Republicans asked renowned atheist lecturer Robert Ingersoll to nominate their candidate James G. Blaine. The modern equivalent would be Madalyn O'Hair nominating Bill Frist.

In 1923, Veben published *Absentee Ownership and Business Enterprise in Recent Times: The Case of America*. (A translation of an Icelandic saga is one of the few works to be presented even later to the public.) This book continues to develop Veblen's theme about the transforming character of technology. It talks about waste in the private sector and presages a Chicago theme about how many resources are "wasted" in maintaining monopolies. In lapidary prose, it also brings to the fore topics particularly relevant to our interest in land.

Just consider the following:

> Real estate is the one community interest that binds the townsmen with a common bond; and it is highly significant – perhaps it is pathetic, perhaps admirable – that those inhabitants of the town who have no holdings of real estate and who never hope to have any will commonly also do their little best to inflate the speculative values by adding the clamour of their unpaid chorus to the paid clamour of the professional publicity-agents, at the cost of so adding a little something to their own cost of living in the enhanced rentals and prices out of which the expenses of publicity are to be met.
>
> Real estate is an enterprise in "futures," designed to get something for nothing from the unwary, of whom it is believed by experienced persons that "there is one born every minute." So, farmers and townsmen together throughout the great farming region are pilgrims of hope looking forward to the time when the community's advancing needs will enable them to realize on the inflated values of their real estate, or looking more immediately to the chance that one or another of those who are "born every minute" may be so ill advised as to take them at their word and become their debtors in the amount which they say their real estate is worth. The purpose of country-town real estate, as of farm real estate in a less extreme degree, is to realize on it. This is the common bond of community interest which binds and animates the business community of the country town. In this enterprise there is concerted action and a spirit of solidarity, as well as a running business of mutual manoeuvring to get the better of one another. For eternal vigilance is the price of country-town real estate, being an enterprise in salesmanship.

Aside from this common insterest in the town's inflated real esate, the townsmen are engaged in a vigilant rivalry.... (pp. 143-4)

In a footnote, Veblen observes: "'The great American game,' they say, is Poker. Just why Real Estate should not come in for honorable mention in that way is not to be explained off hand...But even persons who are laymen on both heads will recognize the same family traits in both." (pg. 143)

Page 145 continues: 'The conscientiously habitual overstatements of the real-estate interests continually draw new trader's into the town, for the retail trade of the town also gets its quota of such persons as are born every minute, who then transiently become supernumerary retail traders."

A little later (pp. 146-8), Veblen wryly observes,

Which [waste of overhead] is perhaps to be deprecated, although one may well hesitate to find fault with it all, inasmuch as it is a simple and obvious outcome of those democratic principles of self-help and cupidity on which the commonwealth is founded. These principles are fundamentally and eternally right and good – so long as popular sentiment runs to that effect – and they are to be accepted gratefully, with the defects of their qualities. The whole arrangement is doubtless all right and worth its cost; indeed it is avowed to be the chief care and most righteous solicitude of the constituted authorities to maintain and cherish it all...

(pp.151-2) [T]he habits of thought engendered by the preoccupations of the retail trade have shaped popular sentiment and popular morals and have dominated public policy in what was to be done and what was to be left undone, locally and at large, in political, civil, social, ecclesiastical, and educational concerns...[D]emocracy, at least in America, has moved forward and upward to a higher business level, where larger vested interests dominate and bulkier margins of net gain are in the hazard. It has come to be recognized that the country-town situation of the nineteenth century is now by way of being left behind; and so it is now recognized, or at least acted on, that the salvation of twentieth-century democracy is best to be worked out by making the world safe for Big Business and then let Big Business take care of the interests of the retail trade and the country town, together with much less.

(pg. 157) One must be circumspect, acquire merit, and avoid offense. So one must eschew opinions, or information, which are not acceptable to the common run of those whose good-will has or may conceivably come to have any commercial value. The country-town is conservative; aggressively and truculently so, since any assertion or denial that runs counter to any appreciable set of respectable prejudices would come in for some degree of disfavor, and any degree of disfavor is intolerable to men whose business would presumably suffer from it. Whereas there is no (business) harm done in assenting to, and so in time coming to believe in, any or all of the commonplaces of the day before yesterday.

(pg. 164) [I]n any community of men, the professions made and insisted on will unavoidably shape the effectual scheme of knowledge and belief. Such is the known force of inveterate habit. To the young generation the prescriptive holdovers are handed down as self-evident and immutable principles of reality, and the (reputable) schools can allow themselves no latitude and no question. And what is more to the point, men and women come to believe in the truths which they profess, on whatever ground, provided only that they continue stubbornly to profess them. Their professions may have come out of expedient make-believe, but, all the same, they serve as premises in all the projects, reflections, and reveries of these folks who profess them. And it will be only on provocation of harsh and protracted exposure to material facts running unbroken to the contrary that the current of their sentiments and convictions can be brought to range outside of the lines drawn for them by these professed articles of truth.

We have quoted at length not only because of Veblen's superior writing style. We also suggest that, in the twenty-first century, many of our assumptions, implicit and otherwise, will not "bear the light of alien scrutiny." (pg. 164) Are landowners the new predators we now seek to join rather than overthrow?

Law, among other things, is the outcome of human interactions, and some humans are more powerful than others. Taxes are kinds of laws. Ever think about the fact that George Washington was one of history's greatest landowners? And that, although all men are created equal, only men of property were originally allowed to vote?

In the last half of this book, we shall develop some of the consequences of the speculation in land that Veblen, as well as George, have developed. They, and other aspects of the Land Question, shall challenge some of our basic beliefs. And none too soon: "all the while the material conditions are progressively drawing together into such shape that this plain country-town common sense will no longer work." (pg. 165)

As Ben Franklin said, and Veblen has echoed, we complain about taxes, but are taxed more by our own follies than by the government. Not only Veblen's outsider status and crisp writing but also his humor help us re-examine ourselves. Humor tweaks perspective. Let us continue to tweak our own.

The tale of the railroads is also the tale of land grabs and absentee ownership, indeed publishing a book of that title in .

This is an excellent piece by Adele Wick, perhaps intended as an introductory chapter

John Maynard Keynes
1883 – 1946
Keynesianism
1934 – 1980
and Macroeconomics
1934 -

Not just "culture" was roaring in the '20s – so was the economy. Nowhere in the world had an average citizen ever before been so prosperous. Never before had the stock market seemed so easy, cheap and quick a ticket to fabulous riches. Four decades before President Lyndon Johnson began a government war to end poverty, President Herbert Hoover thought no such public policy was necessary: he assured Americans that the combination of God and the private economy made us "within sight of the day when poverty will be banished from the nation." (H, 248-9) Another politician, John Raskob, chairman of the Democratic party, added admonishment to assurance, asserting to men and women alike (albeit in the *Ladies Home Journal*) that "Everybody Ought to Be Rich." He even provided a simple plan: investing $15 a week in "good common stocks." (H, 249) Even one of the Dismal Science's most distinguished practitioners, Irving Fisher of Yale, threw customary caution to the winds and waxed eloquent about the economy's "permanently high plateau." (H, 251)

Exactly one week later, Black Tuesday challenged this optimism. The stock market collapsed in the last week of October 1929; in two months, it lost all of the value it had gained in two years of exuberant growth. The wealth had indeed been "fabulous", much of it – most of it -- on paper only, a fable only; the Great Depression had begun. It continued, and continued, and continued. From $87 billion in 1929, national income fell to $75 billion in 1930, $59 billion in 1931, $42 billion in 1932, and $39 billion in 1933. Average income retreated to its levels of *twenty* years ago. National unemployment reached 25% of the workforce, and even this appalling statistic understates the magnitude of the problem: you have to be registered as looking for work to be officially unemployed, and why register, why look, if the odds are so against you? Further, even a higher percentage of Americans with jobs were "underemployed," working well beneath their skill levels – and previous wage levels. Proud men pretended they still had their old jobs; proud men committed suicide. The only thing on the rise besides unemployment was the associated black humor.

As we have remarked at the beginning of almost every chapter, one of the most distinctive and appealing aspects of economics and the practitioners who have moved it forward is how actual problems of the day have inspired theoretical advances to explain them, with this new understanding then used to develop policy recommendations to bolster progress and ameliorate poverty. When employment and income, stocks and skirts were all on the rise, economists turned abstractly academic, honing their skills on market equilibrium, relative prices, efficiency. These subjects have come to be known as

"Microeconomics." Growth was assumed, but time was eliminated – and with its elimination, that third factor, "land", was rendered indistinguishable from that second factor, "capital". In addition, however, to black humor and an astonishing deepening of the arts, the Great Depression gave rise to "Macroeconomics," pushing a renewed interest in economic cycles and stability to center stage and challenging Neoclassical Economics' rosy assumptions that flexible prices would prevent both long-term shortages and long-term surpluses of any product, including labor.

The lead actor on this stage was John Maynard Keynes. A Brit of prodigious natural talent, an extraordinary percentage of which he developed into actual achievement in areas as disparate as theater management, musicology, public and foreign service, and -- oh, the irony-- investing with enviable success in commodities and foreign exchange markets,* [FOOTNOTE: Ricardo was our other financial wizard, but with different markets.] Keynes was also brilliant as both a theorist and a policy wonk in a vast range of economic matters. Not even in sexual preference were his tastes or his actions limited. With his record and contacts in government and his professorial position at his Cambridge *alma mater*, Keynes was able to attack conventional economics research of the day with sufficient credentials to guarantee an ample, serious and powerful audience, especially when he could express his new ideas with accomplished and compelling style. And the daring to make such an attack, to challenge established views rather than smugly to refrain from biting the hands that fed him, doubtless emerged from the combination of his bisexuality and his membership in the Bloomsbury set of luminous intellectuals who paradoxically as well set artistic standards for the very society from which they willfully in some senses disengaged. Whatever. When insiders provide outside perspective, the results are powerful – very.

With national income and employment sinking, sinking, and then stagnant for more than a decade, Keynes shifted the focus of economics from individual markets and "partial" equilibrium to national markets and "general" equilibrium. The former, as noted above, has become known as "microeconomics," the latter as "macroeconomics" – and "never the twain shall meet"...until, as Kipling continues those famous lines, "Earth and Sky stand presently at God's great Judgment Seat," for

> there is neither East nor West, Border, nor Breed, nor Birth,
> when two good man stand face to face, though they come from
> the ends of the earth.

We are still awaiting those good men (and women), but there is hope. David Friedman once called the study of macroeconomics – at least at an undergraduate level – "a tour of graveyards and calls for future research." Lots of that research is now current, with many scholars building microeconomic foundations for macroeconomic analysis. Unfortunately, aggregation problems remain prodigious, not only because of the "fallacy of composition." Further, hardly a handful of the best of Wall Street economists can forecast or even identify turning points – and none, to the best of our knowledge has ever done so consistently -- in spite of the huge market rewards that would accrue to such a

talent, especially because the stock market is a *leading indicator*: it rises before upturns in the economy and falls before downturns.

Back, then, to the ill-understood problem of cycles – booms, busts, recoveries, recessions; to John Maynard Keynes, to the history of economic thought. As John Kenneth Galbraith has remarked:

> [F]or more than a century…whether or not a person accepted Say's Law was…the prime test by which economists were distinguished from crackpots…It was the historic achievement of John Maynard (later Lord) Keynes in the mid-thirties, in the wake of numerous less reputable voices (who lacked Keynes's prestige and the savage reinforcement of the circumstances of the Great Depression) to destroy Say's Law virtually without a trace and therewith the illusion of a self-righting economy. (Economics and the Public Purpose, p.21)

"Say's Law," recall, is the belief that, because the production of goods and services also creates the income to purchase those goods and services, "supply creates its own demand." How did Keynes overthrow so venerable and comforting a principle? As Galbraith has noted, he had a significant boost from the real world. In addition, he had earned academic and governmental credentials, wrote and spoke well. These attributes combined to make his voice one the world was open to hear, and to take seriously. As we shall now see, Keynes developed a theory to explain the ups and downs of this world and then some policy recommendations to smooth them out. What Keynes critically identified are, first, "aggregate demand" -- demand totaled for all individuals across all final goods and services in a nation; and, second, its sometime insufficiency to generate "full employment."

In a simple world without government and international trade, there are two sources of aggregate demand: *consumption* and *investment*. Consumption is sum of all individual (or private) purchases of final goods and services; investment is the sum of all individual (or private) purchases of new capital. The source of investment is *saving*, and saving is that part of income that is not spent (consumed). Because, for equilibrium in this simple model, saving must equal investment (interest rates will rise or fall to make it so), in equilibrium, income must equal consumption plus investment.

FOOTNOTE OR REFERENCE TO APPENDIX AND OTHER EQUATIONS/GRAPHS PARKED THEREIN: $S = I$; $Y = C+I$

Keynes's key insight is that an economy has more than one potential equilibrium, and the one it settles on at any point in time may not be sufficient to generate full employment. The villain in the piece is initially *investment.* What if the prospects for future demand are not sufficient to motivate companies/firms to invest? Then there is no incentive to invest, regardless of how inexpensive increasing the stock of capital might prove to be (how low interest rates might fall). Further (a point we shall develop with the other side

of the coin, consumption), savings fall with income, an effect which counters the decline in interest rates necessary to increase the quantity of investment when the whole demand curve for investment has declined. [GRAPH HERE] Both investment and savings functions, in brief, depend on income (prospective and actual) as well as on interest rates.

All goods produced, all income thereby generated, must ultimately be demanded: aggregate supply must equal aggregate demand. But all personal income is not necessarily spent. Individuals save, and only when all of their saving makes its way into investment will Say's Law be met. In other words (and as the vocabulary has developed), "leakages" (saving) must equal "injections" (investment) and may not do so at an income level that generates full employment.

What Keynes has here accomplished is to create an *endogenous* reason for capitalism or free markets to be unstable, to experience cycles. Jevons, an economist insider, had discussed cycles way back in 1875, but had sourced the instability in sunspots, a factor *exogenous* to the system. (Better data have disproved the theory, because sunspots and cycles are not perfectly synchronous, and time magnifies the slight difference.) Economists whose voices Galbraith called "less reputable" *supra* -- most notably Marx and George – modeled capitalism as inherently unstable. (Marx did so to the point of ruin: the system bore within it the seeds of its own destruction, and didn't need political revolution or foreign invasion to bury it for good.) But Marx and George lacked the academic credentials and university/institutional support seriously to undermine the Neoclassicists, at least for a time. Insider and impeccably credentialed Keynes was harder to dismiss, and the Great Depression was *impossible* to dismiss.

Not only investment, but consumption itself, Keynes continues, may prove inadequate for the generation of full employment. As the vocabulary of macroeconomics has developed, here is how the analysis has followed suit, with the focus, as usual, on the *margin*. All income is not automatically consumed by individuals. Some is saved. Not only is the link between savings and investment a tested and untrue way to reach full-employment equilibrium, but consumption itself proves increasing ill-suited to the task. People have a *marginal propensity to consume* (MPC) and an associated *marginal propensity to save* (MPS). (Because all of their extra income in this simplest of models must be either consumed or saved, MPC + MPS = 1.) That class of economists called "Keynesians" came to believe that the MPC declined with income, and the data seemed to support this view: people with higher incomes spend less and less of each extra dollar. The flip side of this coin, and the one corroborative of our statements on savings three paragraphs earlier, is that when income declines, so does saving – and more so at higher levels of prosperity. In other words, the MPS is positive *and* rises with income.

One result is to encourage re-exploration of the subject of income distribution. Helping the poor may also help the middle class and the rich, from economic as well as equity considerations: it may lift the economy out of the doldrums, raising their wage and equity income. Keynes is a proponent of raising wages.

Another result is to focus on the possibility that, as a country prospers, private demand is increasingly inadequate to generate full employment even with hefty redistributions of income. As an economy and the individuals within it prosper, less and less of each addition dollar of output/income will be spent and more and more will be saved. Investment cannot be relied upon to fill the gap. Why invest in greater capacity when a mature economy may suffer from *underconsumption*? With a MPC that declines with income (and a MPS that rises), aggregate demand will grow slower than production (unless demand for exports will bail us out). Further, as we've already seen, investment responds to many more factors than just interest rates. It responds to expectations of the future and inventory and just plain (and mysterious) animal spirits. Best not to count on it for continued prosperity.

Karl Marx predicts the inevitable demise of capitalism: within itself (endogenous) is the source of its own destruction – and good riddance! One can and should do nothing to keep in on life support. In contradistinction, John Maynard Keynes likes capitalism. It had served him well, and he seeks government policies to shore it up, as does fellow supporter, Henry George. While George calls on the government to collect all land rent – allowing private use but insisting on private payment to the government for the privilege of that use, Keynes calls on the government to take on the responsibility of attaining full employment, developing *monetary* and *fiscal* policies precisely to that end.

Monetary policy, in the Keynesian model, works through its effect on interest rates. Interest rates can be reduced, at least temporarily, by increasing the supply of money. It is this line of reasoning that has led to the *Phillips Curve*, with Professor Phillips asserting a trade-off between inflation and unemployment. We shall return to this relationship later. Right now, we simply note that when unemployment keeps rising, with incomes and therefore demand continually falling, the economy may fall prey to the *liquidity trap*, with investment no longer sensitive to a decline in its cost. When there's no demand for the final product increased capital can help produce, why increase capital? And when returns to putting savings to use are so low, why take on the risk, especially when, because prices are falling (the situation is one of *deflation*), cash under the mattress earns a positive return? These being the cases for both investment and savings considerations during the Great Depression, we shall accordingly turn our attention immediately and more enduringly to fiscal policy.

Fiscal policy is the use of government spending and government taxation employed to pull an economy out of a recession/depression or, at the other end, an inflationary heat-up. Government spending can ward off recession by increasing total demand, now seen as *consumption* plus *investment* plus *government spending* (C+I+G). It can do so directly, by increasing G, or indirectly, by decreasing taxes (T).

In the Keynesian world, we have seen that investment has an autonomous (at least in the context of this simple model) and volatile nature. Keynes also thought that the world was running out of investment opportunities. The old geographical "frontier" was closed. (His American apostle, Alvin Hansen, combined his prognostications with the "Turner thesis" about the closing of the western frontier.) The solutions he proposed to the

problems this constellation of factors can create are several. First, the government can step in and undertake investment projects itself (it has long been the current authors' view that government spending should be categorized, just like private spending, as either consumption or investment). The US government can – and it did – build roads and dams directly. It can also increase private investment indirectly, subsidizing capital expenditures, and, by producing its own research and development and offering it up to private industry at prices below cost, raising the marginal rate of return on new capital.

In contradistinction to investment in the Keynesian world, consumption is passive and predictable. It depends on income – disposable income, what individuals are left with after taxes, when government enters the picture. Because individuals don't spend all of their addition income (they save; MPC is less than one, MPS is greater than zero), there's more bang from the buck in increasing G than in reducing T. But both work. It just takes a greater reduction in T to get the same increase in aggregate demand. For this reason, the economy will expand even when increased government spending is fully matched by an increase in government taxes. It will do so one on one. An increase in G unmatched by an increase in T, however, will expand equilibrium income by a multiple of G, and that multiple is 1/MPC (a result readers who are competent in calculus can readily corroborate).

You will notice four things. First, we have not just added *government* to our simple model, we have made stabilization policies one of its key roles. Second, we have implicitly suggested that government deficits can be appropriate, a way to "jump start" the economy and pull it out of a recession/depression. Third, we have introduced the concept of positive feedback, a factor that magnifies rather than dampening any change. Fourth, we have replaced the "dismal science" with a model where society can have it all.

What are the consequences? Equilibrium will now exist only when the fuller concept of injections equals the fuller concept of leakages: $I + G = S + T$. (One should never assume that the government's budget is balanced, and only then will $I = S$; professors love to trip up their students with this kind of "nuance." Also remember that, in a recessionary context, we have just learned that deficits can be good.) Positive feedback indicates that any change in aggregate demand, be it in government or in investment or in the consumption function itself, will be magnified in its effect on equilibrium income. The multiplier, the source of this magnification, has its own source in the fact that consumption is a function of income. The impact of change in one of the components of aggregate demand is therefore far less than the cumulative effect. That impact causes an increase in income, which causes an increase in consumption, which causes another increase in income, and so on, in an ever-dampening way. When responding to an initial increase in aggregate demand, the multiplier looks good in a recession or depression; it looks worrisome in the context of employment already full, when the consequences are likely to be inflationary. When one component of aggregate demand declines during a recession, the multiplier will aggravate this decline – if some investors feel bad about the economy's future and pull back their spending, the economy will become bad in the future. Their prophecy is self-fulfilling. In microeconomics, the study of individual markets and partial equilibria, recall that feedback is negative. If the price goes above

market clearing, the quantity supplied will increase and the quantity demanded will decrease, both causing the price to fall back to where the two quantities are again equal and equilibrium is again established. Positive feedback creates a virtuous spiral in the Keynesian general equilibrium model only when an initial increase in aggregate demand is magnified to pull the economy out of recession/depression. It makes for a vicious downward spiral when, say, investment declines to reflect declining opportunities, thus pulling the economy further and further away from full employment equilibrium. This was the situation on which Keynes and his followers focused. This was the world their model was developed to explain. However, this is also a world where the correction mechanism is a win-win set of policies. Investment (and savings) are not stark alternatives to consumption in a macroeconomic setting. Rather, they are "reinforcing complements" [Mason, p.33]. More of one so propels the economy forward that it creates more of the other – when aggregate demand has heretofore been inadequate to create full employment; when, in other words, there is slack in the economy and it is operating inside the production possibilities curve.

In this world, Keynes didn't see an alternative to increased government involvement in the economy. Not only the geographical but also the technological frontier he saw as closing. All the great inventions had already been invented. What more could there possibly be after the automobile, the airplane, and the radio? The government had to get involved: private investment left to its own devices would falter. Moreover, aggregate private consumption would prove equally inadequate to the task of growth and increased prosperity. Not only was less of every extra bit of income consumed as an economy began to prosper, but population growth itself was beginning to level off. The private economy, for all these reasons, approached stagnation.

Readers should here be reminded of the gloomy forecasts of the three Ms – Malthus, Mill, and Marx. Malthus foresaw population growing too fast, pressing on a limited supply of land and leading to the grimmest of poverty. The only solutions he saw were birth control through abstinence and, failing that, high death rates caused by hunger, disease, and war. Mill forecast a "static state" (he and Ricardo, along with Marx and Keynes, thought capital would become superabundant, leading to interest rates falling towards zero). Marx's prognostications included not only a falling rate of profit (as the *organic composition* of capital rose) but also (along with Hobson) a problem of *under-consumption* (*over-saving*) for the economy as a whole (Hobson, along with Keynes, focused as well on the role of the distribution of income in causing this insufficiency).

Keynes was born the year Marx died. *Inter* alia, he resurrected Marx's concern with under-consumption and cycles, exposing these moribund concepts to a light respected by academics, politicians and policy-wonks alike. Both men were wont, on occasion, to express themselves with a vocabulary of death. When Marx talked about the rising organic composition of capital, he meant that more capital (*dead labor*) combined with less and less *living labor*. Keynes, meantime, anticipated what he dramatically and memorably called the *euthanasia of the rentier* (albeit in a vague fashion that's perhaps deliberate). Marx also thought capitalism carried inevitably within it the seeds of its own destruction, its ultimate death, and with it, the ultimate death of government. Keynes,

himself born as Marx died, thought that although the private sector suffered from what we might call "disease", it could ably be cured by, born again by a hefty assist from government. This shared language may be more amusing than significant. Significant and not at all amusing are these two salient and pugilistic similarities:

> Marxists like Hobson and Lenin predicted that capitalism would temporarily prolong its life by *imperialism*, seeking to conquer foreign markets as a response to insufficient domestic demand; and
>
> The United States continued to wallow in recession/depression until entering World War II, when aggregate demand soared due to massive spending on defense, a critical component of government spending.

Well! Does capitalism require WAR, after all? Is the price of its continued life continual death, on the massive scale of combat among nations? Surely, these questions provide ample incentive for us to re-examine the Keynesian model in search of their answers.

SIMON AND MACE: I SUSPECT THAT WHAT FOLLOWS MAY BE A NEW CHAPTER, MY LINK BETWEEN THE HISTORY OF ECONOMIC THOUGHT AND MASON'S CHAPTERS. WHAT SAY YOU? I SAY, INTER ALIA, THAT I LIKE MY DRAMATIC LAST PARAGRAPH, A REAL TEASER. I'M ALSO AFRAID MUCH OF THIS STUFF MAY BE TOO TOUGH. AGAIN, WHAT SAY YOU?

Keynesian economics ruled the profession – and the Democratic Party – from roughly right before the publication of his *magnum opus*, The General Theory of Employment, Interest and Money, in 1936 to the election of President Ronald Reagan in 1980. We have already mentioned how congruent Keynes' policy recommendations were with FDR's "New Deal". In the 1960s, particularly when JFK was president, with Walter Heller his chief economic advisor, Keynesian policies ruled the day. Stimulating the economy through tax cuts that particularly encouraged investment became a hallmark of "Business Keynesianism", beloved, as you might imagine, by most of the business community. Some times, even in the United States, academics influence politicians, and vice-versa.* *[fn: Notice, in this context, how very American was the economist Henry George: a folk-hero, best-selling author and political leader, he believed in and practiced democracy, the more and more direct, the better. The British Keynes, on the other hand, took it for granted that sparklingly elite intellectuals like himself should lead society; he made little effort to communicate outside a small circle of academics, intellectuals, and political leaders. Meantime, the Continental European Marx, writing mostly in England, took it for granted that another kind of elite would take over: a small cadre of self-educated professional revolutionaries, working through labor unions.]

With the election of Reagan, *Supply-Side Economics* dethroned Keynesian or *Demand-Management Economics*. Again, the theory and its adherents were responding to the problems of their day. Under President Jimmy Carter, the American economy was suffering not from unemployment but rather from *stagflation*, a combination of inflation

and unemployment Keynes' analysis neither predicted nor satisfactorily explained. Here, then, is the story of how American economics and American policy and government came to deal with Keynes – how for many of today's economists, as we quoted David Friedman, much earlier, the study of his model seems more like a tour of a graveyard than an exploration of something both alive and giving of life.

Perhaps the two most important lessons in economics are that "there's no such thing as a free lunch" and "behavior follows incentive." The implications of these lessons are important, and many.

Information is not free. Nor is it of necessity timely. One of the peskiest aspects of trying to implement fiscal or monetary policy, both at the heart of practical Keynesianism, is the problem of lags. It takes time for advisors to notice that an economy is slipping. It takes time to pass tax reform. It takes time for individuals and corporations to respond to changes in the tax code, whether in consumption or investment behavior. It takes even more time to pass spending programs through Congress and then marshal the resources and start the spending.

The bad news is that because of these lags, fiscal policy in particular may start stimulating the economy when it has already started healing itself. The result, then, is over-stimulation, leading to inflation. The good news is that government policy is full of *automatic stabilizers*. When the economy slumps, taxes automatically decline: most of them (income taxes, corporate taxes, even property taxes) depend on the state of the economy. When the economy slumps, government spending automatically rises: a significant proportion of its totality (unemployment compensation, Medicaid) also depends on the state of the economy. A budget formulated to be balanced with full employment will automatically slip into deficit during a recession.

Lots of scholarly work at the University of Chicago has focused on how individuals respond to their incentives in and out of government. Part of this work considers the private sector's response to government* spending. *[FOOTNOTE Libertarians like Milton Friedman refuse to call the government "the public sector" because they don't think it serves the public and don't know how to define "the public interest" anyway.] Most of the results serve to debunk the government's ability to stabilize the economy.

The problem of how the government gains and utilizes information to act in a timely anti-cyclical fashion we can now deem the first Chicagoesque problem; the second shortcoming with *discretionary spending* comes from the hard and fast fact that politicians are just utility-maximizing people like the rest of us.[here, insert that WONDERFUL QUOTE FROM THE FEDERALIST PAPERS] Politicians wouldn't be elected and re-elected if they were angels. They get votes through political contributions and promising voters enough benefits that they bother to turn out to vote. One of the many consequences of this fact of political life is that it is very, very hard to disband a program once it has been established. Stabilization spending, in other words, has a tendency to become permanent spending.

The question then turns, in a "no free lunch" fashion, on the issue of whether the private or the governmental sector will use scarce resources more appropriately. This problem should make all readers first suspicious of government efforts to increase investment, directly by building its own bridges, indirectly by reducing taxes on new capital and producing its own research then offered up to the private sector at reduced (or zero) price.

First, however, we shall re-examine the so-called inherent instability in the private economy. Was insufficient aggregate demand, due to volatile investment and to a marginal propensity to consume that declines with income, the villain of the piece? Did any other factors contribute? There should be no doubt in any reader's mind that consumption responds not just to current income but also to expectations of a whole stream of income in the foreseeable future. One cause, then, of the Great Depression was the precipitous fall in the stock market, a large source of private wealth. Why did it fall so suddenly and so sharply? What happened to change expectations? One powerful suggestion is that events in Congress, right before the fall, indicated that the Smoot-Hawley tariff was bound to pass. This tariff slapped punitively high taxes on imports, to support local industries competing with producers abroad. The tariff thus introduced multiple inefficiencies and dropped foreign demand for our products. As private wealth dropped, so did private consumption. Investment as well fell, as producers responded to declines in both domestic and foreign demand for their products.

Another widely accepted reason for the Great Depression is that the Federal Reserve responded inappropriately. Data show that the money supply declined by **one third** at this time, thereby turning a recession that might have proved mild into a depression most vicious and long lasting. For six years before Black Tuesday, bank failures had proceeded at a rate of two a day (WP, p.250). The profitable system of fractional reserves meant that when a significant number of customers demanded the assets in their checking accounts, not all demands could be met and a run on banks would ensue. To prevent these runs, the Fed raised reserve requirements. The result was to shrink the money supply and thereby the economy; a better policy would have been, and has come to be, government insurance of individual accounts.

What about the inherent inadequacy of the consumption element of aggregate demand to maintain growth? Data that reveal a marginal propensity to consume that declines with income have studied *current income* and its relationship to *current consumption*. The implication is that as economies prosper, that fraction of total income comprised of government must rise (as consumption falls as a percentage). Newer studies show, however, that .the relationship of consumption to stable, permanent, over-a-life-cycle income to spending is steady at 0.9 (90% of each extra dollar earned is spent).
Current income, particularly in professions like farming, can be highly variable, and, recognizing this fact, consumers tend to adjust their savings more than their spending in short-run response. Students training to be well renumerated doctors and investment bankers spend more of their current income than individuals who expect their current situation to continue well into their lifetimes.

Further, if individuals respond, in their spending, to permanent, not temporary changes in income, a temporary reduction in their taxes, of the sort designed to pull the economy out of recession, will not generate much of a reaction. The power of fiscal stimulation through a tax reduction, in other words, is minimal.

The oft-touted trade-off between inflation and unemployment also proves a chimera, if individuals are *rational* in their expectations of the future and their understanding of how government policies work. Unemployment goes down as inflation goes up only if individuals confuse a rise in overall prices (inflation) with a rise in the relative prices that matter to them (their wages and the prices of the products they produce and sell). The theory of "rational expectations," how individuals and firms predict the future, particularly how changes in the money supply will affect general prices or inflation, has therefore vitiated much of the power of monetary policy and its ability to reduce unemployment in any but the shortest of terms.

This theory has ramifications in particular for monetary policy. It implies that the best policy the Fed can follow is to have the supply of money grow one-on-one with its demand (since the income elasticity of the demand for money appears to be 1, this translates into growing at exactly the rate of growth in the economy). Milton Friedman has succeeded in persuading most that the best monetary policy can accomplish is to *accommodate* (not cause) growth, by its sheer predictability making it possible for individuals to distinguish between price changes that are relative and those that are general – between a real change in renumeration or cost and simple inflation. The power of monetary policy, in this view, is entirely negative – very negative. It makes individuals make decisions on mistaken information. The Phillips Curve, in other words, is a very short-run phenomenon, based on workers mistakenly accepting job offers involving wages that are not *really* (that is, in purchasing power) as high as they initially appear. Is it okay to reduce unemployment by sham? No, says Friedman, and, any way, the effect disappears in the long run. Keynes' reply would be, "So do we!" As he actually said, "In the long run, we are all dead. What trade-offs are we willing to make between the long and the short run?

None of the above is actual cause for total despair about the role of government in either run. It serves rather to refocus the problems society face. The focus reverts in part to questions of what the government should do, long term, because the private sector won't, or will do so less well. It also reverts to questions of equity.

Neoclassical economists now regard Keynes' magnum opus not as a *general*, but rather as a [very] *partial* theory of unemployment, one that depends critically on the implicit assumption that wages are *sticky*. In [again] the short run, they don't adjust downward easily or quickly.

Neoclassical economics is, indeed, all about opportunity cost and trade-offs. When wages adjust to assure full employment (not zero unemployment because of *search* employment and the transitions necessary in a growing economy), the economy is then operating on its production possibilities curve. All resources are then scarce; there is no

more free (or discounted) lunch. More government spending, NCE's assert, then comes only at the expense of less private spending. The *crowding out of investment*, for example, occurs regardless of whether increased spending is financed by more government debt, more printing of money, or more taxes. Debt finance raises interest rates, as the government increases its demand for savings; the quantity of private investment therefore falls in response to an increase in its cost. [FOOTNOTE: Foreign demand for US debt, which is very, very safe in the sense of default possibilities, not so safe as regards exchange-rate risk) can and has dampened the effect of deficits on interest rates.)] Such deficits also raise, in both consumer and investor minds, the possibility of increases in future taxes. Since they base their decisions rationally on future probabilities, they cut back on current activities. The private return to investment will drop both as that return is taxed at a higher rate and as the demand for whatever the new capital will produce drops with the decline in disposable income occasioned by the rise in individual taxes. Future taxes are really no different from current taxes. The primary concern, then, is whether resources should be deployed by government or private hands; how that spending is financed becomes only secondary in its import. It matters only if voters respond more strongly to immediate increases in taxes or to immediate increases in debt and anticipated future increases in taxes. When Republicans, as a consequence, look at deficits, they tend to recommend spending cuts (of all programs but those that benefit their own states and therefore their own selves), while Democrats tend to recommend tax hikes, especially of the rich (who, since they are exceptionally able at avoiding, even legally, the payment of taxes, may end up paying even less, except to the accountants and financial planners who work out their dodges).

This analysis of government spending also breaks the link between deficits and inflation. Only deficits "paid for" by printing money (an option not open to the private sector) at such a rate that its supply rises faster than its demand will cause inflation (a reduction in money's price).* [Those archest of arch-conservatives/NCE'rs, the Chicago School, deeply respect Keynes not for the work on which we have most focused but rather for his analysis of monetary manners and his breath-takingly accurate (and painful) prediction that the Versailles Treaty was so punitive that it would continue the destruction of Europe begun by World War I. Indeed, the reparations imposed on Germany were so stiff that the country met its obligations by printing marks. The resultant hyperinflation (prices rose 1.4 **million** per cent) destroyed all other ways of financing any government spending, destroyed the middleclass, subsidized the rise of Hitler, and set the stage for World War II.]

John Maynard Keynes, so successful in so many ways, once remarked that "economists should be humble, like dentists." (H 284) In this context, it's fun to consider the supreme confidence he showed in his youth – surely no real study was necessary for ***him*** to place within the top ten in a civil service exam. He placed second, with his lowest score in Economics, and responded, "I evidently knew more about Economy than my examiners." (H 255)

With all due respect to dentists, this is one of the smartest things this very smart individual ever uttered. It is the authors' view that the study of economic at an

undergraduate level is importantly, but also merely, structured common sense, while, at a graduate level, it becomes common sense often structured to a nonsensical degree. In the remaining chapters of this book, we shall ever remind ourselves of the need for humility *and* common sense as we focus, almost exclusively, on the role of that vanishing third factor, *land*. We shall see that, when land is privately owned (and, recall, "land" is all natural resources, not just "location on this planet"), speculation in its price can cause market bubbles, which in turn cause overheated economies inevitably followed by bursts and recession. We shall see that private ownership of land causes not only economic cycles but also economy-wide waste, inefficiency, and inequity. We shall see that charging private individuals for their private use of this common resource increases both efficiency and equity. We shall consider the effect of this analysis on the proper role of government, and we shall see that economics, properly viewed, need no longer be "the dismal science." How very American we shall turn out to be!



THOMAS HILL GREEN
(1836-1882)
AND
THE FABIANS

The storming of the Bastile in 1789 set in motion what we call "modern times." For two generations, and even beyond, armies marched and countermarched across Europe. The French Revolution and the Napoleonic Wars shook foundations of Europe that had been sturdy for centuries, undermining such feudal remnants as the churches, the monarchies, and the aristocracies. Although the march was only – literally – in Europe, the entire globe was to witness both the reorganization of states and a new cluster of political, economic and social relationships.

Ideas and institutions, not just physical goods, can be exported and imported. In their number at this time were Romanticism, Idealism, Utilitarianism, and Liberalism, philosophies also imbuing art, literature and music. Perhaps Fate's insistent entrance in Beethoven's Fifth Symphony and the two hammer blows that open his Third best symbolize these changes -- along with the composer's destroying the Eroica's dedication to Napolean when the general began his tear across Europe. Nationalism, you see, was also taking on new meaning. It is during this century that Germany and Italy were unified. Sad legacies of this development were an arms race and massive colonialism, contributing to constant tension and ultimately to the First World War.

With the rise of the Industrial Revolution, the countryside lost ground to the city, the plow to the mechanized hammer. Work became categorized less by the craft skills of artisans and more by the standardization and dehumanization of the factories, and a new bourgeois elite began to replace the old aristocracies new dynamic, bringing new 'isms in their wake. Romanticism began to yield to Realism, Idealism to Pragmatism and Materialism, but a certain hopefulness that anything and, indeed, everything could be changed by man held steady in transition. The sciences, after all, were making new discoveries in leaps and bounds, allowing life to become more comfortable, at least materially, at least for some. For some. As the flight into cities from the countryside continued apace, that new social force, the middle class, reaped most of the benefits of increased industrialization *cum* urbanization, and trade gained predominance and power. But new urban problems also became part of the daily scene, inspiring new converts to Utopianism, Socialism, and Anarchism, and the monopolization of the land, the underlying foundation of economic, political and social control as we shall see, grew apace with these new forces.

The mixture was volatile; revolutions as well as contentment were its products. 1830 and 1848, in particular, were years of great ferment, rocking Europe and fueling the growth of several varieties of Socialism and Liberalism. While the former often espoused radical change for the masses, the latter appealed and generally applied only to those who had money and aspired to reach social positions equal to those of the aristocracy. Essential creation and reflection of its time, it is 19th Century Liberalism on which we shall concentrate here.

Sedate and measured, Liberalism was highly amenable to the growing middle class. Coming into the chambers of deputies were not farmers and workers, but physicians, lawyers, merchants and manufacturers. The Liberalism they espoused supports the principles of parliamentary government, constitutional monarchy, freedom from the constraints of the state, and the rights of man – or, rather, of the right sort of man: propertied man, who, it is assumed, has developed responsibility along with material well-being. Prudent laws are necessary to guarantee the rights of citizens, but the proper role of government is minimal. Government is more a necessary evil than a force for good.

This political side to Liberalism supports quite handily the economic policy of laissez-faire: the celebration of free markets with minimal state intervention. Liberals believed that since competition is motivated by self-interest and private profit, it can more wisely be regulated by natural market forces than by other institutions, whatever their stripes or colors. Such thinking has no truck with legislation -- even ameliorative laws for the poor -- that will interfere with the prosperity of others. Hampering the financial gain of the upper and middle classes is *verboten*. Liberalism at this time, in sum, is primarily an entrepreneurial ethic based on the material morality of an industrial society, with success and gain increasingly viewed as the bedrock of happiness. Is it any wonder that Darwin's evolutionary dynamic, a struggle for survival by the fittest, becomes justificatory graft onto such endeavors as the prosperity seeking of individuals and the war-like designs of nations? Or that free rein for the rich to control the working classes and to acquire riches in this context seems acceptable, even commendable? The brightest jewel in the crowning competition to amass riches was land; the monopolization of this natural treasure and all its benefits – including its connection to political and social, as well as economic, control – grew apace with industry and commerce. And those who espoused free trade and internationalism, who sanctified private property, also advocated Nationalism, Militarism and crusading missions for the acquisition of colonies for prestige, new markets, and . . . new land. No foolish consistency here, but lots of narrow minds – a dangerous mix, as history would soon reveal.

Thomas Hill Green

Into these times was born Thomas Hill Green. Nurtured, *inter alia*, by the Idealism of Kant and Hegel, and therefore disturbed by some of the moral aspects of bourgeoisified industrialism and the growing numbers of disenfranchised and poor, he reacted with the following thoughts. The free enterprise system is basically sound: it creates mutual dependence and service for the betterment of humankind. A positive force, it fosters a better ethical climate. Still, the market economy should not be allowed to run untrammeled: many are the problems it creates as well as leaves unsolved, or even exacerbates. Its unfortunate consequences do not, however, arise from the nature of capitalism itself so much as from the feudalistic legacy of monopolistic landowning itself based on forceful seizure. "The original landlords have been conquerors," he bluntly states. These social forces have imprinted their style on a state created to perpetuate the power of the few at the expense of the many. The proletariat are just renamed and modern serfs, serfs who have fled to the cities after being stripped of rights and denied any land to till. Industrialization is therefore the cause of both unprecedented wealth and

previously unimaginable horrors; generating low wages and even starvation, it plays havoc with people and social relations, falling far short of protecting individual rights and destroying any sound basis for a just ethical climate.

Green's goal is accordingly one of promoting a government that takes on a positive role in the nation and in the economy. Government should not just prevent evil, it should promote good. The best means of perfecting individuals and society, it is duty-bound to create and maintain conditions propitious for maintaining and enhancing the moral life and the general good, removing obstacles the poor often face in their quest to better living conditions. Not minimalist but active, even activist, participation can and should also create more balance between the individual and the collective, resulting in a truly liberal citizenry based on moral self-determination and dignity. He writes:

> The happiness and misery of society is the happiness and misery of human beings heightened or deepened by its sense of common possession. Its will is their will in the conjoint result. Its conscience is an expression of what is noble or ignoble in them when the balance is struck. If we may judge each man by the contribution he makes to the community, we are equally right to ask of the community what it is doing for this man. The greatest happiness will not be realized by the greatest or any great number unless in a form in which all can share, in which indeed the sharing is for each an essential ingredient. But there is no happiness at all except that experienced by individual men and women, and there is no common self submerging the soul of men. There are societies in which their distinct and separate personalities may develop in harmony and contribute to a collective achievement.

The motive force behind these positive changes, based on equipoise between individuals and society, is the development of a new sense of public duty. An idealist of the persuasion that people and institutions are the vehicles of ideas and spiritual forces, Green believes he speaks (admittedly in our parlance) not of "utopia" (literally, "no place"), but of "eutopia" (a "good place"). With the perfecting of society, humankind will come closer to the eternal consciousness.

With the articulation of this goal, there transpired a profound change in the course of Liberalism. Green laid the foundations of the modern welfare state and its reform legislation: hereinafter the government, especially an enlightened one responsive to public opinion, would have to take an active part in society and in the lives of its citizenry. At least in theory, no longer would the goals of individualism and the collective good be in opposition to each other. No life would truly be worth living outside state institutions, because these institutions would be seen as the embodiment of divine principles. Due to Green's influence, by the end of the 19th Century, Liberalism had definitely taken on new meaning. It no longer stood for minimalist government, but rather gave clarion call to an ever-increasing role for the state.

The Fabians

Into this climate, influenced on so many levels by Thomas Green, came the Fabians, 19th Century English intellectuals also concerned with the problems rapid industrialization and urbanization occasioned. Members like George Bernard Shaw and Sidney and Beatrice Webb deplored the dislocation of the poor and the failure of a government seemingly far more interested in empire, trade, and the landed aristocracy frontally to address the issue.

Socialists shorn of revolutionary impulses or beliefs in the dynamics of materialism and class struggle in the Marxian mode to reshape society, Fabians place their faith in gradual and cumulative change effected through gentle tools within the system: legislation, education and the ballot box – hence their name, from the eponymous Fabius Cunctator, the Roman general famous for using delaying tactics rather than outright battle against Hannibal in the Second Punic War. Socialism, Fabians believe, is the natural development of tendencies already inherent in capitalism; like Green, they think of themselves as purifying classical Liberalism through this positive form of state interference. Fabian Socialism accords enlightened civil service administration and a more centralized government control over production, distribution, and exchange. Among the social reforms they support are a minimum wage, a shorter workday, and municipalization of industries and services. Essential to their agenda are compensating the private owners of land and capital and then having these factors of production owned by the community and managed by its government, preferably at the local, and most democratic level. All legislation should benefit society as a whole, with the goal of expanding political and economic freedoms and helping individuals realize their potential. Socialism and Democracy are at base identical. The class structure will dwindle or even disappear as everyone is obliged to work for a living. Why? Because rents from land and returns from capital will be appropriated, through taxation, and the community will control socially created value, thereby undercutting landowner and capitalist profits.

The influence of the Fabians has been profound. *Inter alia*, they have helped shape the present form of Liberalism, which supports substantial, and positive, role for government. In British society, their weight has been far out of proportion to their numbers, especially in creating the Labour Party at the beginning of the 20th Century. It was Sidney Webb's program that the Party adopted in 1918; called "Labour and the New Social Order," it demanded a national minimum wage, nationalization of industry, radical changes in national finance, and using surplus wealth for the nation. The Fabians also served in various ministries when the Labour Party came to power in 1923 and 1929 and most especially in 1945, when Fabian Prime Minister Clement Attlee took office. It was during this period that the modern welfare state created such programs as socialized medicine, guaranteed subsistence, insurance, and the extension of public ownership of coal mines, railroads, utilities and the Bank of England. Also to their credit is the establishment of the London School of Economics and the launching of the New Statesman. Because of this little group of thinkers and doers, as J. Salwyn Schapiro has noted, "English socialism has become synonymous with Fabianism." It has been the

preeminent home for English radicals over the last century, and one that has provided a viable outlet for radical social ideas without the stultification of dogmatism.

The Influence of Green and George on Fabianism and the Modern Welfare State

For all practical purposes, the Great Britain of today is the grandchild of Thomas Green and Henry George, but the child of the Fabians. Many of her major industries and utilities are state-controlled; the government dispenses many of her public services, and does so for the benefit of the community at large. Britain, in brief, exemplifies the modern welfare state.

Green's contribution lay in setting up the initial climate for the reorientation of Liberal thought. At first, as we have seen, it was restricted to a middle-class definition with virtually no state interference. But Green envisions a government that would dismantle obstacles to greater freedom and in so doing would benefit the entire population. Green's government is a positive force for good, not a negative force to be tolerated and minimized. In like mind thinking that they are purifying Liberalism, the Fabians extend this view and grafted evolutionary socialism on top of it. Their support for the municipalization and nationalization of various services and industries is a logical implication of his reasoning that if the economy is left unchecked, the results will prove disastrous. Also in essence similar to Green's is their conviction that liberty is impossible without some degree of security, and that social security and stability are objectives of state policy as much as is protection of liberty. As Sabine put it, a planned society can be a "far more free society" than a competitive one, because it can "over those who work in it the sense, on the one hand, of continuous opportunity for the expression of capacity, and the power, on the other, to share fully in the making of the rules under which they work." As Shaw wrote in a letter, "We really did knock Laissez Faire into a cocked hat . . . State enterprise, State control, State finance . . . rose . . . to be the only hope of survival for civilization."

Henry George stirred the consciences of many people in Great Britain, especially during the 1880s, especially as regards the land question. It was his call for judicious reform that galvanized the minds of many, from conservative to liberal to radical. Even Arthur Balfour, averred, soon before becoming Prime Minister,

> As will readily be believed, I am no Socialist, but to compare the work of such men as Mr. Henry George with that of such men, for instance, as Karl Marx, either in respect of its intellectual force, its consistency, its command of reasoning in general, or of economic reasoning in particular, seems to be absurd.

Balfour preferred George, who focused on the land question. On that question we shall now focus as well.

The Third Factor of Production: Land

Although Green does not go so far as to suggest major alterations in property rights and ownership, he decries their violent origins. We observed this element of this thought above, briefly, and shall expand on it, in Green's own words, below:

> We shall see the unfairness of laying on capitalism or the free development of individual wealth the blame which is really due to the arbitrary and violent manner in which rights over land have been acquired and exercised, and to the failure of the state to fulfill those functions which under a system of unlimited private ownership are necessary to maintain the conditions of a free life.

Although Green does not believe in major alterations to property rights and ownership, he does believe in some regulation of the usage of land:

> The state . . . in the interest of public freedom which is its business to maintain, cannot allow the individual to deal as he likes with his land to the same extent to which it allows him to deal as he likes with other commodities . . . Should not the state, which for public purposes compels the sale of land, also for public purposes prevent it from being tied up in a manner which prevents its natural distribution and keeps it in the hands of those who cannot make the most of it?

Property, therefore, has a social character: its fundamental *raison d'etre* hinges on its contribution to the "social well-being" of a healthy functioning society and is the source of materials for all industry. Land usage must be channeled for positive purposes, and everyone should ultimately have access to this natural commodity.

Unlike George, however, Green does not think that the unearned increments should be taxed. First, although such a tax would be fair, it would be far too complicated to implement. Second, Green does not support interference with the accumulation of individual wealth. His ambition is to spread free trade and individual landownership to as many people as possible for the common good, rather than to socialize or nationalize it.

Green's revision of Idealism helped set the state for the social and economic justice advocated by Henry George. It was this American who helped alert people in the British Isles to the grave social, political and economic problems of the 1880s. In their number was G.B. Shaw, who confesses:

> My attention was first drawn to political economy as the science of social salvation by Henry George's eloquence, and by his Progress and Poverty, which . . . had more to do with the Socialist revival of that period in England than any other book.
>
> I have never denied or belittled our debt to Henry George. If we

> outgrew Progress and Poverty in may respects, so did George himself too, but nobody ever has got away, or ever will get away, from the truths that were the center of his propaganda. . .

Indeed, according to Sabine, this indebtedness to George is shared by the Fabian movement as a whole. "Fabian economics, " he writes, "[is] for the most part not Marxian but an extension of the theory of economic rent to the accumulation of capital, on lines already suggested by Henry George. Fabian policy [is] based on the justice and the desirability of recapturing unearned increment for social purposes."

All "unearned" increments, not just land rents. Although many organizations formed with the specific goal of reforming unjust land relations, few were content to make the expropriation of rent the sole tax in the government's arsenal, and their energy turned instead to Socialism for broader policies and answers. Such was the case with Shaw and the other Fabians. But the Georgian influence remained strong, not only because he helped them focus their *modus operandi* and sense of social mission but also because his emphasis on political action through the use of elections, Parliament and legislation gave them a solid basis for future action. According to Edward R. Pease, the first historian of the Fabians:

> to George belongs the extraordinary merit of recognizing the right way of social salvation . . . political institutions could be moulded to suit the will of the electorate; he believed that the majority desired to seek their own well-being and this could not fail to be also the well-being of the community as a whole. From Henry George I think it may be taken that the early Fabians learned to associate the new gospel with the old political method.

Fabians did share George's belief that private property in land is an undeniable form of theft. Viewing the aristocracy with disdain, they thought their power can be appropriately clipped by the appropriation of a land tax, as advocated by George. This revenue can then be used for community purposes and the betterment of individual lives. George's taxation of land values was therefore adopted as part of their platform. But unlike George, they did not think that it alone could address all of Britain's problems, and, unlike George, they also advocated taxing capital from private enterprises in a similar manner. Such policies have become part and parcel of England today.

George would have both applauded the use of ground rent for society and anathematized the extension of this social expropriation into the returns from capital. In his view, such taxation would stifle free enterprise retard economic growth. Is it possible that one reason Britain's growth falls short of others lies in the high taxes its government levies? And that this country has had so many internal problems because the state ias arrogated too much power and interferes too much with the workings of society and the lives of individuals? Henry George would have responded with two succinct and resounding "Yes!""s. It is not only possible but probable.

Shaw did believe, according to [WHOM? Sabine?], that

> once the single-tax proposal was adopted its operation would not cease until it had absorbed the entire economic rent of the country, and when this happened the State would be in control of the revenue from which industry drew its free capital. The outcome would be State Capitalism."

The version of this State Capitalism would be Fabian, as described in the Fabian Manifesto (Tract no. 2), which makes it quite clear that Fabian economics is for the most part less Marxian than Georgian -- an extension of the theory of economic rent to the accumulation of capital:

> That a life interest in the Land and Capital of the nation is the birthright of every individual born within its confines and that access to this birthright should not depend upon the will of any private person other than the person seeking it.
>
> That the most striking result of our present system of farming out the national Land and Capital to private persons has been the division of Society into hostile classes, with large appetites and no dinners at one extreme and large dinners and no appetites at the other.
>
> That the practice of entrusting the Land of the nation to private persons in the hope that they will make the best of it has been discredited by the consistency with which they have made the the worst of it; and that Nationalization of the Land in some form is a public duty.

"The Basis of the Fabian Society" was indeed the organization's basis until 1919, and its wording is even more explicit, advocating:

> the reorganization of society by the emancipation of Land and Industrial Capital from individual and class ownership, and the vesting of them in the community for the general benefit... The Society accordingly works for the extinction of private property in Land and of the consequent individual appropriation, in the form of Rent, of the price pad for permission to use the earth, as well as for the advantages of superior soils and sites.

The emphasis of the Fabians, according to G.D.H. Cole was accordingly:

> not on social administration, but on the transfer to the community of the surplus to which the Fabians gave the general name "rent," in preference to the Marxist term "surplus value."

Public enterprises could be established with these funds to compete with the capitalists and eventually put them out of business.

The World Today

Many are the debts we owe George Bernard Shaw today, and, because they are in the realm of ideas, arts and letters, on them our monetary burden is zero. It is to Shaw's witty eloquence that we are indebted for perhaps the best known and best loved description of economists: "men who, even laid end to end, would still never reach a conclusion." There is, of course, considerable truth in this clever turn of phrase – otherwise, it would not be so humorous. But it is our purpose to trace the equally considerable threads of consistency in economic thinking both past and present, particularly as they relate to land.

As we look at the world today, we see many of the problems the 19th Century faced – alas, with appallingly more powerful weapons lining up on all sides of them. When Henry George looked around at his world, a century plus ago, he devoted his life to making life better for people under all the circumstances of change they faced. George would conclude that we are still succumbing to problems that originated in land monopoly in his century and earlier – industrialization, urbanization, crime, poverty, the arms race, and new forms of colonialism disguised under corporate capitalism. There is primarily only one major difference in the problems faced today from those faced in his day: their degree and intensity have been immeasurably magnified. Growing expectations and an impatience manifested in greater material wants compound the volatility of our situation. Tinderbox economic conditions, with a greater dependence on the state as a source of justice; formicary-like lives driven by machines, electricity, and greed; loss of personal responsibility, along with spurious group identifications, exacerbated by a crushing of education and perversion of knowledge; and a sleeping but callous consciousness with a distortion of morality: such is the legacy which had its roots in the 19th Century. [is this a quotation?} The fruits are in the 21st. Ours is the plate on which they will sit.

Editor's Notes:
I degender all references to people.
I refuse to let "this" or "that" refer back to anything but a noun (gerunds are okay)
all the metaphors and clumsiness of the passive voice
I think, distract from the substance.
May I (please) weed them out?

BACKGROUND TO LESSON 1

LAND AS A DISTINCTIVE FACTOR OF PRODUCTION

Mason Gaffney

The classical economists treated land as distinct from capital: "land, labour and capital" were the three basic "factors of production." They were mutually exclusive. They were comprehensive, including all economic agents. Each was also "imitational," meaning at least some of each was needed for all economic activity. They ~~made~~ comprised a coherent system.

Neo-classical economists denied the distinction and undertook to purge land from economese. Many of them, following John B. Clark and Frank Knight, still deny the distinction, ~~as I explain in *The Corruption of Economics*, a companion volume in this series.~~ Many treat the matter by seizing on and stressing all similarities of land and capital, while ignoring all differences. Some invent gray areas that seem to fuse land and capital, present them as typical, and quickly move on. Many more simply ignore land, ~~which has the~~ in effect ~~of~~ accepting the Clark-Knight verdict in practice. Others uneasily finesse and blur the issue by writing "land" in quotation marks, ~~quotes~~, or trivializing its value, or referring vaguely to "quasi-rents" to comprehend a broad spectrum of incomes both from land and other factors.

Whatever possessed the neo-classical to leave such a mess? One needs to know something of their times and politics. J.B. Clark and E.R.A. Seligman of Columbia University were obsessed with deflecting proposals, strongly supported at the time and place they wrote, to focus taxation on land. Henry George, after all, was nearly elected Mayor of New York City in 1886 and 1897. Frank Knight, founder of The Chicago School, followed them closely. ~~That explains why~~ Some of the points made herein may seem obvious to readers who have been spared the formal conditioning imposed on graduate students in economics. In graduate training, however, the obvious is obscured, silenced, or denied. Hundreds of books on economic theory are published with "land" absent from the index. Denial is reinforced by dominant figures using sophistical, pedantic cant, which students learn to ape to distinguish themselves from the laity and advance their careers.

The dominance of "fusers" is shown by the prevalence of 2-factor models, wherein the world is divided into just labour and capital. Land is melded with capital, and simply disappears as a separate category, along with its distinctive attributes. A number of economists don't buy it, but don't do anything about it - acquiescing in error by silence, indifference, passivity, or anxiety of the professional consequences. They handle the question by "going into denial," as it were, resolving a vexing issue by pretending it isn't there. Truth will not be made manifest by hedging, especially against such motivated forces as have an interest in hiding unearned wealth behind the skirts of capital

The market exchange of capital for land causes an elementary failure in the minds of many. Land and capital each have their prices and may be bought and sold for money. Each alike is part of an individual's assets, colloquially called his "capital." Each is a store of

the disappearance
move to "labor" here?
xer (?!)
Time our historical/British...

value to the individual. What is true of each individual must be true for all together, is the thinking: it is the "fallacy of composition." We will see herein that society cannot turn land into capital, and land is not a store of value for society.

The discipline has not totally eliminated land, but marginalized it. There is a subdiscipline called "Land Economics," and a journal of that name. There are journals of Agricultural Economics, Urban Economics, Regional Science, Environmental Economics, Natural Resources, and more. There are also whole disciplines of Geography, Economic Geography, Military Science, Biogeography, Geology, Geometry, Surveying, Astronomy, Theology, Ecology, Oceanography, Meteorology, Soils, Physiography, Topography, and Hydrology, all dealing with The Earth and Nature and Creation as definable topics distinct from man's works.

The subdisciplines are kept away from the "core" and "mainstream" of economic thinking by compartmentalization and colonialization. Patronizing "land economics" as a colonial discipline keeps potentially contagious movements within the empire, where they can absorb critical tendencies under watchful control, while yet remaining safely remote, in the outskirts of the system. Orthodoxy flows out from the core, communicated via mandatory "core courses." Land economics is banished from the "commanding heights" of money and banking, macro policy, and required "basic" courses in methodology and micro theory.

mixed metaphor ?

Colonial life is safe and easy, if dull and unfulfilling, but once labelled "colonial" one is supposed to remain in the assigned cage. One who attempts integration is "overambitious" and "spread too thin." Colonials are not supposed to relate land economics to unemployment, inflation, financial collapse, deficit finance, and such core topics. They become unwitting co-conspirators in marginalizing their subject.

Micro theory is the inmost citadel of holy writ, where "the economic way of thinking" is inculcated. It is required of all economics students before they venture into real issues. It becomes their shibboleth, their lingua franca, and shapes their world view. Within common micro theory, to the extent it relates to real life at all, the technique has been first to relegate production economics to a minor role: "price theory" comes first. Production economics deals with the optimal combination of inputs in production, and how this relates to their relative costs. That should lead right into factoral distribution, but this aspect is soft-pedaled or omitted entirely. This omission alone is a fatal fault, ~~considering that~~ because the forces determining land rents vary inversely with those determining rates of return on capital.

?

Within production economics, "variable proportions" with "factor symmetry" replaces diminishing returns. The parcel of land disappears as a unit of analysis, replaced by "the firm," a disembodied spirit that combines resources optimally, treating all alike as variable "in the long run." In the "short run," land is subsumed in "fixed costs." Rising demand that raises rents is just "imputed away" silently and lumped with other elements of "fixed cost." If ~~that~~ sounds muddled, it is because ~~what~~ it describes is muddled.

This analysis

"In the short run,"

?

Common micro theory finesses Time. It deals with economic relations as though they occurred at a point in time. Sometimes two points are allowed (short run and long). Thus micro theory can ignore the birth of capital, its growth, maturity, senescence, death, burial, and replacement, vital elements of its difference from land. Time, and relations of sequence, are hived off to the far satellite of "finance," usually not even taught in departments of economics. Time is also referred to under "history of economic thought," as an obsession of some 19th century Austrians who wrote quaintly of "roundabout" (time-using) methods of production. Relations of sequence are found in macro, but not firmly integrated with micro theory, which is the enduring core of the discipline. Micro theory still deals with relations of coexistence int time, and space as well. As A.A. Milne once wrote, "It isn't really anywhere, it's somewhere else instead." Of neo-classical theory we may add, "It isn't really anytime, it's some other time instead."

this palaver?

All ~~that~~ is confusing for students and others. Land does have distinctive qualities for economic analysis and policy. This essay gives 10 primary reasons why land is distinct from capital (and of course from mankind itself) as an economic input. Then it gives 18 important economic consequences thereof, and their policy implications. Making land markets, land policy, and land taxation work well for the general welfare is a major challenge for economists and statesmen. They have neglected it too long by crediting and following the peculiar neo-classical sophisms that obscure or deny all distinctions between land and capital.

statespeople?

too many metaphors

PRIMARY DISTINCTIONS

1. Land is not produced nor reproduceable.

Land is not produced, it was created. It is the world, the planet from which man evolved, with the sun that energizes it and the orbit that tempers it. Land is a free gift, variously expressed in different philosophies as Spaceship Earth, the Big Blue Marble, God's Gift, Creation, Gaia, The Promised Land, or Nature. Mankind did not create The Earth with its space and resources, nor can we add to them. We can only acquire them, often by fighting, or rent-seeking, or in other counterproductive ways. Man at best improves and develops capacities inherent in the free gift. It is disappointing, and should alert us and make us suspicious, that economic analysis would ever purge out this paramount, self-evident truth.

"Land" in economics means all natural resources and agents, with their sites (locations and extensions in space). Land is not just the matter occupying space: it *is* space. It includes many things not colloquially called land, such as water and the beds under it, the radio spectrum, docks, rights of way, take-off/landing time slots for aircraft, aquifers, ambient air (the right to breathe it and the license to pollute), "air rights" to strata in the third dimension of cities, falling water, wild fish, game, and vegetation, natural scenery, weather, the environment, the ecology, the natural gene pool, ~~etc~~. Any franchise, license or privilege giving territorial rights is a species of easement over land. Your driver's license is a right to use land: red lights remind us of the critical value of space at central locations, since two objects cannot occupy the same space at the same time. It is worth a lot to have the right-of-way, as railroads do.

Economic land excludes many things, too, that are colloquially called "land." It excludes land-fill, ~~for example,~~ by which many cities are extended into shallow waters. The site and seabed are properly land; the land-fill is an improvement. There is no "made land" in the economic sense: it is reallocated from other uses. Expanding cities take farmland from producing food and fiber, much of it for the expanding city itself. Filled land in shallow water near cities is taken away from anglers and sailors and viewers and ecologists, who now routinely organize to save it from being "made" away with. Drained and filled wetlands are taken away from endangered species, as well as from their primal role as filters protecting coastal waters from river trash and pollutants. Thanks to the myopia and dereliction of economists, it has taken militant environmentalists to carry home this truth, developing in their struggle to be heard and understood a deep skepticism of economists and their "way of thinking."

Capital is that which has been produced but not yet used up. Capital is formed by human thrift, forbearance, investment and production. Only after ~~man~~kind forms and makes capital does it bear much likeness to land, in that they coexist. Ordinary micro-economics obscures the differences because it deals mainly with relations of coexistence, ignoring the continual formation and destruction of capital, ignoring time and relations of sequence. Thus it excludes from its purview one of the prime differences between land and capital. The life of capital, like that of people, is marked by major sacraments of birth, growth, aging and

death - all missing from micro theory. Micro deals mainly with how existing resources are allocated at a moment in time, not how they originate, grow, flourish, reproduce, age, die, and decompose.

Capital occupies space; land *is* space. In common micro theory, resources and markets come together at a point not just in time but in space. Again, it excludes from its purview one of the prime qualities of land.

For the reasons given, alone, land and capital are mutually exclusive.

2. Land as site is permanent and recyclable.

Land as "site" (location plus extension) does not normally wear out, depreciate, spoil, obsolesce, nor get used up by human activities incident to occupancy and production. In contrast, capital depreciates from time and use, routinely and by nature. After being formed, it must be conserved from entropy by continual maintenance, repair, remodeling, safeguarding against theft and fire, and so on. Like our own bodies, it returns to dust; land is the dust to which it returns. Inventories are depleted; moving parts wear out; fixed capital depreciates with use and time.

Land normally does not depreciate as a function of time. Most attributes of land also withstand use and abuse. Most land is, rather, expected to appreciate in real value in the long run. Values go in cycles, but the secular history is upwards as population, capital, and demands all grow while land remains fixed. Capital has a period of formation during which it accretes value by storing up other inputs and changing physical form, but that is a phase. Once formed, almost all capital fails with time.

Perhaps the most durable capital is intellectual, like the writings of Plato. These, however, do not endure generations without the continual human effort and expanse of education. As schools starve and libraries close, it is sadly certain that much will be lost. Under any conditions much is twisted in transmission, like classical economics itself.

Capital, however durable, also obsolesces because it is subject to continual competition from streams of new products. Intellectual capital, however classic, is subject to endless competition from floods of new ideas and discoveries. Land does not obsolesce from this cause: there is no new land, let alone modern, state-of-the-art land. Both land and capital are subject to demand-obsolescence from changes in tastes and fashions, but overall the taste for land as a consumer good rises as incomes and wealth grow. ~~The writer has documented elsewhere how~~ the land share of residential real estate is a "superior good"; the building part is not.

It follows that the demand for land rises over time with incomes, but faster than incomes. For example, the soaring demand for golf has produced 150 golf courses in one California county (Riverside) alone, preempting a good bit of the usable land and a huge

share of this natural desert's limited water resources. The western quarter of Massachusetts, the Berkshires, with adjoining parts of Connecticut, New York, and Vermont, has become one vast country estate for suburban New Yorkers and pensioners, and is priced high above its farm value. Ski resorts, hunting clubs, yacht harbors, spas, beach resorts, and such uses increasingly outbid mere utilitarian uses for prime lands. There is also a high and rising technical multiplier of demand for land to complement modern consumer capital. For example, the parking demands alone of 200 million private cars in the USA preempt an area as large as Maryland and Delaware combined. Soaring demands and reuse values are thus the norm in an affluent society.

What can it mean to "consume" land, when it does not get used up? It can only mean to occupy or preempt a time-slot of space. That has the most profound implications for the meaning of "consumption" in economic thinking, and "consumer taxation" in fiscal policy. Economists have neglected and papered over these matters almost completely. These are pursued ~~in B-13~~ below.

Some attributes of some lands do deteriorate from some uses or abuses. Extractive resources call for special analysis, ~~which the writer has attempted elsewhere. To avoid lengthy repetition from previous publications,~~ the word "land" herein refers to the permanent qualities of land, exemplified by (but not limited to) site. Remember, land is not just matter, it is space itself. It is not unusual for land first to be mined, then used for dumping wastes, then sealed for urban use. I myself have lived comfortably over an old munitions dump on Lockehaven Drive, Victoria, B.C.

Land is reusable. All the land we have is second-hand, most of it previously-owned. Our descendants, in turn, will have nothing but our hand-me-downs. As there is never any new supply, the old is recycled periodically, and will be in perpetuity, without changing form or location. Melded briefly with fixed buildings, land survives them to go one more round of use. Even while melded with capital, land is fit for another use at any time, unlike the capital on it. Land retains a practicable, measurable, meaningful opportunity cost. Land value in cities may be defined as "what is left after a good fire"; arsonists take that quite literally. In Beverly Hills, California, "tear-downs" are routine as taste-obsolescence races through fashionable neighborhoods where the land outvalues even the elegant buildings. These are dated after thirty years.

The opportunity cost of capital is fleeting. Capital loses most of it the moment it is committed to a specific form, whose physical alternative use is often only as scrap. Land's "opportunity cost" is real and viable at all times. The scrap value of capital is often zero or negative (radioactive waste supplying an extreme example).

Land may be afflicted with such "negative capital," the harmful waste from prior usage. An example is the spent carcass of an old building needing costly demolition. Some would class that spent carcass as a subtraction from the site value, but "negative capital" makes more sense, as may be inferred by considering the relations between a landlord and a tenant in a perfect market. The lease holds the tenant liable for damages he does and wastes

he leaves; the prudent landlord requires of the tenant a deposit, or in larger cases a bond, to assure performance. Both acknowledge that damage done by use is imputed to the user, not to the land.

Too often, from institutional or market or human failure, the land is left damaged, with no recourse against those responsible. Then, indeed, the damage becomes part of the land, just as some of the good relics of history may as well be considered part of the land. Toxic wastes, and endemic parasites imported with previous crops or trees, become mixed into the dirt. We do not trivialize nor quibble over what to call such damage: it happens, and it impairs the reuse value of land. In such cases the site is less valuable, but still permanent and recyclable. Such cases are, fortunately, still more the exception than the rule. They are at most a minor qualification to the major points made here.

Physical abuse of land is less a problem, actually, than the fall of value that results from social decay. Much of land value is a social product. When a society sickens, declines, and self-destructs, as we know may happen, it lowers ground rents, which mirror social progress and decay. We cannot surely forecast that our own society will not self-destruct, as parts of cities already have. However, until it does, land will outlast capital economically. Even when it does, landownership may remain the last bastion, as happened in the feudal system. Even if barbarians overrun us, it is the land they will take: little else will remain.

3. Land supply is fixed.

Being both unreproducible and permanent, land remains fixed. Both the overall quantity and the special qualities of specific lands remain fixed. Capital changes its form and location with each turnover, while land remains the same. The Tyler Galleria neighborhood in Riverside, California, makes an example. In the last fifteen years over half the buildings have been replaced or heavily remodeled. Streets have been repaved and widened; utilities enhanced. Inventories have turned over hundreds of times; cars in the parking lots have come and gone thousands of times. The land is the same.

The fixity of land has several aspects.

a. The overall planet is fixed.

Even the planet may change, but "fixed" here means "given" or "exogenous" or "outside individual control," but not necessarily static. Cosmic and tectonic and climatic changes are given, so far as human is concerned. Changes caused by ~~mankind~~ human collectively are given so far as individual landowners are concerned.

b. Land is fixed within political jurisdictions.

Political jurisdictions are defined as areas of land. Capital and labour cross political boundary lines; land stays put. An "open economy" is open to money and goods, to capital and labor, not to land. For tax consequences. ?

c. Land as site is immobile in space, permanently.

Much capital, on the other hand, is physically mobile by wheel, hoof, wing or boat. California calls this "unsecured" property, and France calls it "*meubles*," as distinct from the other kind which is "secured" and "*immeuble*." Most American jurisdictions use the less expressive "personal" and "real" property for the same distinction.

Secured or "real" capital is capital affixed to land. The physical carcass of most buildings is rooted to the spot, leading some to allege buildings are as fixed in location as land. That assertion would be specious, economically. The capital locked up in the carcasses of buildings is normally recovered, as they depreciate, in Capital Consumption Allowances (CCAs) which may be reinvested anywhere.

"Basic" micro economic theory, as ordinarily ordained today, is constructed so as to paper over these basic difference of land and capital. In its "short run" land and capital are both fixed. In its "long run" both are equally variable to "the firm," the disembodied spirit used as its unit of analysis, existing at a point in time and space. Thus, one can specialize for a lifetime in "basic micro" while remaining unaware that capital, over time, changes its form and location as it turns over, unlike land. Land yields no such mobile funds as CCAs. It does not depreciate, and is priced accordingly higher, so its income is only enough to yield a return on the price paid, not a return of it. This is refuted below. ?

Land is "mobile" only in the limited sense that its use may change. Some micro economists would have this sort of "mobility" equate land to capital.

d. Land is fixed in form.

Capital, in contrast, is Protean, assuming one form after another. Capital is also fungible with each turnover. ~~Capital Consumption Allowances~~ CCAs in money join the common worldwide pool of disposable capital. Money itself is not capital, but is generalized command over a share of the flow of current production. Thus, capital loses its specific identity with each turnover.

e. Acquiring land must mean taking others'.

No one can get more land without others keeping less. One can acquire more capital by forming it through saving and investing. One can consume more by working more, while others work no less. Land is different: it is the most common basis of market power.

4. **Land is immobile in space and uncontrollable in time .**

a. Land does not migrate.

When demand grows for land in a specific area or neighborhood, land cannot immigrate to meet the higher demand. It is true that land elsewhere can be converted to the specific land use that is demanded. Some micro theorists argue that this possibility makes land as "mobile" as anything else, which equates land and capital. It dovetails with and reinforces their paradigm centered on "~~the~~ firms" a unit that can add unlimited inputs of all kinds in the long run, and among which competition drives all profits to zero. This rationalization overlooks the hoary adage of real estate: "value depends on three factors, location, location, and location." What happens then is not that supply rises to meet higher demand, but ground rent rises.

Robert Triffin wrote that "excess returns are either competed away, or imputed away." Excess returns to capital are the ones that get competed away; excess returns to land get imputed away. Rents and land prices rise where demand is focused. Interest rates, the cost of capital, do not rise: capital abhors a vacuum, and rushes in to bring returns back down to the common worldwide level. If anything, interest rates are lower in central cities because of the more perfect markets that develop there. Intensive development and use of the third dimension at the hub of a city makes it even more ~~attractive~~ through synergy (conglomerate increasing returns to scale), raising rents still more.

b. The services of land flow and perish with time.

Land is "immobile in time" in the sense that its services flow steadily with time. They cannot be stored and shifted forward to meet anticipated higher future demand, like stored goods. They cannot be bunched, like military tanks for an attach. One cannot reach into the future and marshal them for present needs or emergencies. They are never "on tap," for drawing down at will; neither may they be set aside for future use. Rather they flow down the river and out the gates of time to sink forever into the dead past.

Land services may be and are used to produce capital, and the capital is stored up. An example is land used for growing timber, or raising seedlings to bearing age. Another example is flowing water stored in a reservoir. ~~This does not~~ human activity convert land into capital, however, any more than it converts labor into capital. Stored-up labor and land-service *are* capital; ~~that is what capital is~~, by definition. Nature's services *per se*, however, come in a flow like time itself, unbidden and uncontrollable. ~~Mankind~~ human cannot neither advance nor retard its services at will. Considering the improvident nature of ~~mankind~~ human ~~that~~ is perhaps a good thing, but good or bad, it is so. our impotence in this regard

Land titles serve as "stores of value" for individual owners. By the common fallacy of composition, plus some confusion, ~~that makes it all too easy~~ for laymen, and economists too, accordingly to think of land as a store of social value. The individual can tap this store, however, only by selling it to another. Neither of them can advance or retard the flow of services at will.

find it all too easy

Usually the given flow is steady or seasonal, but not always or necessarily. Seasons change, climates change, environments change, blights and pestilences come and go. The essence of land service flow is not steadiness, but exogenity. Alfred Marshall defined the "public value of land" as the product of three factors exogenous to the private owner: nature, public services, and spillovers from the use of nearby private land. This "neo-classical" was classically right on this point (great economists seldom fit snugly into tight boxes).

c. Land is not uniform to user or firm.

When a firm adds land to its operation, the added land is normally farther from the firm's nucleus and not, therefore, homogeneous. The added land is marginal to the firm in location, not just in quantity. The marginal location means that more internal transportation cost is required to integrate the added land with the operation, creating a prime diseconomy of scale, limiting the optimal area of producing units.

As a firm expands, it takes land from the margins of neighboring firms. As Firm A continues to expand, the zone of acquisition moves farther from A's nucleus, but closer to that of B, its neighbor. As the zone advances, the contested land becomes of higher value to B, and lower value to A. Again, this is a matter both of pure quantity and specific location. Military Science would produce few winners if it aped Economics and ignored such facts.

The circumstances are
It is different when a growing firm adds labor and capital to is operation. These are drawn from the margins of other operations, but they are marginal only in quantity, not in location. They are homogenous units, and may be added to the core of the growing operation. These qualities
That continues to be so, however much Firm A grows, or B shrinks. This is because labor and capital migrate, and their supplies are a "pool." No one neighbor is singled out for raiding; there is no locational factor.

This locational factor qualifies the idea of "factor symmetry," as developed by Clark and Wicksteed, and expressed in the replacement of "diminishing returns" by "variable proportions" in economic analysis. It is impossible to add "homogenous" land to an operation: each unit has a unique location, and added land is normally farther from the nucleus.

This consideration, taken alone, would make landholdings tend toward uniformity, to minimize internal transport costs. In fact, however, landholdings are less uniform than other measures of firm size, like labor force, capital improvements, sales, and value-added. These facts are consistent with an hypothesis that the acquisition of land as a store of value, dominated by financial forces tending toward concentration, interferes with efficiency in land markets.

Added land, besides being farther from a nucleus, may be farther from a street interface. In retailing this is extremely weighty. Land added to water front parcels may be far from the shore, and so on.

The results are

d. Land division is a highly social process.

Land division entails "packing."

One individual parcel does not expand or contract without ~~impacting~~ affecting the whole system. Parcels have common boundaries and must be packed together so that they all fit. Many costs like fencing and roads and utilities are shared along the common boundaries. These costs vary with the length of the boundaries.

Capital and labor come in "nuclei."

Each parcel has its nucleus; ~~as~~, for example, a farm centers on its farmstead. The nucleus is the indivisible core of labor/capital applied to the land. Land division entails more nuclei, hence greater intensity of land use, for whatever purpose.

"Nucleus" here is a proxy for labor/capital, although one nucleus is not a fixed quantity of labor/capital. Generally the nucleus shrinks as the acreage shrinks, but in lesser proportion, so intensity of land use rises.

e. Nuclei are interdependent.

In finding the optimal resultant of these opposing forces we are faced with more than a standard example of diminishing returns. One could perceive land division as simply a matter of applying more people and capital to a given area of land. The more intensive application to each acre justifies itself up to a point by added yields from each acre; beyond that the added yields do not compensate for the added costs.

But there is more here than a simple matter of quantities and proportions of inputs. There is also a distance factor. The more parcels we add, the closer are their nuclei, and the ~~less~~ lower is the cost of linking them along the common lines. The cost per acre is, to be sure, higher: that increase is inherent in adding more labor and capital to a given amount of land. But the linkage cost per parcel drops as we add nuclei by dividing land into more parcels.

There is an asymmetry here that has been obscured in the evolution of marginal productivity theory, with its effort to show that the relationships among all the classical factors of production are "symmetrical," so that diminishing returns is simply variable proportions. Land is not symmetrical with labor/capital. When you add nuclei of labor/capital to land, they get packed close together. But when you add land to fixed labor and capital, ~~the units all get farther apart~~ the land units as well as the nuclei of labor/capital get farther apart.

f. Land is immobile among taxing jurisdictions.

Tax jurisdictions are specific areas of land; they are defined that way. Land cannot escape ~~from~~ taxation. Further, it follows that all purely local taxes are shifted to land,

whatever the nominal base of the tax. If the application of labor and capital to land yields no surplus or rent, there is no tax base: any attempt to tax the labor and capital must simply drive them away, unless the use of the taxes itself creates rent. This is the "Physiocratic law of tax incidence." Likewise, purely local services add to land rents.

5. Land does not turn over. It is recycled and is versatile.

a. Land is not convertible into other land.

Each unit of land is permanently unique. Capital, on the other hand, is a homogeneous "pool" over time: as each unit degrades and yields back its substance, the owner may reinvest the ~~Capital Consumption Allowances~~ CCAs in anything. Thus, capital is fungible: once specific item of capital is universally convertible into any other. Land is not at all fungible: no specific unit of land is convertible into any other.

J. B. Clark tried to wipe out this distinction, ~~which brought him into~~ thereby entering a debate with Boehm-Bawerk over whether capital has a "period of production." Frank Knight, following Clark, renewed the debate with Friedrich von Hayek. The intent of both Clark and Knight was to shelter land behind the skirts of capital, to counter a popular movement for taxing land more and capital less. Students are still required to study these dreary, mystical exchanges, which seem to have no other purpose.

The rate of turnover of capital may vary, and does, over a wide range, from once a day for restaurant fresh vegetables to once a century for slow-growth timber. Thus, the "valency" with which capital combines with labor is highly variable. The land/labor valency is not fixed, but it contains no such extreme factor as this.

b. Land is necessarily versatile.

Capital is made to order for specific needs. Land must serve all of ~~man~~ our needs of the day, and perpetual streams, waves, and eddies of new fads and demands, with no physical change.

New demands and discoveries bring out new virtues in old land but it is ~~man~~ we that ~~has~~ have changed, not land. The resources were always there waiting.

In the long run, the pool of capital is ~~totally~~ completely versatile as old specialized capital wears out and is replaced with new. Thus, land is less versatile than capital regarded as a pool in the long run. However, existing specialized capital, committed to a specific form, loses most of its opportunity cost. Capital suffers from various kinds of obsolescence, including, when affixed to land, locational obsolescence. Land rarely does. Land's opportunity cost remains a viable option, because the only source of land for new uses today, as for ages past, is to take it from its previous use. Even land taken from ~~the Indians~~ Native Americans, as they keep reminding us, had a previous use.

It is the common markets in labor, capital and commodities that exert the common influences. The versatility of individual land parcels is often considerable, it is true. Land in the long run is more versatile than is specialized existing capital in the short run. Comparing long run with long run, however, it is capital that is totally versatile.

c. Land *per se* is economically divisible, unlike capital.

Since land does not have to be produced, it can be divided into parcels as small as you please. Capital is economically indivisible, and economist's work which does not mean quite what it appears to. One can produce very small trucks or ships or buildings, but the cost per unit of useful capacity rises as they get smaller; that is "indivisibility." Its converse is economies of scale.

Economies of scale are inherent attributes of capital and labour, not land. They spring from using large units of capital, or large teams of workers with specialized members. For this large lands are required, but the scale economies are not in the land. It is usually a social diseconomy to acquire large lands because they impinge on others and push them out of the way. Thus a large truck requires more street space which may require widening streets which take land from the buildings between the streets. Large buildings require either land assembly, or prior withholding of land over long periods, or going to bad locations on cheap land. All of these are costly.

In subdividing land into small parcels there are, it is true, extra costs, but the cost per lot falls. Of course, the cost per square foot rises, but the cost per dollar of value created generally also falls, which is why it is done. Apartments, condominia, strata titles and time-sharing represent extreme subdivision without increasing cost.

Those who require much land normally have limited choice of locations: they must go where land may be had in large pieces. It is either that, or buy it already assembled by others. that is not so true of those who need large labor or capital inputs.

d. It is cheaper to build units of capital all at once.

Capital, unlike land, has to be built. Normally capital will retain through life its original scale, and other basic characteristics, because it is so costly to add on after construction. Buildings are adapted to particular sites when built, and are seldom raised or lowered after construction. (Capital in its making has economies both of scale and of "simultaneity.")

6. Land is not interchangeable with capital

Land is not convertible into capital, nor *vice versa*. Exchange of land for capital has misled many into equating them, but only through inadvertence and the fallacy of composition. Exchange is not interchange: exchange does not change the quantity of either

land or capital. Capital is convertible into any other form of capital each time it turns over, by using Capital Consumption Allowances, the proceedings of turnover, to hire people actually to produce new capital. Capital may also be disinvested and consumed, or augmented by new saving and investment. None of those is true of land.

The fact above seems simple when laid out overtly, yet economists overlook it when they frame tax policy. Nonconvertibility gives an entirely new meaning to the old goal of "uniformity" in taxation, belying the notion that uniformity makes for a "level playing field," or neutrality in taxation. Uniformity is desirable to avoid "excise tax" effects, but that end does not require uniformity as between land and capital, only uniformity within each class.

7. Land rents are subject to market forces that differ from those that determine interest rates (the price of capital).

Interest rates around the world rise and fall in sympathy. They are subject to common, interconnecting forces of supply and demand, transmitted swiftly even in past centuries, and today instantaneously.

Land rents, too, rise and fall together in response to common forces. However, the forces are different for land rents than for interest rates, so they do not vary in sympathy. Even though the lands are not mutually convertible, they are subject to common forces, the greatest of which is the interest rate itself. Capital and land are rivals for the same pie, so usually their returns vary inversely. Ground rent equals operating cash flow less interest on the cost of building, and less building depreciation. A rise of interest rates lowers ground rents.

It is hard to see how any forecast of the results of economic policy, or any forecast for investment purposes, could have any value without keeping focused on this distinction. Sometimes it is handled by distinguishing "old" from "new" assets or issues. Yet, in general, neo-classical doctrine tells us to meld land and capital in economic thinking of all kinds.

8. Land price guides investors and determines the character of capital, as capital substitutes for land.

High land price guides investors to prefer kinds of capital that substitute for land. Although capital cannot be converted into land, it can substitute for land, and does so when rents and land prices are high. John Stuart Mill long ago pointed out that the structure and character of capital is determined by the level of rents and wages. Such substitution is an integral part of the equilibrating function of markets; the human race could never have attained its present numbers and density without it. High wages evoke labor-saving capital; high rents evoke land-saving capital. It is useful to carry this further, and recognize five kinds of substitutive capital evoked by high rents and land prices:

a. Land-saving capital, like high buildings.

b. Land-enhancing capital, meaning capital used to improve land for a new, higher use.

c. Land-linking capital, like canals and rails and city streets.

d. Land-capturing (rent-seeking) capital, like squatters' improvements, ~~and~~ canal and rails lines built to secure land grants, and dams and canals built to secure water rights.

e. Rent-leading capital.

between
~~of~~ To understand the forces shaping capital investment, one must recognize the difference of land and capital. High land prices evoke substitution of capital for land, shaping the capital stock in particular ways. Viewed positively, this is a central part of economic equilibration, tempering land scarcity. Viewed negatively, it has led historically to boom and bust cycles.

9, **Land is limitational.**

Land and capital are mutually exclusive. Each is also limitational; ~~meaning~~ all human activity requires at least some of each.

Land is indispensable to life, hence to economic activity. The same is generally true of labor and capital, but less "absolutely." Land can exist perfectly well without labor or capital, and support timber and wildlife, but labor and capital cannot exist at all without at least some land, and often a great deal of land. Substitution is limited. It will not do just to have 57 varieties of labor, or of capital. There must be at least some land. Remember, land includes space itself, and a time-slot in it. It includes air and water, the environment and the ecology and all original matter itself. Without land there is nothing. Coupling ~~this~~ with the non-reproduceability of land, and its fixity, land is distinctive.

"Homelessness," a modern plague, is essentially landlessness. A popular ditty from the 1930s includes the catchy line, "If you can't pay the rent, you can live in a tent," but you can't do even that without a campsite. Perhaps this is why modern economists have so little to say about homelessness. Joblessness they have dismissed as part of the vital economic function of "job-seeking," with which they have persuaded at least themselves. The next logical step is that the person sleeping in the doorway is not really homeless, but just engaged in the vital market function of "home-seeking." Rather than seem totally absurd they are simply silent, except to stress the "exclusionary principle" of private property as the bedrock of their system, and their system as a panacea.

In this they are out of step with general thinking. In France, at least, polls have shown for several years the two most respected and popular figures are the Abbé Pierre, who crusades for the homeless, and Jacques Cousteau the environmentalist, who also preaches on the folly of ignoring the limitational nature of land.

There is scope for massive substitution of land for labor and capital, and labor and capital for land. That is, the proportions in which we combine the factors are variable. This substitution cannot, however, be carried so far as to dispense with land altogether: this is the meaning of limitational. Piling more capital on the same land is limited by diminishing returns.

Therefore the three factors are always found working in combination, and much of economic theory used to deal with how they are combined. Some of it still does; the rest floats in outer space, perhaps communing with the ghost of Plato.

10. Land value is not an economic fund

Economists teach that all economic values are either funds or flows. It is a seductive division, and often useful, but too simple by far. Land value is neither, but a third kind of value, *sui generis*. Mankind cannot add to it, nor draw from it as from a true fund. Individuals can and do, by exchange. Even nations can, by selling to aliens. Thanks to the fallacy of composition that lets us forget that these are merely intermediate transactions which collectively accomplish nothing. In famine, or war, or capital shortage, society cannot live on land values. These are not accumulations of stores, but merely the present value of anticipated future service flows which cannot be hastened.

Further divisions are distinctive too, in other contexts. Exhaustible resources (excluded from this discussion) could be called "natural funds." Fixed capital, slowly depreciating with time, is a "flowing fund." Soils have additional components. But basic permanent location value, our present focus, is in no way an economic "fund."

SUMMARY

Land and capital are mutually exclusive categories, provided that "exclusive" is understood properly. First, a

a. Some of each is essential to production. Second, although they are substitutes

b. They are not mutually convertible.

~~They are substitutes (see above), but convertible is different~~. Capital and labor in the long run (not very long, for most capital) are fungible pools as they reproduce and replace themselves, generation following generation. That is, all capital is convertible into any other form of capital when it is replaced. It is not convertible into land. That is one implication of "mutually exclusive."

Capital is fungible in the long run, i.e., every unit or "molecule" is convertible to any other. Labor is slightly less so, and the generations are longer.

Thus, all capital tends to earn the same rate of return at the margin. There is a "pool" of capital, whose returns are subject to common influences. The labor pool is more differentiated, but ~~still~~ all wage and salary rates are still subject to common influences through the interflow caused by competition and mobility. In the long run, replaceability of capital makes individual "capitals" totally fungible, ~~i.e.~~, that is, perfect substitutes for each other — but not for land. So it is, too, with labor, without the same perfection.

Land rents tend to rise and fall together, too, being subject to common influences: direct demand, indirect demand via commodity prices, input costs, wage rates, and real interest rates.

Not clear we need this — if we do, shouldn't it be stronger?

LAND AS A MAJOR BASIS OF MONOPOLY AND OTHER MARKET POWER

We have seen that landownership is highly concentrated and conveys superior bargaining power. We have seen that markets are sticky. It follows that landownership is a natural, and significant, basis of market power, and that its expansion is zero-sum. Land supports monopoly and monopsony, and its differentiation is permanent. It conveys local market power, is often the basis of cartels, and puts the lock on monopoly. We shall now consider each of these implications in turn.

Zero-Sum Expansion

Amassing land is always done – can only be done – by shrinking the holdings of others: to expand in this fashion is to preempt. Amassing claims on wealth by creating and producing is not, however, a threat to others. Expanding the capital holdings of one individual or group can occur by saving and creating new capital, leaving others' holdings untouched. One family's labor income can increase by working harder or longer or smarter, or even by having more children; none of these changes need reduce the work efforts and incomes of others. Labor, like capital, is reproducible and indefinitely augmentable. Producing goods does not interfere with others doing the same. One producer may drive others from a particular limited market, but glutting one market increases real demand for the products of other markets, and raises the real value of their incomes by lowering prices. Possessing land, however, means just one thing: displacing others, depriving them both relatively and absolutely.

In the region of the mind, the thing possessed may be shared by all, with diminution to none. No one person's pleasure in reading Shakespeare, listening to Beethoven, or understanding physics is any less because at the same time millions of others experience the same delight. Art, letters, and science are the common property of humankind, open to all who care to acquire them, or to see them in museums or as reproductions, and their creators' pleasure is in proportion to the number with whom the creation is shared. The gratification is from inclusion, not exclusion. The contrast with landholding is near total.

Concentrated holding and control of land have always threatened the well-being of those without. The only way the landless can acquire land is from those who now possess it. "Growth" is often advanced as the solution to maldistribution, injustice and poverty, but that is mere temporizing because land does not grow. When production and demand grow, land rents rise. Of land, it is starkly true: "the problem is not production, but distribution." There is no production – only distribution.

A Natural Base for Monopoly and Monopsony

Massed control of land is the most natural base for monopolizing markets because land is limited. Buying land always does double duty: when one person expands, *ipso facto* another is preempted opportunities. For example, a chain of service stations with most of the best corners in a town has market power, the more so if it also holds a large share of oil sources, refinery sites, "offset rights" to pollute air, transmission rights of way, harbor sites, and other such limited lands.

Preemption, moreover, is not always just a by-product of expansion: it may be the main point of a business strategy. One illustration is when Builders' Emporium, a large chain of California hardware stores with large parking lots in good locations, closed

down and sold out to a grocery chain in 1993. According to news reports, the stores remain empty today, the land idle. The purpose is to keep the sites from Ralph's, a competing grocery chain.

"Vertical integration" occurs when a business owns its own suppliers, and holding land for future expansion is one of the forms it takes. Land is a raw material used in building. The composite result of individuals buying for future contingent demand is that the market in raw land is turned to glue. It ceases to serve the median person in time of need. The effect is a species of vertical integration and, like all vertical integration, it destroys the free market in raw materials and vastly inflates the aggregate need for holding raw materials. It does so by neutralizing the pooling effect that is otherwise provided by the market. For example, the grocer obtains, stores and keeps a wide variety of food and sundries on tap for thousands of customers. Lacking a grocer, each customer would have to maintain individual stores, and the aggregate required would far exceed that in the common grocery story. A good land market would likewise keep land on tap for the contingent needs of all, greatly lowering aggregate individual or unpooled needs. The social purpose and rationale for private property and land markets is to get land into its best use. When preemption overrides use, market failure is total; private property is discredited.

Viewed in the aggregate, vertical integration aggravates itself, and does so via a "positive feedback loop," a self-authenticating and, in this context, vicious spiral or snowballing effect. When one business, an oil refinery for example, acquires its own supply of raw materials, oil wells in this case, it forces competitive firms to do the same, and markets become sticky. The phenomenon is one that necessitates and justifies itself, considered in the aggregate: when one producer buys and holds for future expansion, others must as well. The positive feedback loop is one of possessiveness run wild. While competition in free markets can be benign and on-going, a positive feedback loop ends in monopoly. Racing to tie up raw materials differs from competition in that races end,while competition is an ongoing process.

Permanent Differentiation

If monopoly were based simply on owning a particular form of capital, all the other capital in the world could be converted into the monopolized form each time it were liquidated and the proceeds were reinvested. The same is not true of land, whose specialized qualities are permanent.

Land with differentiated special qualities is fixed. Easy examples include land in the City of London; land suitable for growing macadamia nuts, or unloading ocean vessels, or relaying radio signals; and residential land within a superior high school district, or with ocean views and breezes. Substitution is generally possible but only at higher costs, resulting in rent gradients out from the best locations. This phenomenon is well studied and associated with the names of Von Thunen, Ricardo, and many modern location theorists.

This quality makes land a natural basis for oligopoly control of markets, or attempts at such control. Land bearing certain minerals, like diamonds or oil, is fixed and limited, in spite of new discoveries and technologies. Sites most suitable for refining oil are also limited: they must be near markets, with access to cheap water transport and pipelines, with "offset rights" to pollute air, with "ancient rights" to endanger or downgrade

surrounding residential lands and occasionally spill oil, with access to rails and a freeway system and a labor pool, with vast back lots for tank farms, inside supportive political jurisdictions, and so on.

The fixity of land also lends itself to stability of association among oligopolists. People come and go; capital turns over, flows in and out; corporations, partnerships and syndicates are collapsed, merged, refinanced, bankrupted and reorganized. Land remains: it is always in the same place, unmistakably identifiable and findable. It is the permanent, underlying resource whose control is always the objective of the shuffling and agitating and striving about if. Its owners, whoever they may be, will reliably join and support the local employers' and trade associations.

Local Market Power

As Tip O'Neill, the former Speaker of the US Congress, oft said, and was oft quoted, "All politics is local politics." One might – I shall – say the same of market power. Some lands are sold or leased with covenants against competition, as Gimbel's Department Store holds a covenant on a lot adjoining its parent store on 3rd Street and Wisconsin Avenue, Milwaukee. Such anti-competitive arrangements, however blatant, are intra-state, and apparently immune from sanctions under US Federal anti=trust laws. Scholars of industrial organization, ma of them doing outstanding work otherwise, pay these grass-roots matters little heed. Researchers and activists concentrate on commodity markets at national and world levels – the ones subject to Federal sanctions, such as they are. They could probably find more severe and blatant market failure in local land markets.

Bargaining power increases with the number of options one has. A large landowner with a chain of holdings in different jurisdictions is positioned to bargain, to play off one competitor against another. Thus, the Disney Corporation, 1991-1993, considered rebuilding and expanding Disneyland at its current site in Anaheim, or in Long Beach, where it had tenure over another suitable site. Using this leverage, it won concessions from both cities, "finally" choosing to expand in Anaheim.

Likewise, land is a basis for oligopsony power in local labor markets. A city's labor pool is often faced with a local employers' association whose membership is limited by the amount of industrial land within reach of the labor pool. Migrant farm labor is faced with statewide employers' associations who have the advantages of limited numbers, wealth, ancient roots and stability. Labor unions that organize a local plant are faced with the threat of the "runaway shop," or merely reallocating work among plants the employer may own elsewhere.

Custom has dulled us to this reality: a corporation is a pool of separate individual landowners bargaining in concert. A century ago, corporations and limited liability were viewed with suspicion and apprehension. Today, hundreds and thousands of separate landowners pool their corporate strength against labor as a matter of course. Some employees bargain through unions, but not as a matter of course, and hardly ever with international options. In the US, less than 20% of the labor force is unionized, and yet many, probably most, economists treat labor as the only threatening monopoly. They see corporations as so benign that many today carry as prime cause today eliminating the corporate income tax completely. Would that we saw such support for eliminating the payroll tax, an obvious cause of unemployment. Perhaps the stock market crash in the

last years, and the equally obvious lack of "transparency" in corporate numbers will renew a healthy skepticism of the corporation and its redistribution of power.

The Basis of Cartels

Cartels are associations of businesses that produce the same products or services and have a mutual agreement to fix prices and thereby avoid competition. Organizational and enforcement costs make it difficult to coordinate large numbers of producers with varied products, so economists can predict which industries are likely to be run by cartels – and oil is chief in their number. Clearly important in its own right, politically perhaps because economically, OPEC is only one of a whole genus that it represents so conspicuously. Government often gets into the act, explicitly or implicitly to keep production down and prices up. Because higher prices make each member eager to expand, cartels have a tendency to overexpand under the price umbrella they support; they then collapse, taking with them a lot of wasted capital. The effect of short-run monopoly may thus be long-run instability. Either way, the effects are harmful and impoverishing. Researchers and activists concentrate on commodity markets at national and world levels – the ones subject to Federal sanctions, such as they are. They could probably find more severe and blatant market failure in local land markets.

Farmland is too plentiful to permit monopoly control through private action. However, production controls are exerted through public action and force of law. These controls operate through control of land, by limiting the allowable acreage in certain crops. Seldom is there any attempt to control other farming inputs like labor, fertilizer, farm capital or pesticides.

The Lock on Monopoly

Both the monopoly that limits output and the monopsony that limits hiring throw workers out on the street and release other resources, too. Why don't these workers and these raw materials combine in new firms? The monopoly would defeat itself if they could. Its persistence points to control over, or creation of, some key bottleneck. Land is the most likely one, because of its limited supply and nonreproduceability. Somehow, ordinary microeconomics or price theory never addresses this question. We suggest that the analysis is crippled by the absence of one limb: land.

ESTIMATING LAND VALUES

Land is nature's gift to humankind; it has no cost of production. But land is also scarce. All people, at all times, must make use of land. More people want land than can successfully compete to have land. The question, then, is how, both efficiently and equitably, to ration its use, to determine its "price". What follows is a condensation of the work of Ted Qwartney, Executive Director of the Robert Schalkenbach Foundation, and long-time student, teacher and practitioner of land valuation.

Land is here defined as the entire material universe outside of people and their products. Rent then becomes the price paid annually for the exclusive right to use land, be it location, acre, or other natural resource (oil, airwaves, air itself). Because land is fixed in supply, demand is the sole determinant of its rent. Because land is fixed in supply, changes in land rents and taxes affect only demand. We can lay Marshall's two-bladed scissors aside as we proceed to develop proper policies toward this natural resource, but we do need a knife of singular acuity.

Land, you see, has become the predominant force in determining the progress or poverty of all people within a community. In the more developed countries of the world, land rent comprises more than 40 per cent of gross annual production. Land in major cities has become so costly that people move farther and farther away, traveling great, and increasingly congested distances, to work and to play.

This great value of land has been created more by society than by individual effort. The collection of its rent, its annual value, if used properly, can return to the public in services the value they have created in production. In doing so, it also obliges the individual still willing to pay for its use to return to the community this community-cum-nature-created value, while retaining, in wages and profits, his or her individual contribution.

What follows is a step-by-step determination of how to assess this value and therefore this taxation. First, we shall compare land rent to land market value, with some definition of terms. Second and third are discussions of the principles and procedures of land assessment; fourth is a more extensive analysis of three methods commonly employed.

LAND RENT AND MARKET VALUE

1. *Land Rental Value (LRV)* is the annual fee individuals are willing to pay for the exclusive right to use a land site for a period of time so long it approaches infinity. This may include a speculative opportunity cost.
2. *Land Taxes (LT)* are the portions of land rental value claimed by government, also for a period of time long enough to approach infinity.
3. *Capitalization Rate (CR)* is a market-determined rate of return that attracts individuals to invest in land, considering all the risks and benefits that can be realized.

Because *Land Market Value (LMV)* is the capitalized value of net rent,

$$LMV = (LRV - LT) / CR$$

so that

$$LRV = (LMV)(CR) + LT.$$

Note: the simplifying assumptions here are many. More accurately, and with much more complexity, equations would sum different net values, each discounted by the appropriate rate for the appropriate period~~, in continuous time~~. Only if the rents, taxes, and discount rates are constant over basically an infinite amount of time do we have the simple equations above, but they make key points without undue distortion.

Carrying on with an example, we see that if the land rent for a site is $1800, land taxes are $300, and the rate of capitalization is 6%,

$$LMV = (\$1800 - \$300)/6\% = \$1500/.06 = \$25,000$$

If taxes were increased four fold, what would happen to market value?

$$LMV = (\$1800 - \$1200)/6\% = \$600/.06 = 10,000.$$

The higher are taxes on rent, the lower is land's market value, even though its productivity is unchanged. Taxes on rent, we are beginning to see, can make land more accessible to the population as a whole: they lower the barrier of high purchase prices. Such taxes can also reduce speculation in land and its attendant ills; discussing such a benefit is beyond the purview of the present piece.

LAND ASSESSMENT

An *appraisal* is essentially an expert opinion of the market value of a certain amount of land, supported by data and explained with precise terms. Although the careful reader has already memorized the economist's definition of *land*, it is useful even for him or her to repeat it along with some other definitions here.

1. *Land* is the entire non-reproducible physically universe.
2. A *land site* is a parcel of land that is ready for use under the standards prevailing in its location. These might include having in place such "necessary" utilities as gas, electricity, water, telephone and sewer services, as well as streets, sidewalks, drainage and grading.
3. The *assessment process* is the valuation of rights to use or possess land sites Such rights include those for subsurface minerals, water, grazing, timber, fishing, hunting, access and air.

The competent assessor integrates these concepts with some standard economic principles. These it is devoutly hoped all readers have mastered; they are repeated here so that this "manual" of a chapter has stand-alone value for those of practical bent.

1. *Substitution*, inter alia one of Mill's most important contributions, is the principle that there are many ways to skin a cat. The maximum price anyone is willing to

Land taxes on a properly assessed but improperly improved site provide strong incentives for better improvements and/or sale to those better able to deploy the land in more valuable a way. Through its relationship to taxes, then, proper assessment can advance the goal of making a land site available to those who can pursue its *highest and best* use, thereby maximizing the site benefits for all people. To the techniques that advance this objective we now turn.

PROCEDURES AND TECHNIQUES FOR LAND ASSESSMENT

The process of appraisal involves six basic phases in the organization and analysis of data.

1. *Defining the Assignment* is, of course, the essential first step. The goal may be to estimate the market value of all land sites within a given district, and to be able to support these assessments both in discussion and in writing. The sites may include such highly variable uses as farming, manufacturing, commercial, governmental, single-family and apartment residential; the terminology, however, must be tight and universal.
2. *Determining the Data Requirements and Sources* comes second. Relevant facts include those mentioned above, and they are often already, and readily, available to assessors.
3. *Collecting and Recording the Data* is not so straightforward as might be hoped. Most governments have abundant data, but rarely are they available in a single data base amenable to analysis. Still, building upon existing systems while making constant improvements in data collection is usually the best way to proceed. The efficient assessor should therefore determine how values or acquisition fees are currently being paid, how land market values have been estimated in the past, and how effective these existing systems really are. Displaying the data in forms like land market value maps and computer printouts can also be most helpful. Hiring small teams to gather more information, interviewing residents and businessmen and real estate agents, planners, appraisers and government officials, has also proved most effective. The assessor's job is then skillfully to determine the relative priorities in each locality (see *infra*).
4. *Verifying the Data* then becomes key. Obtaining more than one source for each assessment helps judge its objectivity. Potential sources include actual buyers and sellers or their representatives, government land agents and officials with first-hand knowledge of exchanges. Making the data available to the public often inspires enlightened citizens to come forth with corrections or affirmations as well.
5. *Analyzing and Interpreting the Data* can be accomplished in many different ways; the bulk of this paper will be dedicated to their discussion, here deferred.
6. *Estimating Market Values* of each plot within the designated area is now possible. Assessors will assign preliminary values based on estimated comparative desirability, and, unless/until adjusted (see #7), these will serve

as the basis of purchases and sales in the area. New information, including public opinion, will, of course, trigger adjustments over time.

7. *Public Examination and Analysis of the Land Market Values* then help clarify and refine the valuations. Self-interested individuals tend to be well informed and admirably adept in noticing slight differences in land characteristics. Arraying the initial assessments on a land market map readily available to this public allows the assessors to tap into their talents, and balancing the perspectives of buyers, sellers and owners affords can provide a reasonable simulacrum of objectivity and market equilibrium.
8. *Periodic Updating of Assessments* is *de rigueur*. Land values tend to increase faster than inflation, while building values decrease with wear and tear and obsolescence. If both are taxed and neither is regularly updated, the former will become greatly under-assessed, and the latter over-assessed, within only a few years. Computers have become so inexpensive, so easy to use, and so powerful that annual updates are now as possible as they are desirable.

As emphasized *supra*, land should be publicly valued at its highest and best use. The four criteria in this determination are uses that are physically possible, legally permissible, financially feasible, and maximally productive. The assessor should endeavor to determine highest and best uses both for vacant lots and for lots that either are improved or have been proposed for improvements.

Three standard approaches comprise the foundation for current appraisal theory. They are the *cost approach*, the *sales approach*, and the *income approach*. We shall consider each in turn.

First, the cost approach is based on the principle that informed buyers will pay no more for one property than the cost to produce a close substitute. This approach is most attractive when the improvements are relatively new, unique, or specialized, so that no comparable properties exist for comparison.

Second, the sales approach utilizes information provided by prices paid in actual market transactions for properties deemed reasonably similar in character. "Reasonably similar" is, of course, both a necessity and a warning, and must reflect timing as well as qualities of the properties themselves. When this approach works, it can also be applied to the determination of rental value; it provides the most objectivity (reliability) in both cases.

Third, the income approach is widely applied to valuing properties that produce income. Present and anticipated future net operating income, including reversions, are discounted or capitalized into a net present value figure; the approach also relies on market data to establish or predict values, revenues and costs.

Although the sales approach should be every appraisor's preferred tool, if all three approaches to valuation are possible, all should be employed, with their results correlated and consolidated into final estimates. Unfortunately, such is not always the case. And even the sales approach must also be tweaked and modified. Constraints that preclude

some approaches entirely and necessitate compromise in others always boil down to inadequacies in data, whether because record-keeping is minimal or because the properties in question are so unusual. What follows is first an almost bare listing and second a deeper discussion of some of these compromises.

1. *Sales Comparisons* are first restated as the goal to which all appraisers should aspire. Under this approach, sales of similar, vacant parcels are analyzed, compared, and adjusted to provide an indication of the value of the specific parcel of land in question.
2. *Proportional Relationships* deal with data inadequacies by relating the site in question to a known standard site, expressing the differences as percentages.
3. *Land Residual Techniques* first assume that the land has been improved to its highest and best use, then deduct from the gross income it produces all operating expenses and returns attributable to other factors, and finally capitalize this net income as an estimate of land value.
4. *Allocation Approaches* analyzes sale of improved properties and assigns portions of these prices among the land and its various improvements.
5. *Extraction Methods* estimate land value by subtracting the estimated worth of depreciated improvements from the known sales price of the property.
6. *Ground Rent Capitalization* is a technique that requires readily available data on land rental and capitalization rates, as can be the case in well-developed areas. Net ground rent is the net amount paid for the right to use and occupy the land; this is estimated from the available data and then divided by the land-capitalization rate.
7. *Subdivision Development Appraisals* are developed in stages. First, the total value of the undeveloped land is estimated as if it were subdivided, developed and sold. Second, developmental, incentive and carrying costs are subtracted from the estimated proceeds of sale; and, third, this net income projection is discounted over the estimated time required for market absorption of all the developed subsites.

1. Sales Comparisons, to repeat, are the best way to assess property when the appropriate data are available. Moving on, we note that the first step is to develop *standardized units of measure*, or *value per unit*, for each project, with units measured in the form of *dwelling unit sites, square feet, acres, and front-feet.* These standards should best reflect the average property in the designated market. The second step is to adjust the estimated value of each specific property according to how it departs from this established norm.

The important choice of which measurement standard to employ should be made not by abstract principle or personal preference but by carefully analyzing the market and the data it has yielded up. For example, if similar in size and arranged in more-or-less orderly rows, standard residential sites may well be valued per dwelling unit site; standard industrial sites, where size is the main desideratum, per square-foot; standard commercial sites, especially in densely developed cities where exposure to customers is key, per front-foot; and standard farm or rural sites, where large parcels are the norm, per acre.

Once the value of a standard unit has been determined, the assessor must then make positive adjustments for desirable and distinguishing characteristics and negative adjustments for those of special and unpleasant bent. In the former camp are superior locations, with splendid views, topography, services and access; in the latter are inferior locations, with longer distances to work and play, poor transportation, rocky soil, poor access and unattractive climates. With parcels large enough to warrant per acre valuation, the relevant adjustments may relate to such agricultural considerations as soil fertility, distance to markets and water supply. For commercial properties, corrections for width and depth can be expressed as *adjusted frontage*. The retailing principle, "cheaper by the dozen," may also apply to frontage feet: they may be cheaper per unit when the total exceeds the standard width, and a width table presenting a series of percentage adjustments can help the assessor make these accommodations. Even condominium units, which in some sense have the same location, shared the use of a large site, command different market value due to differing heights, access, views and preferences.

If the data base is sufficiently large, computer analysis can now create *hedonic price indices*. Holding all but one characteristic constant across properties, it generates *shadow prices*, if you will, that allow assessors to value each distinguishing feature of the properties in question and then make *standardized adjustments* for it. In the real world of assessors, these data requirements are often staggering, and time and budget constraints also prove binding. They should, however, be ever mindful of this ideal.

2. *Proportional Relationships* for valuations is a variation on the Sales Comparisons technique, and one that comes into play when sales or rental data are insufficient in the area under study, but capable of being imported from another. The first step is still to establish the value of a standard unit; and the second, to evaluate specific properties by adjusting for their departures, positive and negative, from this norm. But since local market values have been deemed insufficient, the first step now itself involves adjustments: established norms from other markets with good data need now be tweaked for the specific market in question.

3. *Land Residual Techniques* are also methods to assess land value when market or sales data are deemed insufficient for the Sales Comparison approach. The data needs of this developmental analysis include reasonable estimates of the best use of the land site, the building value, the net income to the development and the capitalization rate. In pursuit of these data, the assessor must first therefore determine which improvements would maximize rent on each site. The second task is to estimate the gross income attributable both to these hypothetical capital expenditures and to the site itself. Netted out should then be both an allowance for average vacancy over the life of the investment and probably operating expenses (other than those attributable to land). The assessor should now proceed to estimate the cost of the building and its furnishings required to support "best use," and then further net out funds required by market opportunity costs to recapture the investment in this hypothetical building and what's in it. Figures for net land income are now in hand, and the value of the land can be determined by netting out one last figure, taxes, and then capitalizing this after-tax residual with the appropriate discount rate.

4. *Allocation Approaches* come into play when finding vacant lots that either have sold recently or are currently being offered up for sale are in scant supply, but market data do exist for improved properties. This approach has merit because the ratio of the value of the land alone to the value of the land plus the improvements on it tends to be constant across properties in the same market area. As in all other assessment techniques, the accuracy of existing data and the competitive nature of the market should be tested rather than assumed.

5. *Extraction Methods* are simplified variants of the allocation and developmental techniques employed when data on vacant lots are insufficient and time and dollar budgets are slight. Rather than calculating best uses, in this case the assessor simply studies the current use, estimates and then subtracts the annual dollar contribution of the actual building and its furnishing from gross income, capitalizes, and establishes land value before taxes. This technique is less subject to flaw in areas where buildings and other improvements contribute less importantly to total value.

6. *Ground Rent Capitalization* is a technique that does as it says: it calculates the net present value of rent. As such, it is an excellent assessment tool when land is owned by individuals or government and leased to tenants who pay an annual rental fee to these owners and are responsible for the decisions and expenses of constructing buildings and make other improvements to the property. These conditions apply in many parts of the world, including areas of the United States. As in the other methods, establishing standard units of value and then making the appropriate adjustments should structure this approach for properties without direct market data.

7. *Subdivision Development Appraisals* calculate the value of undeveloped land according to its potential sales value when subdivided and developed. From this value, of course, costs associated with this development -- incentive and carrying charges as well as those for brick and mortar -- should be subtracted, with the net income projection then discounted over the estimated period required for market absorption of the developed sites. Developers should use this same technique to estimate the price they are willing to pay for raw land, so relevant checks may be available through market data.

THE SOCIAL VALUE OF ESTIMATING LAND VALUES

Even the most ardent and extreme of libertarians will agree that government at some level is necessary; that government, unlike land, is not free, and that government must therefore be paid for, at least in some measure through taxation. (With anarchists we have no truck here.) If the asset, land, or the income, rent, is to be part of this revenue base, accurate assessment of land value is essential to advance the commonly held principle of tax equity. If, as this book has been dedicated to asserting, a tax on land should not only be *a* tax, but *the* (or the major) tax to finance government spending, the matter of accurate assessment becomes even more important.

The value of land to an individual, as we have seen, is its discounted net present value. The higher the taxes, the lower this value, and this assessment. Indeed, were annual taxes exactly to equal annual rents, the private value of land would fall to zero; ditto, its price.

If the price of land were zero, income barriers to the entry of some occupations would be significantly reduced, and at no supply-side cost: the land has nowhere to go. From an efficiency standpoint, then, land taxes may actually raise, not lower, private production.

Adam Smith outlined four principles of good taxation in the year American colonies declared their independence, in part due to bad taxation. Taxes, he declared, should be a charge for services that benefit all and are more efficiently performed by one. Each tax should be:

1. light on the production of wealth, neither impeding nor reducing production;
2. cheap to collect, easy to understand and requiring few collectors;
3. certain and unavoidable, with little opportunity for corruption but ample opportunity for revenue; and
4. impartial and just, equitable and fair, as payment for benefits received, insofar as possible.

As you can see, with proper valuation, land meets these criteria, handily. The current system of taxation may cost upwards of 25% in reduced production, due to reduced incentives and tax avoidance. Taxes on wage income discourage labor and investment in human capital. Taxes on buildings and machinery make them less attractive to build, improve, and maintain. Heavier, even sole, reliance on land taxes would not only reduce these hidden costs. It would also reduce the costs of invading privacy, its valuation being significantly less intrusive than determinations of income and sales.

Heavier taxation of land can also serve to reduce urban sprawl and should therefore have great appeal to the environmentalists in our number. Many are the city lots now vacant; increasing the tax burden they bear would inspire best use, and that use cannot be waiting for speculative gain when any such gains are returned to the community. Cities that collect the full rental value of land are therefore more compact. Failure to collect this rent is a hidden subsidy that causes premature use of natural resources and clutters the environment. It also increases the cost (in resources and in dollars) of public service, which must now be extended farther than appropriate from the city's core.

For these reasons and because they can then reduce the more burdensome forms of revenue raising, studies (WHICH?) demonstrate that communities prosper in more ways than compactness when they raise the percentage of rent they collect, and do so proportionately. All countries collect some rent; none, as yet, all. The first to do so will surely have at least a temporary competitive advantage over all the others.

Additional equity considerations add strength to efficiency arguments in support of taxing land more heavily, if not exclusively. It is communities and whole countries that create much of the value in location. Theirs are the schools and colleges, libraries, transportation, local and national defense, and systems of law that make one place so much more attractive for work and play than another. By collecting land rents, governments can make individuals pay for the privilege of benefiting from these investments, returning to the community fair value for exclusive use. They can also allow them to keep what they have created with their own efforts, in support of a Lockean definition of property. Each person should have the right to keep what he or she

produces, but no one should have the right to waste what belongs to all people: the additional value they have created in the land, originally gifted them by nature. It is a responsibility of good government to tax land, and to assess it properly first.