



Unemployment as Related to Land and Its Taxation

By Dr. Mason Gaffney

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CONFERENCE ON
URBAN ECONOMIC PROBLEMS AND LAND VALUE TAXATION

Unemployment as Related to Land and its Taxation,
by Dr. M. Mason Gaffney

Hott Memorial Center
Monticello, Illinois

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can't afford them.

I don't know what the tax position of Hott's estate was, but I daresay this house had very limited market value when the university acquired it. I don't imagine there was a great demand for it, although it was more durable than other houses in this town which have been occupied for a longer period of time.

DR. ROWLANDS: May I just submit--I have never yet seen a house collapse, no matter how speculatively built it was.

DR. CASE: Be careful. I can give you several.

DR. ROWLANDS: I think you can overemphasize that. The significance of quality of construction is in the operation or maintenance cost, not in durability.

DR. GAFFNEY: Let me say this. I don't know whether the houses of the rich or houses of the poor last longer, but I will say this, though, that a house can be built to last a longer or shorter time. The shorter it lasts, the more frequently the site is renewed, the more employment is generated on that site over a long pull.

DR. ROWLANDS: No. Okay, go ahead. Pardon me for interrupting.

DR. GAFFNEY: If the average house lasts twenty years and there is an old building, no new replacement, then, what is it, five percent of the sites in the city would be renewed every year, whereas if the average house lasted one hundred years, then one percent would be replaced each year. Is that right?

DR. BERKMAN: The problem is the physical building, the physical durability, as Arthur Grey was getting at, and the economic flows through the city.

DR. GREY: I believe Grebler says that the average life of a residential dwelling is something like seventy three years, and that most of them have been demolished--they burn down, or they are demolished to make way for another use as a succession process.

Very few are taken down because they are going to fall down.

Get Fred Case over here to enforce the code and we'll get a few of them down.

DR. GAFFNEY: I don't say they come down because they are going to fall down, but only that they come down for some reason.

DR. GREY: They come down for an economic reason rather than a physical reason.

DR. BERKMAN: If that argument were so, I think we are in pretty good shape.

In other words, if it was true that houses are shoddily put together and they would fall apart and would somehow require this rebuilding, this would be marvelous, this would be terrific, but it doesn't happen. What happens is they keep using them and using them and using them even though they are not good construction.

DR. GAFFNEY: I agree with that. I'm not saying why this happens, I am simply proposing this as a mathematical trueism.

DR. BERKMAN: Oh, as a mathematical trueism.

DR. ROWLANDS: We will accept that.

DR. GAFFNEY: The labor input in the dwelling comes largely at the time of construction, so the more frequently the site is renewed, the more frequently labor is applied to the site.

This would be true regardless of whether the house was well built or poorly built at the beginning.

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DR. CASE: There is no analogy between a forest

and a building.

DR. GAFFNEY: There is no analogy?

DR. ROWLANDS: I wouldn't think so.

DR. BERKMAN: You're not trying to make one, are you?

DR. SAUSE: I think you are, aren't you?

DR. GAFFNEY: Well, I would say that in improvements in land you have two general kinds, one of which appreciates and one of which depreciates, and a house represents the one and the forest represents the other, and there is that difference, but there is also a similarity in that the factor proportions depend on the frequency of renewal.

DR. GREY: The time period is the relevant thing. A redwood forest might appreciate for four thousand years.

I think you have got groves of trees on property--wasn't it Joe Heikoff was telling us--and they are probably not very good; the tree doesn't live very long, it's blighted, and so on, so it could be a truck crop and the appreciation might go on for three months.

DR. WOLFE: He is talking about a house crop or

a land crop in another sense.

DR. GREY: Well, anything that grows on the land we assume appreciates over some kind of cycle, and then ceases to appreciate and loses value.

You may have to cut the timber at a certain time in order to realize that value.

DR. CASE: Put fruit trees on there, would be better.

DR. GAFFNEY: I have a new system of accounting whereby actually a house would be treated like a tree.

DR. CASE: But if a tree produces no income during its life and a house does--

DR. GAFFNEY: That is why I had to work out a new system of accounting.

(Laughter)

DR. GAFFNEY: If we graph time along the horizontal axis here, and I will indicate the market value of a house by a declining curve, representing depreciation over time, we could conceive of it as--lets say it's a fifty year period--we could conceive of one house as being fifty houses, which are nested together, and one of these houses is being consumed each year, and

the fiftieth house not being consumed until the fiftieth year, that is the one that is deepest inside the walls, and then we could regard the present value of the house as being the summation of the present values of those fifty future houses, and the present value of the fiftieth house would be an extremely small value today and it would appreciate over time, something like a tree, until you reach the year, terminal year in which the value would liquidate, at which time it would not be regarded as an income but as liquidation.

DR. GREY: It is simpler to take Mike Wolfe's viewpoint on this, likening trees to houses. You know there is nothing like a tree, the idea of beauty.

Why is the fiftieth house--why is it the end of the cycle?

DR. GAFFNEY: I assumed that for simplicity.

I think the time to clear an old site and renew it is when the interest on the unliquidated capital, plus the value of the site, annual value of the site in its future use, when those, regarded as the marginal costs of time, are equal to the marginal revenue in the present use. Then you have

reached an equilibrium.

In the case of timber, as time goes by the tree becomes more valuable and the interest on the capital tied up in the tree becomes a fair amount factor, and the rent becomes a rather small factor, but in the case of the houses you have the opposite situation, the value of the house becomes negligibly small and the rent, representing the best future use of the site, becomes the determining factor.

DR. CASE: That's why they are not the same.

DR. GREY: Are they inverse?

DR. GAFFNEY: I agree with you that there is a difference, but there are also similarities, and in respect to the question that we are dealing with, namely the application of labor to land, I think they are the same, in that the application of labor to the land is concentrated at the end points of the cycle, so the shorter the cycles are, the more frequently labor is applied.

DR. CASE: Is that line physical depreciation?

DR. GAFFNEY: No. That would represent economic depreciation, value depreciation.

DR. CASE: You can maintain that line by applying

equal units of labor consistently, then.

DR. GAFFNEY: In effect, then, you would be rebuilding the house a little at a time.

DR. CASE: Then you don't have your labor coming in cycles, you have it spread out.

DR. GAFFNEY: In practice we would have to make some modification for that.

Even if we don't do that, I think we have to recognize the inputs other than labor, such as the contribution of the site and the contribution of the capital are constant.

DR. BERKMAN: The more building, the more labor you use. The greater number of building you put up, the more labor you use.

DR. CASE: Assuming that there are no alternative uses for labor.

DR. BERKMAN: Yes.

DR. GAFFNEY: Well, perhaps I am getting a little bit ahead of my story here.

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DR. GREY: Was that a policy during the depression?

DR. GAFFNEY: In some cities it certainly was.

I am not sure the policy is quite the right word. That

implies positive thinking. It may be more failure to act vigorously to get this land back into use.

DR. GREY: They created a lot of land, of course, in the subdivision policies of the twenties, and so on, and land was burdened with special assessment.

You meant they don't do anything to rectify that so that you would have a lot of scattered development.

DR. GAFFNEY: I meant the land which reverted to the city, came into the possession of the city for non payment of taxes, and that stayed there for thirty years instead of having the titles vigorously cleared up and returned to private use as rapidly as possible.

DR. ROWLANDS: Is that because of policy or lack of market?

DR. GAFFNEY: The market was weak, but there was a definite desire to valorize real estate.

DR. ROWLANDS: Marchand made a statement back in the middle thirties that there was enough land subdivided in Chicago to take care of its needs for the next thirty five years, with utilities and all.

DR. GAFFNEY: I agree with that. Now, I am not saying this policy was wrong, but I am merely pointing

out that if there was an avowed effort to maintain the value of real estate, why wasn't this land thrown on the market--because it would depress the value of real estate.

DR. BERKMAN: Who did that?

I mean, there is no, as you say, positive policy that somebody is deliberately doing this as a plan to keep it down.

DR. GAFFNEY: Well, I would say that an article by Walter Bluker of the--what is it--A.S.P.O. advocated this, to keep it off the market in order to keep the price up. That was stated in so many words.

Since I am going to come to the opposite conclusion, I guess I don't need to press this point anyway.

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DR. GREY: Of course there is a historic reason in terms of advantage of the city. It's not just the nature of the state legislature.

The rural areas were a hinterland for which a city was a market center and it was desirable to facilitate them.

DR. GAFFNEY: There was some of that, but, as you

say, the state legislatures are set up in such a way that it has pretty clearly gone beyond that.

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DR. BERKMAN: I had always held this same position. Of course Bob Harvey's position this morning was kind of interesting in this regard. I don't know if he can build up substantiation and verify this. Milliman is the same thing, but I don't know if there is substantiation for this, that actually maybe the timing of the installation, when it is put in, the interest rates as of the time it is put in, and a lot of other considerations, may be such that we don't have so much cost of lateral expansion.

Now, I don't see it myself at the moment, but I think we have to raise it.

Do you see it?

DR. GREY: Was that the burden of anything that Jerry said?

DR. BERKMAN: No, not directly; mostly Bob.

DR. GREY: His indication was that growth was expensive, we were underpricing, we weren't considering the marginal cost.

DR. BERKMAN: By agreement, depending upon the time it was done, but Bob Harvey certainly felt--there was a very strong position there that the continuous extension of the utilities, the lines, wasn't--he even went so far as to say the pockets may not be too expensive.

DR. BECKER: I got the other impression, that he was recommending, or suggesting the way to curtail or stop urban sprawl was to make sure that when new land was brought into subdivision, that it should be, you might say, fully improved; that there should be laws requiring all the installations and improvements to the land be made at the time of bringing it on the market. This would be another way to eliminate or reduce your urban sprawl.

DR. GREY: He said the public utility extension should be an instrument of public policy, very definitely.

DR. BERKMAN: When he discussed the costs of sprawl, he said he really didn't think we had sufficient evidence that the costs of sprawl were high.

DR. BECKER: But the point is that then his conclusion was--well, it was somewhat inconsistent

with that point that you just cited, I think.

DR. BERKMAN: Yes, that's right. Yes.

DR. GAFFNEY: We have a philosophy that no matter where a man chooses to locate society is obliged to run a road out to him.

DR. BERKMAN: But suppose that is on the conditions of, what, depression. I mean, these are all different kinds of conditions, different time periods.

He says, depending upon the terrain, and so forth, that there will be conditions under which the costs of sprawl are not very great. I don't know.

I am just raising it again.

DR. GREY: Well, I think, Herman--poor Harvey, unfortunate he is not with us, but I think he is the only one who has been logically inconsistent.

(Laughter)

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DR. CASE: What would his return be on his restaurant, two percent?

DR. GAFFNEY: Presumably his net return, if everything worked out, would be the same, but if you have got a hundred dollars and you turn it over that fast, the net return on your hundred dollars ceases

to be a significant factor.

DR. CASE: That reminds me of the white queen in Alice in Wonderland: Sometimes you have to run awfully hard just to stay in place.

Are you sure you are not doing that?

DR. GAFFNEY: Well, could you expand on that?

DR. CASE: Well, you don't go into business to turn over your capital. You go into business to earn return on your capital.

Maybe I misunderstood what you are turning over.

DR. GAFFNEY: Well, the entrepreneur with limited capital, and himself to employ, has an additional motive, to create an outlet for his own labor.

DR. BERKMAN: You know, there was someone who advocated breaking windows.

DR. GAFFNEY: I am not advocating breaking windows.

DR. BERKMAN: You are advocating just turning over capital just to have more labor. You are not advocating it, but this is what we are getting into here.

DR. BECKER: Couldn't this increase the return to

capital, too, if you could turn it into thirty six thousand, presuming that at least there would be some differential between the gross return and costs.

DR. CASE: I think you are thinking of society in general.

DR. BECKER: This is quite a big return, whereas putting it in land would give you nothing, comparatively speaking.

DR. GREY: I'm not sure. I think there is another point here, though, Herman.

The presumed reason that urban renewal was instituted was for the policy reason of creating better housing, and the thing that is unsatisfactory about this is the absence of what is better housing.

If you are suggesting here that a rate at which capital will waste away, this could be a socially determined thing and you would have some standard against which to work when you talked in terms of better housing.

You are going to say, in effect, that we are going to replace this at a certain rate, as a matter of public policy, rather than saying we assume it has a life of such and such.

In other words, you are not letting market determine it, but you are determining it for purposes of social policy, which might be the employment of labor, if I get anything out of this. I don't know.

DR. BERKMAN: Well, that would make--that would make some sense in the matter of social policy, but the way it is presented, Mason, it sounds as though it's twisted.

DR. GAFFNEY: In this case the labor is cheap, you see, to this individual.

He, in a sense--there is no perfect labor market. He wants to be an independent entrepreneur, he wants to employ himself. He has a limited capital and he is willing to put up his labor at, perhaps, less than what he could get working for someone else, which is fairly typical of a small entrepreneur. He can do this by turning his capital over rapidly. Again, this is typical of small entrepreneurs.

DR. BERKMAN: I'm afraid I am missing the point.

Hiatt's theory is there is a capital, is that right?

DR. GAFFNEY: His developed in this way, I believe, that although the stock of capital might

have been adequate, it was frozen, and it was frozen because the investments into which it was placed were too durable and it wasn't recovered fast enough so that the reinvestment process couldn't take place rapidly enough to employ the entire labor supply.

DR. BERKMAN: Too durable.

DR. CASE: Keep the labor supply operating.

DR. GREY: Well, from a demand standpoint.

Durability, I mean, is demand determined.

DR. GAFFNEY: It was frozen, it was all tied up in monuments, let us say, from which the values were recovered so slowly that funds for reinvestment purposes--

DR. GREY: You could explain this, though, on the basis of effective demand and say it was too durable.

DR. GAFFNEY: He explained this on the basis of banking policies.

DR. BERKMAN: Right. That's right. In banking policy there wasn't enough capital, in that sense.

DR. GAFFNEY: As he said, the interest rates are too low because of the way banking--the banking

system works.

Now, the modification I am suggesting is that this takes place through the mechanism of urban expansion, or territorial expansion generally, in which too great a percentage of our limited capital stock is frozen in forms in which it turns over very slowly.

DR. BERKMAN: You mean we have an inadequate amount of capital in the country?

Is this your hypothesis?

DR. GAFFNEY: We have an inadequate amount to waste indefinitely. I'm sure we have an adequate amount if we use it wisely.

DR. GREY: Are you being Ricardian now?

DR. CASE: Let me see. I think maybe we are jumping too fast for what you are arguing, or maybe I misunderstand your argument.

You are arguing that there is a given percentage of unemployment which can be accounted for because there is too much invested in capital which turns over too slowly and that a given amount of unemployment could be eliminated if we would take some of our investment out of this long term capital and put it

into shorter term capital, speaking of turn over.

DR. GAFFNEY: Yes.

DR. CASE: Is that your argument?

DR. GAFFNEY: Yes.

DR. CASE: You are not saying the solution to unemployment is to make capital turn over faster.

DR. GAFFNEY: Well, I suppose you could extend the thought in this way, that you could produce a given output with any mix of factors that you want, and the way that you enrichen the labor factor in the mix is by making the capital turn over.

DR. BERKMAN: No question about that, but what is the object of all of this, to get more labor used or to produce more services in society?

DR. GREY: His problem is unemployment.

DR. BERKMAN: Oh, yes, that's right. I see.

Okay, lets keep on turning it over.

DR. CASE: Just keep people busy.

DR. BERKMAN: Okay. Oh, yes.

DR. GAFFNEY: I don't think there is any implication of waste, but it is just the invisible hand of the free market working out--

DR. BERKMAN: Now, wait. If we do have what you

call frozen capital, there is a question as to whether that capital is productive or whether it is not productive once it has been sunk into the fixed investment.

DR. GAFFNEY: That capital wasn't frozen there by the free market. I would like to emphasize that. That capital is frozen there by public policy decisions, including, frequently, subsidized low interest rates.

DR. CASE: If you throw in all the limitations--

DR. GAFFNEY: You can throw in all the limitations you want. I am not suggesting that I have a crystalized model here.

DR. GREY: Are you changing the production functions, something like the argument that comes up where in an underdeveloped country you should have capital intensive industry, or labor intensive industry?

Are you suggesting the same kind of a thing?

DR. CASE: That is the same argument.

DR. GREY: So you change the production functions to get this, in effect, by redressing the constraints

here on the use of resources.

DR. GAFFNEY: Now, how we do this, I haven't said yet.

DR. GREY: Oh, excuse me.

DR. CASE: I see what he is going to say now, though, don't you?

DR. GAFFNEY: Then there is no point in going farther, is there?

DR. CASE: Well, for the unenlightened I think it would be appropriate.

DR. BERKMAN: I would agree that perhaps the market is not what is really doing this investing, although I do think somebody made the point here yesterday that contractors and builders--oh, Jerry Milliman again--that water supply systems are being dragged out, and that this is a matter of political pressure being put on to extend these utility lines to install ~~this~~ capital.

But there is a kind of market now that also is part of our economy, but even so once the capital is invested, except for this blighted, vacant, unimproved land, which is another kind of a problem, pockets, this is a supposedly productive social

capital. In other words, what we have here is social capital which is being employed in more or less a productive fashion for the satisfaction of human wants, but if this is not your--I mean, I cannot deny that if the bridges had not yet been built, that it would be better to build the bridges to create labor, or, if the bridges were built, to build more bridges that would also use more labor.

DR. GAFFNEY: I am not arguing that we should all live on one point and never expand territorially. It's a question of degree. It's urban sprawl, in effect.

I am saying that urban sprawl soaks up a great deal more capital than is necessary and soaks it up in such a way that the value is recovered very slowly.

DR. GREY: Your plan, then, is not the solution is Frank Lloyd Wright's mile high skyscraper, or something like that.

DR. GAFFNEY: No. No.

DR. BERKMAN: Actually, the concept of marginal social product of that capital, Mason, whether the output is--

DR. GAFFNEY: I am all for marginal efficiency of capital.

DR. BERKMAN: Marginal social product.

DR. GAFFNEY: Or marginal social product, if you prefer.

On the cost side, you have the interest rate that is one constraint on the issues of capital. When I say capital, I mean time.

The second constraint is the rent of land, which again is a function of time; higher rents being the shorter cycles, lower rents meaning longer cycles.

DR. BERKMAN: I'm lost. Higher rents meaning shorter cycles--

DR. CASE: For the recovery of capital.

DR. GAFFNEY: We were talking about when to cut a tree. The marginal revenue of time is the growth of the tree in the last year.

DR. BERKMAN: Marginal revenue of time?

DR. GAFFNEY: Yes, of one year's time, lets say, is the increment in the value of the tree during January 1 and December 31.

DR. BERKMAN: Lets go to the house.

DR. GAFFNEY: Well, I am still on the tree.
I haven't gotten to the other side of the tree.

DR. GREY: He hasn't come down out of the
trees yet, you understand.

DR. GAFFNEY: So the marginal cost is twofold
now, it is interest on the stumpage value of a tree,
that's half of it, plus the annual value of the site.

You tie up these two resources over a
year, the capital and the land, and when you harvest
the tree you release those resources for future uses.

They have an opportunity thought, in the
one case represented by the rate of interest, and
in the other case represented by site rent, so if
the site rent is higher, you harvest the tree sooner,
and if the interest rate is higher, you harvest the
tree sooner, so both these factors are the kind of
economic constraints that cause you to make all
cycles more rapid, and that is another way of saying
that they cause you to produce a given basket of
goods with a higher component of labor and a smaller
component of capital and land.

DR. BERKMAN: If the site rent is higher then what?

DR. GAFFNEY: Then you harvest sooner, or in the

case of old buildings, you demolish old buildings sooner and replace them with new ones sooner, if the site rent is higher.

DR. CASE: Just to keep employment up?

DR. BERKMAN: What?

DR. CASE: Just to keep employment up.

DR. BERKMAN: We are back to that again.

DR. GAFFNEY: I am genuflecting to the free market, I would assume.

DR. BERKMAN: Assuming there is a demand schedule.

DR. GAFFNEY: In the free market process, whereby if labor is redundant, the price of labor will tend to fall relative to other things and cause labor to be substituted for capital and land and this, I think, is the form that it would take.

DR. CASE: We have to go back to the original assumption that there is some purpose for capital other than keep labor employed.

DR. GAFFNEY: Well, right, and a higher marginal efficiency of capital, the higher rate of interest, lets say, would cause you to get a higher return on your capital and this would also mean you would be discouraged from investing in an extremely durable.

asset, if I may go back to my house there.

DR. BERKMAN: Why would that be?

DR. GAFFNEY: Well, because if the interest rate goes up, the effect of the interest rate on the present value of an asset is a function of the durability of the asset.

DR. BERKMAN: Not of course necessarily, as economic life of the asset. Not the durability of the asset.

DR. GAFFNEY: If I may go back to my house here, which consists of a nest of houses.

If this is the first house, then if the liquidation value of the first house for the first year is \$100, then the present value at five percent is \$95.

And if the interest rate goes up to six percent, the value is \$94. The change is very small.

Take the 50th house, on the other hand. If we increase the rate of interest from five to six percent, the present value is also \$50. That goes down from \$14 to \$22, or something of this general magnitude.

The percentage decline, if the present value for a remote future value were an increase

in the interest rate, where it is much greater than the percentage decline in the present value of a future value.

Does that make sense?

DR. CASE: Yes, but if you are going to throw that in, then you have to do something else. You have to say that the value of a property is equal to the gross income minus the expenses.

So if you increase expenses, you automatically lower value. One of the expenses here is a recovery capital, depreciation.

So if you increase the rate of depreciation, you automatically lower the value.

DR. GAFFNEY: Well, I think that follows, if the rate of interest goes up.

You are talking about the value of land now?

DR. CASE: No, value of your investment. This is what you are buying when you introduce this concept here, you are buying income.

But you have a value which represents the total sum of your investment and the value is based upon your rate of return on equity.

Your purpose in buying is to have a maximum value here, value either in terms of total sum or return on capital.

To do this then, to increase total value, you have to lower depreciation, you have to make your recovery of capital a smaller amount all the time.

So if you want me to invest in such a way as to keep people employed, I will increase my depreciation rate. If you want me to invest in a way that I am going to be guided by financial considerations, I lower my recovery of capital.

DR. GREY: It is a financial consideration, equally.

DR. GAFFNEY: I think if we followed your principle to its ultimate conclusion, which perhaps you don't intend, we wouldn't extend the life span of all elements to perpetuity.

DR. CASE: I don't have to recover because it is all there, all the time. I am getting it by selling in the market place.

I am just saying, if he is going to

include the recovery of capital as a charge, you want me to have a quicker recovery value, so I will put some more back in there.

DR. GREY: And this is the whole basis for the tax change that was passed.

DR. CASE: But what I am saying is, depending on your investment objective.

DR. GREY: Whose investment?

I think these things are determinents. You can't do anything about that except respond in a rational way.

DR. CASE: If I am going to constantly reduce individual wealth rapidly, I am reducing society's wealth rapidly.

DR. GAFFNEY: I would say there is a free market force which causes individuals to invest their money in such a way as to increase the frequency of turnover in the circumstances that there is unemployed labor, and that is an increase in the marginal efficiency of capital.

DR. GREY: I think we could look at the bond market or in terms of any fixed return

asset. You get a general change in the interest rate, in the yield, and in capital value.

You have got a question then of yield versus market value of the asset.

DR. CASE: I am just arguing that you have to be pretty careful here what your objective is in trying to accomplish this.

I think that his objective of recovery of capital is at variance with the objective of maximizing the value of your total sum invested.

DR. GAFFNEY: You wouldn't advise the grocer to keep the goods on his shelf in perpetuity, would you?

DR. GREY: Well, --

DR. CASE: In Italy this is a perfectly logical thing to do because that brings people in. You don't want to sell the goods, you want to bring more people in your store.

DR. GAFFNEY: All I am saying is that there is a balance. It seems to me that your argument leads to the extreme conclusion that you never want to liquidate your capital.

DR. CASE: No, it depends what you are going to do with it.

DR. BECKER: Aren't you confusing the two things? The financial capital and the physical capital?

If you have a more frequent turnover of your physical capital, in that sense society is enriching itself.

DR. CASE: To recover your capital more quickly you have to reduce your net income.

DR. GAFFNEY: It seems to me you are not accounting for the course of holding capital over a long period of time. In almost all cases the longer you hold it the greater the difference between what you paid for it and what you get out of it.

But there are two costs involved, interest and rent.

DR. CASE: You have to admit it, that when you increase your expenses, you reduce your net.

DR. GREY: Go back to the common post-war complaint of the low social rate of investment.

DR. CASE: He threw in discounting here, and when you throw in discounting, you lower your net income.

DR. GREY: Of course.

DR. BECKER: If you reinvest, physically you are improving yourself.

DR. GREY: What is depreciation policy except to shorten the life of capital?

An economy where you had lack of competition, capital endured too long, presumably, and therefore it was not competitive on a world market.

DR. CASE: I grant all your arguments, but what is wrong with my formula up there?

DR. BECKER: I am disturbed by capitalizing too long. It sounds like let's have some wars and get rid of it.

DR. GAFFNEY: There is no recommendation here that once you have made the initial mistake of making your capital too durable, that you should break it.

DR. BECKER: I don't see the depreciation, why you increase the rate of depreciation,

unless it is increased for economic reasons.

DR. CASE: Let me give you the answer.

DR. BECKER: You have to increase it.

DR. BERKMAN: You have the same problem here with the physical facilities.

DR. CASE: Let me answer that. There is a socially desirable rate for the using up of capital. You are suggesting there has not been enough attention paid to this, particularly in the field of land and real estate investment.

DR. GREY: He is saying there is a socially necessary rate in order to maximize employment.

DR. BECKER: Why don't you go ahead?

DR. GAFFNEY: I think our aesthetic member looks tired, we should let him retire.

Perhaps I could make this point in this way. Supposing wage rates went down by one percent, in general. Then on an investment that was going to last for one year, that would increase the return to the investor from five percent to six percent.

But on an investment that was going to last for 50 years, a one percent decline in

the initial cost would have a negligible influence on increasing the rate of return.

If it was five percent to begin with, it would still be almost five percent after there was a one percent reduction.

DR. BERKMAN: Where do we go from there?

DR. GAFFNEY: If later it becomes cheaper, we tend to substitute labor for capital by preferring short term investment to long term investment.

This is the mechanism, it seems to me, whereby an imbalance in factor proportions tends to create an adjustment in price structure, which causes all resources to be fully employed.

In this case, if labor is superabundant, labor becomes cheaper. The interest rate goes up, the wage rate goes down.

DR. BERKMAN: The time durability, the physical durability, I just don't see. This is my problem. What is the physical durability? The economic durability I would say yes.

In other words, we are not arguing for a deliberately accelerated depreciation to

wipe out value.

DR. CASE: That is the net result of it.

DR. GAFFNEY: Let me go back to this timber case, which I like to do because it is so simple.

All your inputs concentrated and all your output at the end. Say the value of a tree goes along this curve, which I will call "R".

DR. BERKMAN: You mean the revenue product of the tree?

DR. BECKER: This is the total value.

DR. GAFFNEY: If we cut down a tree and sell it, --

DR. BERKMAN: Market value of the tree.

DR. GAFFNEY: I am just taking one tree here. I think we could make the same points in a continuous harvesting process.

He is talking about staggered rotations, where I plant this acre this year and another acre the next year.

Just for simplicity, we will say the input is concentrated in the year zero and the output in the year of maturity.

Now, let me call this zero. We will put this on a log scale.

When we got out here to the year of maturity, what kind of factor proportions do we have? The initial labor input is this amount, and let's say that labor grows, the initial investment in labor grows at compound interest.

The curve would be formula C zero, compounded.

Then there would be something left over, which would be attributable to the site, the excess of the value of timber over the compounded value of the initial cost.

Now, here are factor proportions, this is labor. This, which is the excess of the compounded value over the initial value would be capital input.

This up here, actually this gets a little complicated, this isn't all rent. You have to figure that you have got part of your land input in this year and you have to figure compound interest. This would be divided between rent and interest.

But I will just call this the land contribution, and what shall I do? I'll put a question mark there.

But anyway, as we go along here, the labor input becomes relatively smaller, the contribution of capital becomes relatively larger, and the contribution of society becomes relatively larger.

So the longer we let things last, the smaller is the fraction that labor contributes to the final value of the product.

DR. CASE: But in getting the value of land, don't we do it by perpetuity assumption?

DR. GAFFNEY: I think that is the way I do it.

DR. CASE: That doesn't increase the contribution of land each year, does it?

DR. GAFFNEY: The annual amount remains the same, but the cumulative value becomes greater.

DR. CASE: I see.

DR. BERKMAN: There is a problem here also of the labor input, when the wage rates are charging overtime. So that the relative cost

of the wage rate is changing.

In other words, what I am saying is that we are changing the labor input overtime. Even if we were to keep this model as it is, and even if we were to consider what Fred wants to, his land factors as including something more than land, there would be a change in the amount of imputed labor.

And whether that would be more or less than capital amounts, would it not depend upon the relative opportunities, marginal revenue products of capital to the time period that you are discussing?

So that even on the log you wouldn't find those proportions being just that way. I don't know whether this is relative to the argument or not.

DR. GAFFNEY: I think we have oversimplified the assumption here, I have kept them as elemental as possible.

Would it change the argument to bring these things in?

DR. BERKMAN: I don't know how much, and I

think that is one point. What would happen to the rate of overtime, the alternative cost of labor?

DR. BECKER: Why don't you come to your conclusion before Fred runs off?

DR. GAFFNEY: All right.

* * * * *

DR. CASE: The highest and best use of a property under your assumption is that which maximizes the potential tax return to society.

DR. GAFFNEY: Well, if that is the case, it is news to me.

DR. CASE: Or it optimizes the potential return to society. You object to a building at less than highest and best use because it not only does not return to society what it should return, but it actually impedes the growth of society or the proper use of all the factors in production society.

DR. GAFFNEY: I see what you mean. That would sound reasonable to me.

DR. CASE: I think that was my conclusion when you started out.

DR. ROWLANDS: Mason, I was just wondering

about your conclusion in terms of development of shopping centers in the suburban areas. You are focusing attention on the development of the core area, the central area.

It seems to me the development of shopping centers reflects that. I wonder what you are going to do about that.

DR. GAFFNEY: Well, it is one piece of the whole problem. My impression is it is being overdone.

DR. ROWLANDS: I agree with you.

DR. GAFFNEY: I have an idea that the half finished shopping center may be the orphan subdivision of the next few years.

DR. BERKMAN: On this subject of sprawl, there is a new report called "Spread City Report."

DR. GAFFNEY: The regional plan outfit came out with a 25 billion dollar estimate a few years ago, and the last one was more like 50 or 75 billion dollars.

DR. BERKMAN: Yes. There was a meeting of the AIP at which this was questioned, the extent of the sprawl which was implied by the RPA state-

ments.

But even so, the amount of new investment in community facilities is just fantastic.

DR. BECKER: I think this is an appropriate time for me to say a word or two, in conclusion.

As you all know, from our communications prior to this conference, it is the hope of the Committee to be able to provide some literature in these various areas that have taken our attention in the last few days.

In this connection I think it might be wise if we set some sort of a deadline.

In this case I think, unless we hear any serious objections, that we ought to try to set it at least at the present time no later than the end of the year. That will give us about six weeks.

If we can finish the papers and send them to me, then we will want to get at the reviewing and possibly the publication of these, without any delay. We are very anxious to get this out as soon as possible.

Hearing no objection to this suggestion,

I will just make one remaining point of thanking all of you who have come here to participate in this conference.

I am sure the Committee, and I can say on behalf of the Committee that we are certainly most pleased with the way this conference has gone. I think it has served the function and justifies the existence of the Committee.

If we can continue this sort of thing in the future, I think we will be contributing in a measureful and meaningful way to exploring some of these ideas.

Present opportunities to publish are constricted, there are certain fads.

I think we want to invite new ideas. I believe that this conference has moved in that direction.

So on behalf of the Committee, and I am sure Mr. Carter and Mrs. Carter, the Foundation that has footed the bill for this conference, yet remains completely aloof in every way in terms of how it would be handled and what might be taken up, I want to thank you all for having

been here. I hope we will see you again sometime soon.

MR. GAFFNEY: Thank you.

(Whereupon, the Conference
ended at 5:00 o'clock p.m.,
November 17, 1962.)