

What I Hope You'll Remember a Year From Now

Classical economics. The classical economists, including Adam Smith, David Ricardo, John Stuart Mill, and the American Henry George, recognize three factors of production: land (by which they meant all natural resources), labor, and capital, owned by three social classes: landlords, workers, and capitalists. (Of course an individual can belong to more than one class.) The landlords earn rent, the workers earn wages and capitalists earn interest. The classical economists recognized that rent is unearned income, arising from the superiority of a piece of land to marginal land. The classical economists were much concerned with the distribution of income among the classes.

Henry George (1839-1897). In his 1879 bestseller, *Progress and Poverty*, Henry George proposed that wages are determined by what workers can earn working on marginal land, which by arbitrage determines wages everywhere. From this it follows that the greater the inequality in ownership of land, the lower the wages in an economy. Henry George proposed to remedy this problem by taxing the economic rent received by the owners of land and using that rent for social purposes. This could be accomplished by applying the ordinary property tax to land only. A hundred years ago, George was enormously popular and influential, and his tax policies were implemented to some degree in many parts of the world but especially English-speaking areas.

Neoclassical economics. Neoclassical economics, under the influence of the American John Bates Clark, merged land with capital, making George's proposal meaningless. Neoclassicals then focused on improving economic efficiency--implicitly taking distribution as given. Vilfredo Pareto developed the Pareto principle as a guide to policy: adopt only policies that leave at least one person better off and no one worse off—thus assuming the *status quo* as a starting point.

Commons, titles and rent. Commons are shared resources, including not just traditional natural resources, but socially created resources like genes, language and culture. Like traditional natural resources, they have a location in space and time. Titles are government created and protected rights to specific activities in a specific territory, subject to limiting conditions, such as an obligation to pay taxes. The archetypical title is title to land; others include broadcast licenses, patents, fishing quotas, and taxi medallions. By giving their owners exclusive rights to valuable resources, titles allow their owners to collect economic rent, unearned income. A great deal of political activity is “rent-seeking behavior” directed at obtaining or improving valuable titles.

Externalities. When people share a common resource, they may impose “externalities” on one another—direct effects not through market transactions. “Positive externalities” begin with the availability of helpful neighbors, who can share information and work. “Negative externalities” include pollution and degradation of common resources such as fishing grounds. Titles legitimately serve to increase positive externalities by encouraging investment and reducing negative externalities. But they often serve as vehicles for rent-seeking.

Public goods. Public goods, such as utilities, provide shared benefits to a population. Public goods create the “commons” of a city. In conventional economic thinking, public goods are underprovided, because beneficiaries have an incentive to “free ride” without paying. In reality, public goods benefit some more than others. For example, new roads, sewers and water extended to fringe land benefit the developer at the expense of central taxpayers. National “defense” primarily benefits multinational corporations. In such circumstances, public goods may well be overprovided.

The Tragedy of the Commons (1968) by Hardin and *Governing the Commons* (1990) by Ostrom. In his famous article, Garrett Hardin argues that herdsmen sharing a commons will destroy it by overgrazing; by analogy, he claims we must impose drastic population controls lest we destroy our world. In 2009, Elinor Ostrom won the Nobel Prize in economics for showing

that communities sharing a “common pool resource” can and do cooperate to manage it sustainably over hundreds of years. CPR’s include coastal fisheries, pastures and forests, and water supplies such as irrigation projects. Question: Can the nations of this earth cooperate to sustain the Great Common Pool in the sky?

Elasticity of Demand and Supply. Elasticity measures the sensitivity of demand or supply to small changes in price. By definition, demand elasticity is the percent change in quantity purchased divided by a one percent change in price. Supply elasticity is the percent change in quantity supplied divided by a 1% change in price. Demand elasticity (i.e. price sensitivity) is higher for items that are an important part of a person's budget and/or have close substitutes. Supply elasticity is zero for items in fixed supply, notably land and other natural resources. Supply elasticity is very low for items such as large buildings or factories or oil wells that take a long time to construct and have a long lifespan.

Taxation – Adam Smith's four maxims of taxation. First, taxes should fall "in proportion to the revenue [taxpayers]...enjoy under the protection of the state." That is, according to the benefits received, among which Smith includes the protection of private property. Second, the amount and time of payment of taxes should be certain. Third, taxes should be levied at a time and manner most convenient to the taxpayer. Fourth, taxes should be inexpensive to collect, that is there should be low administrative expenses and minimal economic distortion. Land taxes, which Smith supported, best meet these criteria. Modern systems of taxation, notably sales taxes and value added taxes, violate Smith's first and fourth maxims. They are regressive, falling harder on the poor than on the rich, they are expensive to administer, and they are a drag on the economy.

Taxation – "passing on". A tax can be successfully passed on from a seller to a buyer if and only if the seller can reduce his tax liability by doing less of whatever is taxed. A fixed “lump-sum” tax cannot be passed on. That includes a tax on something fixed in supply, such as land. The landowner cannot reduce the amount owed except by bribing the taxman. By contrast, a grocer selling tangerines can avoid part of a sales tax by selling fewer tangerines at a higher price. In general, a tax is shared between a seller and a buyer in inverse proportion to their elasticities of supply and demand. Since the supply elasticity of land is zero an entire tax will fall on the landowner. As for income or payroll taxes, since the elasticity of labor supply is very low for high-paid individuals, they cannot pass on an income tax; that is they are highly unlikely to work fewer hours or quit if faced with a small tax increase. By contrast, supply elasticity of labor is very high for poor individuals; that is, they tend to work off and on, frequently quitting or being laid off. In this case a small tax is much more likely to cause them to lose a job

Taxation – "ATCOR principle". "All Taxes Come out of Rent", (and all subsidies go into rent). Taxes on land obviously come out of rent because land income is rent and land taxes cannot be passed on. The ATCOR principle does not so obviously apply to other taxes. By reducing the profitability of a business, sales taxes reduce the value of the businesses land. But what about the portion of a sales tax passed on to customers? The part of the tax that is passed on reduces customers’ ability to spend on other things including property. So indirectly, the tax reduces land values.

Inequality--measurement. An important measure of inequality is the so-called "Gini coefficient", which can range from 0 to 100. The greater the inequality the higher the Gini coefficient. Third world countries, such as Haiti, have very high Gini coefficients, in the 70s. Egalitarian countries, such as Sweden, have low Gini coefficients, in the 20s. The US has a Gini around 45, one of the highest for developed nations. In any given country, Gini coefficients for

wealth are much higher than those for income, indicating that wealth is much more concentrated than income.

Inequality – trends. Inequality in the US reached a peak in 1929 at the end of the great roaring 20s bubble. Inequality fell thereafter, reaching a low in the mid 1970s, then rising again to a present level as high as that in 1929. Important causes for rising inequality include abandonment of anti-trust enforcement in the 1980's, and decreasing progressivity of the US tax system. Top income tax rates have fallen from over 90% to under 35%, while loopholes have increased. The federal payroll tax has grown as large as the income tax. At the state level, sales taxes have steadily replaced property taxes—which remain the most progressive tax in the US.

Inequality – economic consequences. As is apparent in Third World countries, extreme inequality not only creates mass poverty, but also hinders economic productivity and growth. Agricultural statistics from such countries show that that output per acre is much lower on large land holdings than on smaller ones, even though large holdings tend to occupy higher quality land.

Inequality – environmental consequences. In both developed and less developed countries, inequality is associated with environmental destruction on marginal lands. This happens because, as Henry George observed in the United States in the 1850s, ownership of good quality central land by wealthy entities pushes economic activity out on marginal land. Again, as especially apparent in Latin American countries, intensive agricultural production takes place in small plots on steep eroding land.

Inequality—health and social consequences. In *The Spirit Level* and earlier work, statisticians Wilkinson and Pickett argue that among developed countries those that are less equal suffer overall worse health and social problems like crime and mental illness.

Inequality—governance. The greatest problem facing third world countries is bad governance, which maintains the power of a small elite at the expense of the rest of the population. Of course as developing countries like China, India and Brazil demonstrate, it's still possible to have economic growth with undemocratic or corrupt governments and serious inequality.

Population. “Overpopulation” does not cause poverty and environmental destruction. Both can occur where population is very dense as in India, and where it is relatively sparse, as in most of Latin America. Birth rates fall as people's living conditions, health, and security improve; as they move from rural to urban areas; and—especially—as education and job opportunities improve for women. Birth rates are below replacement in much of the developed and developing world, and are falling elsewhere. Population continues to grow due to “population momentum”, that is, because due to recent rapid growth, much of the population is of reproductive age.

Poverty. Hunter-gatherers, like the Hadza in Africa, live in extreme material poverty. Compared to them, the US poor seem wealthy. However, the Hadza live in a supportive egalitarian society. Amartya Sen has developed a “capabilities” definition of poverty, under which what matters as much as material goods is individuals' ability to lead a productive, dignified lifestyle. By this definition, the Hadza may be less poor than people at the bottom of a very unequal society.

Cooperation and Specialization. At the beginning of the *Wealth of Nations*, Adam Smith argues that a society's wealth increases when people can cooperate and specialize, both within organizations like the pin factory and through market exchange. The benefits are limited only by “the extent of the market.” That is, the more people involved, the greater the benefits. Henry George extends Smith's argument to the maxim that “Association in Equality is the Law of

Progress.” It’s not enough to bring people close together; productive cooperation also requires relative equality among them.

Domestic and international trade. The classical economists including George advocated freeing both domestic and international trade from barriers like tariffs, and for the same reason: to increase the benefits from cooperation and specialization. In domestic trade, there’s a background assumption that that trade is “arm’s length”, because government regulation will control fraud, monopoly, and other abusive practices like child labor or pollution or depletion of fisheries. The classical economists and George implicitly extend that background assumption to international trade—as do modern advocates of “free trade.” However, there exists no effective international government to control bad practices—nor would most nations want to yield sovereignty to such a government. (That’s why the Euro is doomed.) A great deal of international trade between developed and less developed countries consists of rent extraction by multinational corporations, paying off local warlords while stripping natural resources.

Monopoly. Monopolists extract rent from their customers by producing less and selling at a higher price. Monopsonists extract rent from their suppliers by buying less at lower prices. International trading companies like Walmart or Swift squeeze their suppliers and their labor force around the world. Since enforcement of anti-trust laws was suspended in the 1980’s in the US, corporations have rapidly merged so that most industries are dominated by a handful of giants, as described in *Cornered*.

Cartels. Cartels are legal organizations of suppliers, empowered to act as monopolists. Agricultural marketing organizations like Sunkist are cartels; they restrict their members’ output to drive up prices. The Organization of Petroleum Exporting Countries (OPEC) is a cartel. Cartels are particularly environmentally destructive as their efforts to control output lead to increased production on marginal land.

Population density. Population density is astoundingly unequal around the world, both between and within regions, notably between cities and rural areas. Some developed countries like Japan and Taiwan have very high density; other developed countries like the US have relatively low density. US density is 82 per square mile; Manhattan density is over 71,000 per square mile, rising over 300,000 in some blocks. Density—people per square mile—is not crowding—people per room of living space. (And “crowding” is partly cultural—a New York studio apartment would seem palatial to a Japanese family.) Most economic activity, innovation and growth occurs in cities, especially cities that are attracting population. Public policies that lower density below that which people would choose, for example, large lot zoning in the US, both reduce the benefits of proximity and cooperation and increase inequality by pushing poorer people out towards the economic margins.

Land values. Land values are highest in the central business districts of large dense cities, where personal interaction is at a premium. CBD values are orders of magnitude higher than fringe or rural land values. For example, in Manhattan midtown land values exceed \$38,000 a square foot; in fringe areas in the north of Manhattan they may be as low as \$2.50 a square foot. Land values rise to sharp peaks with concave sides.

Land values—bubbles. Land values are determined by a formula: $V = \frac{a}{i - g + r}$ where a is

annual rent, i is interest or capitalization rate, g is expected rate of growth, and r is rate of tax on land value. In a bubble, g can get quite high, creating a vicious circle as expected growth raises land values, and rising land values reinforce expected growth. When the bubble inevitably bursts, as began in the US in 2007, land values at first freeze, then collapse. As is apparent from the

formula, a higher tax rate reduces land values and dampens bubbles. Banks use property as collateral for loans. When bubbles burst, borrowers stop paying and banks find themselves holding collateral worth less than the loan. The banks may then collapse, or at least stop lending. As happened in 2008, government may lend money to large banks to keep the whole financial system from collapsing.

Mason Gaffney on cities. According to Gaffney, cities should be "contained" for their own benefit, that is, for the synergy of higher density. "Negative containment" by setting aside green spaces around the city is ineffective or worse. "Neutral containment" consists of not subsidizing the extension of utilities to new developments on the fringe. "Positive containment" consists of using land value taxes to encourage denser development in the central areas.

Mason Gaffney on water. All citizens have a right to water. Gaffney criticizes Western water policies under which water rights are attached to land. Public investments in delivering water enhance the value of land. If water rights are made transferable, that sets off a rent seeking scramble without necessarily making more water available. Gaffney says the public should charge for water, which would make more water available more cheaply and end the financial drain of building ever more water projects.

Mason Gaffney on nonpoint pollution. Nonpoint pollution is pollution from many small dispersed sources, such as runoff from farmland, air pollution from auto exhausts, damage to underground water basins by multiple wells and so forth. The best way to mitigate nonpoint pollution is to encourage intensive use of appropriate land and stay off the marginal land. That means encourage urban density, and intensive farming and forestry on the best lands.

Excessive land and capital intensity. The best mixture of land, labor and capital for production depends on location. Densely-populated countries use more labor per acre, and get more output per acre but less output per manhour. Vice versa for lightly-populated countries. For example, the calculations of Hayami and Ruttan show that Taiwan gets about 10 times US output per acre; while the US gets 10 times Taiwan's output per manhour. However in most countries, taxes, subsidies and regulatory policies encourage excessive land and capital intensity for that location—worsening inequality and lowering wages. For example, the US has heavily subsidized research on machinery to replace farm laborers, such as the tomato harvester. In less developed countries, the "green revolution" has subsidized large farmers at the expense of small farmers and workers.

"Appropriate technology." This is an effort to tailor both agricultural and non-agricultural technology to local conditions, as much as possible using local labor and inexpensive local materials. It is a response to the failure of western-initiated efforts to impose excessively land and capital intensive technology in third world countries—such as huge dams or crops requiring heavy fertilizer.

The Coase Theorem. In "The Problem of Social Cost" Ronald Coase gives a two-party example—a neighboring farmer and cattleman—to argue that it doesn't matter who has the property rights because the two parties can always negotiate the same optimal solution, absent transaction costs (a huge assumption). There was no "theorem" in the original, but Chicago economists expanded Coase's idea to the claim that if property rights are correctly assigned, there is no need for government regulation as the market will resolve conflicts, for example between polluters and the public. (There's an inherent contradiction in the claim that government "interference" in the market can be reduced by engaging the government in defining and policing large numbers of new kinds of titles.)

Mason Gaffney on Coase. Early 20th century economist Arthur Pigou argued that the proper policy to reduce externalities like pollution was to impose a tax. This approach implicitly recognizes that the air and water are common property. In “Sleeping with the Enemy”, Gaffney recalls his encounters with neoclassical economists as they adopted the Coasian ideology. In so doing, they prevent recognition that natural resources are common property. They also sanction the giveaway of resources like fisheries or the air for waste disposal, mostly to powerful corporations. The Coase ideology has furthered the monopolization documented in *Cornered*.

John Stuart Mill on the Stationary State. Unlike the other classical economists, including George, Mill envisions a time where there is no further material growth—though growth in knowledge and culture could continue. Essentially this is “sustainable growth”. Mill is correct that there is nothing in economic logic that requires continuing growth for continuing prosperity. Whether in fact we can coast to a pleasant stop, or fall into a precipitous decline—is for you the next generation to determine.